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Frank D'Andrea
Vice President
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BY COURIER

September 26, 2018

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON M4P 1E4

Dear Ms. Walli,

EB-2018-0270 - Hydro One Networks Inc. MAAD S86 to Purchase all of the issued and outstanding shares of Orillia Power Distribution Corporation – Prefiled Evidence

Please find attached Hydro One Networks Inc.'s prefiled evidence on its application to purchase Orillia Power Distribution Corporation. Two (2) hard copies will be sent to the Board shortly.

An electronic copy of this cover letter and the attached prefiled evidence has been filed through the Ontario Energy Board's Regulatory Electronic Submission System (RESS).

Sincerely,

ORIGINAL SIGNED BY FRANK D'ANDREA

Frank D'Andrea

CC EB-2016-0276/EB-2018-0171 Intervenors

ONTARIO ENERGY BOARD

IN THE MATTER OF an application made by Hydro One Inc. for leave to purchase all of the issued and outstanding shares of Orillia Power Distribution Corporation, made pursuant to section 86(2)(b) of the *Ontario Energy Board Act, 1998*.

AND IN THE MATTER OF an application made by Orillia Power Distribution Corporation seeking to include a rate rider in the current[1] Board-approved rate schedules of Orillia Power Distribution Corporation to give effect to a 1% reduction relative to their Base Distribution Delivery Rates (exclusive of rate riders), made pursuant to section 78 of the *Ontario Energy Board Act, 1998*.

AND IN THE MATTER OF an application made by Orillia Power Distribution Corporation for leave to transfer its distribution system to Hydro One Networks Inc., made pursuant to section 86(1)(a) of the *Ontario Energy Board Act, 1998*.

AND IN THE MATTER OF an application made by Orillia Power Distribution Corporation seeking cancellation of its distribution licence, made pursuant to section 77(5) of the *Ontario Energy Board Act, 1998*.

AND IN THE MATTER OF an application made by Hydro One Networks Inc. seeking an order to amend its distribution licence, made pursuant to section 74 of the *Ontario Energy Board Act, 1998*, to serve the customers of the former Orillia Power Distribution Corporation.

[1] Current rates as of the Closing Date of the transaction based upon the revenue requirement approved in EB-2015-0024.

AND IN THE MATTER OF an application made by Orillia Power Distribution Corporation for leave to transfer its rate order to Hydro One Networks Inc., made pursuant to section 18 of the *Ontario Energy Board Act, 1998*.

AND IN THE MATTER OF an application made by Hydro One Networks Inc., seeking an order to amend the Specific Service Charges in Orillia Power Distribution Corporation's transferred rate order made pursuant to section 78 of the *Ontario Energy Board Act, 1998*.

APPLICATION

1.0 INTRODUCTION

Hydro One Inc. ("HOI") is a corporation incorporated under the laws of the Province of Ontario and is the parent company of Hydro One Networks Inc. ("Hydro One"). Hydro One is a licensed distributor regulated by the Ontario Energy Board in accordance with the *Ontario Energy Board Act, 1998* (the "Act"). A corporate organizational chart of Hydro One, both before and after the transaction, is provided as **Attachment 1**.

Hydro One's distribution system serves approximately 1.3 million customers in its service territory (see **Attachment 2** for further customer details).

Orillia Power Distribution Corporation ("OPDC") is, at the date of this Application, a wholly owned subsidiary of Orillia Power Corporation ("OPC"). OPC is a holding company, currently wholly owned by The Corporation of the City of Orillia (the "City"). A corporate organizational chart of OPC is provided as **Attachment 3**.

OPDC's distribution system serves approximately 13,830 Residential and General Service customers in the OPDC service territory (see **Attachment 4** for further customer details).

2.0 OVERVIEW OF APPLICATION

On August 15, 2016, the City and Orillia Power Corporation (the "Vendor") and HOI (the "Purchaser") entered into a Share Purchase Agreement (the "Agreement"), the effect of which is that the Vendor and the City have agreed to sell, and the Purchaser has agreed to purchase, all of the issued and outstanding shares of OPDC. The purchase price is $41.3 million, comprising a cash payment of approximately $26.4 million for the shares and the assumption of OPDC's short- and long-term debt (including regulatory deferral account balances) of approximately $14.9 million[2]. The Agreement contemplates the closing of the transaction on the first business day of a month and at least 90 days following the Parties' receipt of all required approvals, including Ontario Energy Board ("the Board" or "OEB") approval of this Application.

The Agreement (see **Attachment 5**) contemplates the following items in addition to the sale of the shares:

(a) OPDC will apply to the OEB for approval to include a negative rate rider to OPDC's electricity rates[3] to reduce Base Distribution Delivery Rates by one per cent across residential and general service rate classes, and to have such reduced rates apply for the next five years (see **Exhibit A, Tab 2, Schedule 1 Section 2.0** for further detail);
(b) The Purchaser or its affiliates shall offer all active employees of OPDC continued employment in the City of Orillia for a period of at least one year;

[2] As contemplated in the share purchase agreement, the final purchase price is subject to closing adjustments.
[3] This refers to OPDC's base distribution delivery rates as approved in EB-2015-0024 and adjusted for the move to a monthly fully fixed charge ("Move to Fixed"), as contemplated in the Report of the Board "A New Distribution Rate Design for Residential Electricity Customers" issued April 2, 2015 under proceeding EB-2012-0410. These rates are hereafter referred to as OPDC's "Base Distribution Delivery Rates".

(c) The Purchaser shall establish an advisory committee (the “Advisory Committee”) to provide a forum for communication between the Purchaser and the community;
(d) After closing, the community will be eligible for Hydro One’s community programs;
(e) The purchase price is subject to adjustment, within 90 days following closing, for working capital, net fixed assets, regulatory accounts and long term debt, as defined in the Agreement.

The resolutions that give way for the execution of the Agreement are provided as **Attachment 6**.

This Application adheres to the principles of the “*Report of the Board on Rate-Making Associated with Distributor Consolidation*” issued on March 26, 2015 (“Amended Report”). The Amended Report provides Board policy pronouncements pertaining to rate-making for associated distributor consolidation transactions. These include: (1) an extension to the rate rebasing deferral period, to a duration of up to ten years after the close of the transaction; (2) a requirement for use of an earning sharing mechanism (“ESM”) where an applicant seeks a deferral period greater than five years and up to ten years; (3) utilization of the incremental capital investment module ("ICM") by the consolidating entity during the rate rebasing period; and (4) clarifications as to which incentive plan would apply to distributors who are party to a merger, amalgamation, acquisition, and divestiture (“MAAD”) transaction during any deferred rebasing period. Further guidance was provided by the Board with the release of the “*Handbook to Distributor and Transmitter Consolidations and Filing Requirements for Consolidation Applications”* (the “Handbook”) released on January 19, 2016. Hydro One has considered the intent of these reports in developing this Application.

The proposed Transaction will both benefit and protect ratepayers:

- Ratepayers will receive the benefit of: (i) a reduction of 1% in their Base Distribution Delivery Rates in Years 1 to 5; (ii) a rate increase of less than inflation in years 6 to 10 (inflation less productivity stretch factor); and (iii) a further guaranteed ESM amount of

$2.6 million. In addition, customers will benefit in the longer term from the lower ongoing cost structures.

- The implementation of a guaranteed ESM protects OPDC ratepayers from the risk of Hydro One failing to achieve the forecast level of synergy.

3.0 PREVIOUS MAAD APPLICATION

On September 27, 2016, Hydro One Inc. applied (EB-2016-0276) to the OEB to acquire the shares of OPDC, and sought other approvals as discussed in that application. On April 12, 2018 the OEB issued its Decision and Order on this application denying the acquisition, but indicating that with the exception to pricing, the transaction met the no harm test[4]. In this regard, the evidence in this application is similar to that provided in EB-2016-0276, with the exception of updates to reflect current variables to costs and other metrics. Additionally, in the EB-2016-0276 Decision, the OEB indicated that it required additional evidence on what Hydro One "expects the overall cost structure to be following the deferral period and to explain the impact on Orillia's customers". As a result, Hydro One has complied with the Board's order and has provided a new exhibit (**Exhibit A, Tab 4, Schedule 1**) on Future Cost Structures.

4.0 OEB APPROVAL REQUESTS

The following OEB approvals are requested under Sections 86(2)(b), 86(1)(a), 77(5) and 74 of the Act:

[4] See - Page 12 of Decision and Order, saying that the OEB accepts that the acquisition will lead to some savings on account of eliminating redundancies; Page 16 saying the Board is satisfied that OPDC's quality and reliability of service would be maintained and that the requirement to report on reliability and quality of service would confirm to the OEB that any reduction in service quality would become apparent; and, Page 17 accepting that there will be no adverse impact on Hydro One's financial viability as a result of its proposals for financing the transaction.

- Hydro One is applying to the Board pursuant to section 86(2)(b) of the Act, seeking leave to acquire all the issued and outstanding shares of Orillia Power Distribution Corporation from the City.
- OPDC is applying pursuant to section 86(1)(a) of the Act to dispose of its distribution system to Hydro One.
- If the Board grants leave for OPDC to dispose of its distribution system to Hydro One, after closing and upon integration of the proposed transactions, OPDC requests, pursuant to section 77(5) of the Act, that its electricity distribution licence be cancelled. Hydro One requests, pursuant to section 74 of the Act, that Hydro One's distribution licence be amended such that Appendix B, Tab 1 of Schedule 1 include *The City of Orillia, County of Simcoe as at October 31, 1991*, as described in Schedule 1 of OPDC's licence.
- If the Board grants leave for OPDC's distribution system to be transferred to Hydro One and amends Hydro One's distribution licence to include the former service territory of OPDC, pursuant to section 18 of the Act, Hydro One is also requesting the Board transfer OPDC's rate order to Hydro One.
- OPDC is seeking approval pursuant to section 78 of the Act, to include a rate rider to its OEB-approved rate schedules, to give effect to a 1% reduction relative to the Base Distribution Delivery Rates applicable at the time of closing. This rate rider is proposed to be implemented during the first five years of the deferred rebasing period.
- Hydro One is seeking pursuant to section 78 of the Act to update OPDC's Specific Service Charges to align with the Specific Service Charges that are, or will be, approved by the OEB for Hydro One Distribution.
- Upon completion of integration, HOI will transfer the assets and liabilities of the electricity distribution business from OPDC to Hydro One.
- If the Board grants leave for OPDC to dispose of its distribution system to Hydro One, Hydro One is seeking approval to establish a new deferral account to record the costs of the ESM refund amount for future disposition. Principal amounts recorded in this account will

be added annually, and those balances will attract interest calculated consistent with the Board's approved methodology using the Board's Prescribed Interest Rates.

5.0 OTHER APPROVALS AND CONSIDERATIONS

- Hydro One is applying for approval to defer the rate rebasing of OPDC for ten years from the date of closing of the proposed transaction, consistent with the new Board policy set out in the Amended Report.
- Hydro One is applying for approval to continue to track costs to the regulatory asset accounts currently approved by the OEB for OPDC and to seek disposition of their balances at a future date. See **Exhibit A, Tab 2, Schedule 1, Section 3** for further details.
- All OPDC rate riders will continue as per OPDC's existing rate schedules until expiry.
- Hydro One is applying for approval to utilize US GAAP for OPDC financial reporting.
- Hydro One is applying for approval to use an ESM to operate during the extended deferred rebasing period (i.e., years six to ten), consistent with page 16 of the Handbook. Hydro One's proposed ESM is described in **Exhibit A, Tab 3, Schedule 1**.
- Hydro One is applying to use an Incremental Capital Module ("ICM"), should it be required for the former OPDC service territory, consistent with the OEB's policies for an ICM as described on page 17 of the Handbook.
- During the extended deferred rebasing period, rates of customers of OPDC will be set using the Price Cap Index adjustment mechanism as described in **Exhibit A, Tab 2, Schedule 1**.

This transaction was completed on a commercial basis between a willing seller and a willing buyer. It is a demonstration of the types of benefits that can be realized from voluntary consolidation, and it will deliver cost synergies and economy of scale savings contemplated by the Ontario Distribution Sector Review Panel. Hydro One submits that the evidence supports approval of the Application, as the transaction will have a positive or neutral effect on the attainment of the OEB's statutory objectives, and the customers of both local distribution companies will be held harmless. This is achieved as a result of the following:

- The application has no adverse impact on the price, adequacy, reliability and quality of electricity service of OPDC or Hydro One;
- The application has no adverse impact on the promotion of electricity conservation and demand management, the use and generation of electricity from renewable energy sources, and it facilitates the implementation of a smart grid in Ontario;
- Hydro One is committed to promoting the education of consumers through community involvement and customer consultation for future rate-setting applications;
- The implementation of Hydro One's ESM benefits and protects OPDC customers during the extended deferred rebasing period by guaranteeing \$2.6 million, established on an estimate of savings from the transaction. The guaranteed amount of \$2.6 million corresponds to approximately 37% of OPDC's current Board-approved base revenue requirement;
- The transaction eliminates the duplication of effort between Hydro One and OPDC and results in a single electricity service provider for the Orillia area, the northeastern portion of Simcoe County. This will ultimately create downward pressure on cost structures across both Hydro One and OPDC service areas.

Hydro One respectfully requests a written hearing for this Application.

Hydro One requests that a copy of all documents filed with the Board be served on the Applicant and the Applicant's counsel, as follows:

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IMPACT OF THE PROPOSED TRANSACTION

1.0 INTRODUCTION

This exhibit provides HOI's impact assessment of the proposed transaction and also provides a discussion of the impact of the transaction on OPDC's and Hydro One's future operations in relation to the OEB's statutory objectives. It elaborates on how the transaction promotes economic efficiency and cost-effectiveness in the distribution sector and also discusses other related matters pertaining to this transaction.

2.0 IMPACT OF THE PROPOSED TRANSACTION

The *Handbook to Electricity Distributor and Transmitter Consolidations* (the "Handbook"), Schedule 2 Filing Requirements requires applicants to provide evidence to demonstrate the impact of the proposed transaction with respect to the OEB's first two statutory objectives. The Handbook recognizes that there are other instruments and tools that will ensure that the OEB's remaining statutory objectives, relating to conservation and demand management, implementation of smart grid and the use and generation of electricity from renewable resources, will not be adversely impacted by a consolidation. Therefore, the Board has determined that there is no need or merit in further review of these statutory objectives as part of a consolidation transaction[1].

SECTION 2.1: OBJECTIVE 1 – PROTECT CONSUMERS WITH RESPECT TO PRICE AND ADEQUACY, RELIABILITY AND QUALITY OF ELECTRICITY SERVICE

This Application demonstrates that the ongoing cost structures following the closing of the transaction will result in expected ongoing operations, maintenance and administrative

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[1] Handbook, Page 6

("OM&A") savings of approximately $4.7 million per year and reductions in capital expenditures of approximately $0.2 million per year (based on the level of savings achieved by Year 10). These efficiencies represent an ongoing OM&A reduction of approximately 70% of OPDC's Year 10 status quo forecast. This will result in downward pressure on OPDC's cost structures relative to the status quo and will be realized while maintaining adequacy, reliability and quality of electricity service. These savings are expected to continue beyond the 10-year deferred rebasing period. Table 1 illustrates the projected cost savings from this transaction. How these savings will be attained is further discussed in Section 2.2.

Table 1 savings, illustrated below, are based on a comparison of OPDC's operations as a stand-alone distribution company relative to the costs of operating OPDC's service territory once it is integrated within Hydro One. Year 1 in the table represents a 12 month period post-closing of the transaction. This period is assumed to most closely align with calendar year 2020.

Table 1: Projected Cost Savings - $M

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
OM&A										
Status Quo Forecast	5.5	5.7	5.8	5.9	6.0	6.1	6.2	6.4	6.5	6.6
Hydro One Forecast	4.1	2.0	2.1	1.7	1.7	1.7	1.8	1.8	1.8	1.9
Projected Savings	**1.4**	**3.7**	**3.7**	**4.2**	**4.3**	**4.4**	**4.4**	**4.6**	**4.7**	**4.7**
Capital										
Status Quo Forecast	3.2	4.3	1.5	1.8	2.8	2.8	2.9	3.0	11.1	3.2
Hydro One Forecast	3.4	2.4	2.4	2.5	2.6	2.8	2.8	2.9	2.9	3.0
Projected Savings	**(0.2)**	**1.9**	**(0.9)**	**(0.7)**	**0.2**	**0.0**	**0.1**	**0.1**	**8.2**	**0.2**

Hydro One's 2017 OM&A cost to serve customers in its high density residential rate class (UR) is $179/customer[2], compared to OPDC's cost of $352/customer[3]. Hydro One's urban rate class covers areas containing 3,000 or more customers with line density of at least 60 customers per circuit kilometre. As such, it is reasonable to believe that if this transaction proceeds, Hydro One will be able to serve OPDC's service area, which has approximately 13,800 customers and a density of 57 customers per km of line, at a cost that is comparable to Hydro One's UR rate class.

Price of Electricity Service

The acquired OPDC customers will have rates adjusted in the next ten years as discussed below.

Rate-setting in Years 1-5 of the Deferred Rebasing Period

OPDC's current Base Distribution Delivery Rates[4] will be reduced by 1%, for residential and general service customers of OPDC, and frozen for a period of five years from closing of this transaction[5].

Table 2 shows the customer bill impact of this reduction applied to the average consumption levels for residential and general service rate classes. The impacts on total bill as well as distribution rates are provided. The rate reductions vary slightly from the 1% reduction as a result of rounding from using two decimal places for fixed charges and four decimal places for volumetric charges, as prescribed by the Board, and also due to the fact that the 1% rate

[2] EB-2016-0081, 2017 Draft Rate Order Filed November 18, 2016
[3] Average value for all OPDC customers as shown in the 2017 OEB Yearbook. For the OPDC residential class (which comprises ~ 90% of their customers), the cost to serve is estimated to be $208/customer.
[4] As defined in Exhibit A, Tab 1, Schedule 1, page 3, Footnote 2.
[5] A negative rate rider will result in a 1% reduction to OPDC's Base Distribution Delivery Rates, as approved by the OEB at the time of closing, will be implemented over that term.

reduction does not apply to other existing rate riders or LV rates which are also included in the table below under distribution delivery rates.

Table 2: Bill Impacts for OPDC Customers[6]

Rate Class[7]	Change in Distribution Delivery Rates	Change in Total Bill (%)
Residential	(0.96%)	(0.25%)
General Service less than 50 kW	(1.08%)	(0.27%)
General Service 50 to 4,999 kW	(0.97%)	(0.07%)

Detailed calculations of customer bill impacts and the determination of the rate riders can be found in **Attachment 7** and **Attachment 8**. For the purpose of this application, Hydro One proposes the residential variable rider, to effect the 1% reduction between years one to five of the deferral period, be rounded to five decimal places. This is an exception to the OEB's general rule, of four decimal places. The five decimal places will facilitate Hydro One providing a rider to benefit OPDC customers. The other riders will continue to be rounded to four decimal places, per OEB policy[8]. The proposed rate schedules, which include the requested rate rider for the area currently served by OPDC, effective after closing, are filed as **Attachment 9.**

The cost of providing this rate rider (approximately $80,950 per year[9]) will be recovered from synergies that are generated from consolidating OPDC's operations into Hydro One. This negative rate rider will be discontinued at the end of Year 5 of the deferral period.

[6] Based on OPDC's OEB-approved 2018 rates (EB-2017-0264)
[7] The proposed 1% rate reduction only applies to residential and GS rate classes.
[8] Hydro One asked the Board to approve a variable rate rider to five decimal places in EB-2017-0049 Exhibit H1 Tab 1 Schedule 1
[9] Based on the Residential, and General Service rate class revenues from the OEB 2017 Yearbook for OPD (totaling ($8,095k) multiplied by 1%

OPDC's residential distribution rates will continue to be adjusted to move to a fully fixed distribution charge, per OEB Policy "*A New Distribution Rate Design for Residential Customers*" (EB-2012-0410). In EB-2015-0024, the OEB approved a four-year transition period for OPDC to move to fixed rates, beginning in 2016 and is expected to culminate in fully fixed residential rates by the end of 2019.

All other OPDC tariffs will remain as approved in OPDC's last rate order[10]; with the exception of Specific Service Charges ("SSCs") which Hydro One is seeking approval to amend to align with the SSCs as approved, or will be approved[11], by the OEB for Hydro One Distribution. .

Specific Service Charges

Amending OPDC's rate schedules to reflect Hydro One's SSCs is the most reasonable and cost-effective solution. This approach simplifies and reduces the cost of billing system modifications and/or manual workarounds to accommodate different charges, reduces call centre staff training and provides for a consistent customer experience.

Rate Riders

Table 3 below is a (i) summary of OPDC's current Rate Riders, and (ii) Hydro One's requests for those applicable rate riders.

[10] EB-2017-0264
[11] Hydro One has proposed updates to its SSCs in its 2018-22 distribution rate filing [EB-2017-0049], currently before the OEB.

Table 3: Proposed updates to Orillia's Rate Riders

Current Rider Description	**Proposed Rider Description or Amendments in Proposed OPDC 2020 Rate Schedules**
Rate Rider for Smart Meter Incremental Revenue Requirement - in effect until the effective date of the next cost of service-based rate order	In effect until the effective date of the next cost of service-based rate order
Smart Metering Entity Charge[12] - effective until December 31, 2022	Will remain in effect until December 31, 2022
Rate Rider for Application of Tax Change (2018) - effective until April 30, 2019	This Rider expires in April, 2019. It will be deleted if the transaction closes after this date.
Rate Rider for Disposition of Global Adjustment Account (2018) - effective until April 30, 2019 *Applicable only for Non-RPP Customers*	This Rider expires in April, 2019. It will be deleted if the transaction closes after this date.
Rate Rider for Disposition of Deferral/Variance Accounts (2018) - effective until April 30, 2019	This Rider expires in April, 2019. It will be deleted if the transaction closes after this date.
Rate Rider for Disposition of Deferral/Variance Accounts (2018) - effective until April 30, 2019 *Applicable only for Non-Wholesale Market Participants*	This Rider expires in April, 2019. It will be deleted if the transaction closes after this date.

[12] The Smart Metering Entity Charge is a component of the "Distribution Charge" on a customer's bill, established by the OEB through a separate order. Decision and Order, EB-2017-0290, March 1, 2018

Rate-setting in Years 6-10 of the Deferred Rebasing Period

Beginning in year six through to year ten, rates for the former customers of OPDC will be set using the Price Cap adjustment mechanism, as outlined in the Board's Report: "*Rate Making Associated with Distributor Consolidation*" issued March 26, 2015 ("Amended Report"). At the commencement of year six, Hydro One will apply the OEB's Price Cap Index formula utilizing the former OPDC's efficiency cohort factor (0.3%). This will be anchored to then current OPDC Base Distribution Delivery Rates, and applied annually.

Rate-setting Post the Deferred Rebasing Period (Future Cost Structures)

The OEB, as requested in Hydro One's EB-2016-0276 application, wants information on future cost structures that will underpin the rate-setting that will be applicable to the customers of OPDC in the post-deferral period. As a result, Hydro One is filing evidence on potential rate setting mechanisms in years 11 and beyond (see **Exhibit A, Tab 4, Schedule 1)**.

Earnings Sharing Mechanism ("ESM")

Since Hydro One is requesting a 10-year deferred rebasing period, Hydro One will also be implementing an ESM, in accordance with the Amended Report. As outlined in the Handbook, the ESM as set out in the Amended Report may not achieve the intended objectives for all types of consolidation proposals. Hydro One is therefore proposing an ESM that protects OPDC customer interests during the extended deferred rebasing period. Further details on Hydro One's proposed ESM are found in **Exhibit A, Tab 3, Schedule 1**.

Hydro One Legacy Customers

The proposed transaction also protects Hydro One's existing customers. On March 31, 2017, Hydro One filed a five-year Custom Incentive Regulation (EB-2017-0049) application for rates effective from 2018 through to 2022, which is currently awaiting a Board decision/approval. This application did not include any costs associated with serving the customers of OPDC. Costs to serve these customers will not be included in any Hydro One revenue requirement application until the deferred rebasing period has expired.

Adequacy, Reliability and Quality of Electricity Service

Once the transaction is approved by the OEB, the Vendor intends to transfer OPDC's regulated distribution assets so that they are owned by HOI. Transfer of the distribution system from HOI to Hydro One Networks Inc. is expected to occur within 18 months after the close of the Agreement. Once integration is complete, the assets will be integrated with, and form part of Hydro One's existing distribution system. This change in control is expected to maintain or improve adequacy, reliability and quality of service.

Hydro One endeavors to maintain or improve reliability and quality of electricity service for all of its customers. Hydro One currently has existing assets serving many customers in close proximity to the current OPDC service territory (please see map filed as **Attachment 10**), making Hydro One a natural consolidator for OPDC. As part of the proposed consolidation, Hydro One will retain local knowledge from existing OPDC staff. This local knowledge, in coordination with Hydro One's regional operations and staff, will allow Hydro One to maintain or improve reliability.

The existing reliability metrics for OPDC and Hydro One's local metrics are provided in Table 4 below. Hydro One has used distribution stations (Bass Lake D.S, Rugby D.S & Silver Lake DS) in the vicinity of OPDC to compare with OPDC's metrics provided in the OEB Yearbook.

Table 4: Reliability Metrics*

	2013	2013	2014	2014	2015	2015	2016	2016	2017	2017
	Hydro One	**Orillia Power**[13]	**Hydro One**	**Orillia Power**	**Hydro One**	**Orillia Power**	**Hydro One**	**Orillia Power**	**Hydro One**	**Orillia Power**
Duration (SAIDI)	2.28	1.13	0.57	2.15	3.16	1.06	2.76	0.52	4.31	3.63
Frequency (SAIFI)	1.02	1.03	0.30	1.28	1.01	2.44	0.83	1.10	1.20	0.92

*Excluding LOS[14]

Based on reliability statistics for 2013 to 2017, Hydro One customers in the vicinity of the City of Orillia experienced a level of service in terms of duration and frequency of interruptions similar to the level experienced by OPDC customers. For 2014, Hydro One performed better than OPDC in terms of duration of outages, whereas OPDC performed better in the other years; for 2013, 2014, 2015 and 2016, Hydro One performed better than OPDC in terms of frequency of outages.

Hydro One's 2016 and 2017 SAIDI statistic is higher than OPDC. In 2016, two separate incidents caused by tree contact resulted in 302 customers having service interruptions – one lasted approximately 4.3 hours and the second approximately 3 hours. Both of the 2016 tree contacts occurred in the winter season. The first, resulting in a 4.3 hour outage occurred on November 20, 2016 at approximately 9:00 PM, during heavy storm cell activity across the province. A tree had fallen on one of the conductors of that feeder resulting in a need to replace the line conductor section of the circuit between the closest two poles. On that day, there was

[13] Data-sources for OPDC reliability metrics are the applicable OEB Yearbooks
[14] Loss of Supply ("LOS") interruptions attributable to assets that are not part of the Hydro One distribution System or the OPDC Distribution System

wide spread freezing rain, heavy snow and high winds through Ontario. Hydro One's Ontario Grid Control Centre ("OGCC") activated a 'Level 1'[15] emergency response. During that time Hydro One had approximately 50,000 customers interrupted throughout the province. Hydro One's current service territory in the vicinity of Orillia (non-OPDC territory) is the Central Region, and was heavily hit. The second 2016 interruption occurred on December 6th at approximately 7:00 PM in middle of winter conditions after dark. The winter condition and night interruption in rural areas normally are more challenging for Hydro One line crews to arrive, locate and restore power safely. This interruption was due to tree growth into lines and Hydro One Forestry needed to be routed to the location to trim the trees. This interruption was restored in 3 hours.

In 2017, Hydro One's SAIDI was again slightly higher than OPDC's. Both the OPDC and Hydro One SAIFI for 2017 reflect durations of heavy storm activity that occurred in this area of Ontario. One notable common storm cell occurred between the 2nd and 5th of August impacting approximately 91,000 Hydro One customers throughout the province. The OGCC activated a 'Level 1' emergency response during this time. Again, Hydro One's Central Region (Hydro One's service territory adjacent to OPDC's service territory is in the Central Region) was impacted heavily.

Hydro One has recently changed its Vegetation Management Strategy, moving from an 8-year maintenance schedule, which focused on clearing corridors completely and maintaining hazard trees, to a 3-year vegetation cycle that focuses on defects versus complete clearances. Hydro One expects this approach will reduce system interruption and/or equipment damage resulting from tree contact and other vegetation[16].

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[15] A Hydro One OGCC 'Level 1' event is triggered by either; an outage that results in more than 10,000 customers being interrupted, an outage duration that is estimated to exceed 24-hours, or there are 100 active incidents in the Hydro One Outage Management system.
[16] For further information on the new Vegetation Strategy see EB-2017-0049 Exhibit Q, Tab 1, Schedule 1

Hydro One anticipates that reliability for OPDC customers may in fact improve with the combination of pre-existing Hydro One and former OPDC resources optimized for the broader Orillia area, and the implementation of Hydro One's new vegetation strategy.

In the long term, OPDC customers are expected to benefit from operational efficiencies expected by having the OPDC assets integrated into Hydro One's larger distribution system. Scale efficiencies are expected in the areas of operating and maintaining the distribution system, planning capital replacement and the overhead and management functions. The foregoing is discussed further in Section 2.2. Hydro One is committed to ensuring that quality and reliability of the former OPDC's customers' electricity service will not be adversely impacted as a result of this transaction. As the Board indicated in the EB-2016-0272 Board Decision, Hydro One will be required to report on reliability and quality of service metrics, thus if there is a risk of harm to Hydro One's customers, the OEB's reporting requirements will make this apparent and will need to be addressed.

Other Items

There are no net metering customers in the current OPDC service area. Therefore, the net metering thresholds as a result of this consolidation will remain unchanged.

Hydro One has agreed to establish an Advisory Committee to provide a forum for communication between Hydro One and the community. Under the terms of the Agreement, the Vendor may appoint three representatives to the committee, and Hydro One will include both senior management and local staff representation.

The City of Orillia will retain the current OPDC Operating Centre on West Street for future redevelopment. Hydro One has agreed to enter into a five-year lease agreement with the City to lease this centre. Conditional on the completion of the sale, Hydro One intends to commence construction, during the lease period, of a permanent operations and administration building within the City of Orillia. This new centre will consolidate operations between Hydro One's pre-existing Orillia Operating Centre and OPDC's Operating Centre on West Street.

SECTION 2.2: OBJECTIVE 2 – PROMOTE ECONOMIC EFFICIENCY AND COST EFFECTIVENESS AND FACILITATE THE MAINTENANCE OF A FINANCIALLY VIABLE ELECTRICITY INDUSTRY

Hydro One submits that this transaction will promote economic efficiency and cost effectiveness which will result in lower ongoing cost structures.

Economic efficiency is attained through sector consolidation, which ultimately eliminates redundant activities. Cost effectiveness reduces OM&A and capital expenditures and is achieved by leveraging Hydro One's economies of scale. These together result in sustained operational efficiencies, both quantitative and qualitative.

With the integration of OPDC's staff and operations with Hydro One's existing operations, Hydro One expects sustained operational efficiencies to be realized in distribution operations, administration, information technology and customer service.

Staff Integration

As Hydro One already has an operating organization in place that provides many of the same functions as OPDC, certain redundant positions will no longer be required. Table 5 shows the 2017 actual OPDC labour split between staff occupying direct and indirect positions. Direct staff, such as line and forestry employees, work directly on the distribution assets. Indirect staff are considered support staff such as back-office, customer service, finance, etc.

Table 5: Current OPDC Staff

	Direct	**Indirect**
Management	-	8
Back Office	-	7
Trades & Technical	15	4
Total	**15**	**19**

OPDC's direct staff will be integrated into Hydro One's local operations and will become part of the area's pool of resources working within the larger Hydro One service area, which encompasses OPDC's current service territory. Hydro One will expand its current Central region to include the OPDC service territory. The 15 direct OPDC positions, currently focused solely on servicing the OPDC service area, will be eliminated. However, as a result of this transaction, 9 new local Hydro One positions will be required and are anticipated to be sourced from the existing 15 OPDC staff complement. Therefore, the result is a net reduction of 6 local trades and technical positions to serve the same territory. In addition, Hydro One will eliminate all 19 indirect positions solely focused on the OPDC territory in the management, back office, and indirect trades and technical areas. The remaining 25 personnel will be absorbed into vacancies within Hydro One Networks.

Although certain functions and positions will be eliminated as part of the integration process leading to efficiency gains, Hydro One, due to its size and current staff retirement profile, is able to offer continued employment to existing OPDC staff. OPDC personnel currently in these roles will have the opportunity to transition to existing positions within the Hydro One organization. This will allow Hydro One to leverage the industry knowledge of existing OPDC staff to meet customer needs. As Hydro One will now be planning the electricity requirements for the entire Orillia area, it will be able to more efficiently manage both the operating and capital costs associated with serving customers across the area.

Distribution Operations

Local area operating and capital savings will result in a more efficient distribution system due to the elimination of an artificial electrical boundary and thereby realizing benefits from contiguity.

Hydro One's existing service territory is situated immediately adjacent to the territory served by OPDC. The geographic advantage of contiguity allows for economies of scale to be realized at the field and operational levels through the eventual integration of OPDC's and Hydro One's local systems.

The elimination of the artificial electrical boundary between these contiguous distributors will result in operational efficiencies in various areas. Hydro One will be able to rationalize local space needs through the elimination or repurposing of duplicate facilities such as service and operating centres; more efficiently schedule operating and maintenance work and dispatch crews over a larger service area; and, more efficiently utilize work equipment (e.g., trucks and other tools), leading to lower capital replacement needs over time. The elimination of the service area boundary allows for more rational and efficient planning and development of the distribution system. All of the above provide the potential to result in operating and capital savings, both immediate and over time, which will provide long-term benefits to ratepayers relative to the status quo.

This situation is common throughout the Province and is shown in the attached map (see **Attachment 11**) depicting the current fragmented pattern of the local distribution system, with small- and medium-sized LDCs contiguous to or surrounded by Hydro One.

Hydro One's Asset Risk Assessment ("ARA") process will also assist in achieving ongoing distribution operational efficiencies. Hydro One's ARA process determines the state of Hydro One's distribution system, identifies current asset needs, and creates a line of sight to future needs, which enables an in-depth view of asset risk, and improved decision-making. The ARA incorporates field asset assessment including visual inspections and evaluation. This process allows Hydro One to assess the state of its assets, assess the risks that those assets pose and to develop appropriate plans in order to ensure reliability and service quality are met. This assessment will allow Hydro One to consider the state of the OPDC distribution system, identify current asset needs, and create a line of sight to future asset needs.

Administration

Sustained administrative efficiencies will result due to (a) the elimination of redundant activities and (b) efficiencies resulting from economies of scale.

The following stand-alone OPDC activities provide examples of what will be consolidated into Hydro One's portfolio of activities.

- Financial: financial accounting, planning, forecasting, management reporting, procurement, treasury, tax, and audit functions.
- Regulatory and legal: rate-setting applications, OEB initiatives, compliance, RRR reporting, and other regulatory reporting (e.g., CDM program administration costs, IESO Market Rules).
- Executive and governance: duplicative functions performed by OPDC senior management would be eliminated, and OPDC's Board of Directors would no longer be required.
- Human Resources: Hydro One will have savings in recruitment, training, and staff development costs, as trained and experienced OPDC staff will be available to Hydro One to replace expected retirements and other attrition. As well, there will be a reduction in external consultants and contractor engagement between the two companies.

Hydro One's cost of borrowing is typically lower than that of local LDCs, leading to savings in financing costs over time. For example, in June 2018, Hydro One Inc. issued $250 million of 7-year debt with a 2.97% coupon rate, and $700 million of 31-year debt with a 3.63% coupon rate.

The cost of long-term debt included in OPDC's rates is 6.25% compared to the 4.47% submitted by Hydro One Distribution in its recent 2018 rate application (EB-2017-0049, Exhibit Q, Tab 1, Schedule 1). OPDC's current debt will be refinanced prior to closing of this acquisition. Consequently, the savings that arise from Hydro One's ability to refinance OPDC's debt upon maturation at a lower rate will lead to lower debt return on rate base, relative to the status quo.

Benefits are also expected to accrue to various agencies within the Ontario energy industry. For example, the costs to regulate and administer the sector may be reduced as this and further acquisitions are completed. The IESO, the OEB, and Ministry of Energy can achieve potential savings through reduced regulatory burden and industry oversight. Further, enhanced regional planning efficiencies may also be achieved by having fewer distribution companies planning for larger areas. For instance, capital can be deployed more efficiently than with the current fragmented approach.

Information Technology

A larger customer base resulting from the creation of a larger regional distributor leads to costs for processing systems, such as billing, customer care, human resources and financial, being spread over a larger group of customers. Consolidation of these functions is expected to result in efficiency benefits as duplicate systems are eliminated, leading to lower capital, operating and maintenance costs over time.

The integration of Hydro One and OPDC will allow for efficiency gains to be realized through eliminating duplication in transaction-processing functions. For example, Hydro One currently processes financial, human resource, information technology, and work management transactions for its existing customers and staff. OPDC processes very similar transactions for its own service area. This means that if the transaction proceeds, Hydro One has the opportunity to eliminate these sources of duplication.

OPDC utilizes a Survalent Supervisory Control and Data Acquisition System ("SCADA") which monitors and controls the distribution network. Integration of OPDC into Hydro One will result in the OPDC SCADA being integrated onto Hydro One's SCADA system and eliminating the need for the master stations. This represents a savings of IT capital and ongoing upgrades.

Customer Service

Hydro One is undergoing a historic customer service transformation. From front line service repairs to operational planning to Board of Directors meetings, Hydro One is today more sharply focused on what's best for the customer. The following describes some of the initiatives and ongoing customer services that Hydro One provides its customers, and which would be offered to the customers of OPDC.

Call Centre

Responding to requests for more convenient hours that fit customer schedules, Hydro One has Contact Centres open on Saturdays from 9:00 a.m. to 3:00 p.m. and extended weekday hours from 7:30 a.m. to 8:00 p.m. – making Hydro One the first electricity service provider in Ontario to do so. For power outages and other emergencies, Hydro One provides 24 hour assistance. The Hydro One Call Centre is open 4½ hours per day longer on Monday to Friday than OPDC's call centre and is supported by an award-winning 24/7 Interactive Voice Response ("IVR") system in addition to customer service staff. This IVR provides customers the ability to self-serve, for many of their most common account and service needs, such as reporting a power outage and obtaining their current account balance. This allows the customer to quickly and accurately get responses to many of their inquiries and allows call centre agents to focus on the more complex questions. Hydro One also insourced its Contact Centre representatives back from a third-party provider, allowing Hydro One employees to better serve customers, by providing a more seamless experience. This transition has also delivered improved service quality. By coming back into the organization, the customer representatives will play a large part in advancing

Hydro One's renewed service culture, assuring customers they are now connecting directly with Hydro One service leaders and decision makers who will be better equipped to serve them.

Increased Community Service and Presence:

Hydro One continues to increase its presence in local communities through drop-in sessions, its mobile Electricity Discovery Centre and by opening regional customer service desks at the Sudbury Field Business Centre and piloting customer service offices at the London and Markham Contact Centres. Hydro One also has a traveling customer service team that visited over 20 cities, towns and Indigenous communities throughout the year, meeting customers face-to-face to help answer questions about their bills, provide information about smart meters and help them learn more about conserving energy and reducing their usage.

Outages

When an outage occurs, Hydro One customers can use other channels, such as online access via smart-phone or other battery-charged laptops and devices, for information about outage details, including estimated restoration time. Customers have the option to sign up for e-mail or text outage notifications. OPDC customers currently do not have these outage notifications, but upon integration, these channels will be become available to OPDC customers as well.

Initiatives to Help Customers Manage their Bills

Hydro One helps customers reduce their monthly bills through electricity conservation programs. Hydro One is committed to delivering industry leading Conservation and Demand Management ("CDM") initiatives that help customers save on their electricity usage and bills. In addition to CDM programs, Hydro One typically tops-up Low Income Energy Assistance Program ("LEAP") funding to help those least able to afford their electricity bills. This is not done by OPDC today. Hydro One also eliminated security deposits for residential customers and significantly reduced deposit requirements for business customers and expanded relief measures to help customers who accumulated balances on their accounts over the winter. Customers can sign up for digital notices that include notifications that their eBill is ready, how much electricity they are consuming mid-month, and payment receipt alerts. All of these alerts provide Hydro One customers with the information they need to effectively manage their energy consumption and their finances. Additionally, Hydro One provides a range of support to Indigenous customers through the First Nations Delivery Credit, First Nations Conservation program and Hydro One's Get Local program.

New Services

Hydro One has redesigned the *HydroOne.com* website and *myAccount* self-service portal to make them more intuitive, providing an array of information and tools, such as *Predict My Bill*. The format of Hydro One's electricity bills were also completely redesigned following extensive research and substantial direct feedback from thousands of customers. The new, easy to understand electricity statements began in December 2017. The new version of the bill also translates well digitally as an e-bill on both web and mobile applications. The new bill changes have seen improvements to our customers understanding of their bills.

OPDC's LEAP funds provided annually between 2015 and 2018, were fully utilized, and in each year were depleted by mid-year, with no additional funding available to assist with remaining potentially eligible customers. If this transaction is approved, OPDC's customers would benefit from Hydro One's top-up of LEAP funding.

Service Guarantees

Hydro One was the first of its kind for any electric utility in Ontario to offer Service Guarantees. These guarantees provide tangible evidence Hydro One is prepared to stand behind the service provided to its customers. If Hydro One fails to meet commitments (e.g., misses an appointment, takes longer than 5 business days to connect a new service once all connection requirements are met, does not return a phone call within one business day)[17], the residential customer's account is proactively credited $75.

Incremental Transaction and Integration Costs

Both parties to the transaction will have incurred some incremental costs associated with the transaction.

Hydro One's incremental transaction costs are estimated to be approximately $3 million. These include legal, and tax costs relating to completion of the transaction, and costs associated with the necessary regulatory approvals.

Integration costs include incremental up-front costs to transfer the customers into Hydro One's customer and outage management. These costs are estimated to be approximately $6 million. Hydro One is not expecting to incur any ongoing integration costs.

All of the above incremental costs will be financed through productivity gains associated with the transaction, will not be included in Hydro One's revenue requirement, and thus will not be funded by ratepayers.

Financial Viability/Premium/Financing

As contemplated in the share purchase agreement, Hydro One Inc. will pay $41.3 million for the acquisition of OPDC. This comprises a cash payment of approximately $26.4 million for the shares and the assumption of short and long-term debt of approximately $14.9 million[18]. The purchase price represents the commercial value of the underlying assets established through negotiations with an arms length third party.

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[17] The terms and conditions for these Service Guarantees can be found at:
https://www.hydroone.com/about/corporate-information/our-service-guarantees

[18] As contemplated in the share purchase agreement, the final purchase price is subject to closing adjustments.

The premium paid over the asset's book value will not have a material impact on Hydro One Inc.'s financial viability. This transaction price accounts for less than 1% of Hydro One Distribution's net fixed assets. In addition, the premium paid will not be included in Hydro One's revenue requirement and thus will not be funded by ratepayers. Copies of OPDC's, Hydro One Distribution's and Hydro One Inc.'s Financial Statements for 2016 and 2017 are provided in **Attachments 12 to 17**.

HOI will initially finance the proposed transaction through cash or its short-term commercial paper program, which is operational and fully backed by a syndicated bank line of credit maturing June, 2022. Long-term financing will be through its Medium-Term Note program, which is fully operational and valid until April 2020, and planned to be renewed thereafter.

3.0 OTHER RELATED MATTERS

Regulatory Assets and Rate Riders

OPDC's deferral and variance accounts will be held separately from Hydro One Network's deferral and variance accounts. The Report of the Board on Electricity Distributors' Deferral and Variance Account Review Report ("EDDVAR") provides that under the Price Cap IR, the distributor's Group 1 audited account balances will be reviewed and disposed if the pre-set disposition threshold is met. In the letter Update to EDDVAR Report, released July 2009, dated July 25, 2014, distributors may seek to dispose Group 1 balances that do not exceed the threshold. Hydro One will comply with this policy during the deferred rebasing period and will propose disposition of the former OPDC Group 1 balances once they meet the threshold established by the Board, consistent with this policy.

OPDC is requesting a rate rider to reduce the residential and general service rate classes' Base Distribution Delivery Rates that are in effect at the time this transaction closes, by 1% for years one through five of the deferral period. All other OPDC rate riders will continue as per their existing rate schedules until expiry.

The OPDC regulatory assets currently approved by the OEB will continue to be tracked in their respective accounts, and disposition will be sought at a future date.

Also, Hydro One requests approval to establish and use a regulatory account to track costs associated with the proposed ESM, which is proposed to be active in the deferral period years six through ten as part of this Application. If approval is granted, Hydro One will submit a Draft Accounting Order for the Board's approval either as a condition of this Application's approval, or as a subsequent filing. More detail on Hydro One's proposed ESM is at **Exhibit A, Tab 3, Schedule 1**.

Incremental Capital Module

To encourage consolidation, the Handbook has now explicitly extended the availability of an ICM, for any prudent discrete capital projects, for consolidating distributors that are on either Price Cap Incentive Regulation ("PCIR") or Annual IR Index. Currently, OPDC rates are set in accordance with PCIR.

Hydro One understands, from the Handbook, that an ICM will be made available for the former OPDC service territory should the need arise. Hydro One currently has no plan to apply for ICM relief during the deferred rebasing period, however if circumstances prevail where Hydro One does require an ICM, the details pertaining to the ICM will be provided in that future application.

US GAAP

OPDC's financial statements are currently prepared under IFRS. Hydro One Distribution received OEB approval to utilize US Generally Accepted Accounting Principles ("US GAAP") as its approved framework for rate setting, regulatory accounting and regulatory reporting in the Decision with Reasons in EB-2011-0399 (issued on March 23, 2012). In addition, in the Hydro One Norfolk MAAD (EB-2013-0187/196/198) Decision and Order, the Board decided that using US GAAP methodology in accounting for Norfolk Power Distribution Inc. (the acquired utility) will be more efficient than continuing to use Modified IFRS. Since that Decision, the OEB has also approved the use of US GAAP for Haldimand County Hydro Inc. (EB-2014-0244) and Woodstock Hydro Services Inc. (EB-2014-0213) in their MAAD applications.

Hydro One requests similar approval to utilize US GAAP for accounting purposes in relation to OPDC. Approval to use US GAAP for OPDC will simplify any future rate integration, will avoid incremental costs or productivity losses by simplifying processes and avoiding the need for workarounds, and will facilitate Hydro One Inc.'s consolidated reporting for securities filing purposes (including future U.S. Securities and Exchange Commission), thus avoiding incremental costs and/or reduced productivity. By using one uniform standard of reporting, Hydro One seeks to achieve integration and scale efficiencies. Given the relative small size of the OPDC operations (when compared to Hydro One), Hydro One believes it would be inefficient and costly to maintain two different accounting regimes for divisions within Hydro One.

Compliance Matters

Pending approval of this transaction and after notification to the Board that integration is completed, OPDC's distribution system and Rate Order will be transferred to Hydro One, and Hydro One's distribution licence will be amended to include the OPDC service territory. The customers, assets, systems, processes and operations of OPDC will be fully integrated into Hydro One's business activities.

Hydro One confirms that it is materially in compliance with its regulatory requirements, subject to any approved regulatory exemptions. The list of specific code requirements from which Hydro One has been exempted can be found in Schedule 3 of Hydro One's Electricity Distribution Licence.

To the best of OPDC's knowledge, it is in compliance with all relevant licence and code requirements per its Electricity Distribution Licence. It is expected that following the approval and completion of the transaction and after integration of OPDC's distribution business activities into those of Hydro One, Hydro One will continue to be materially compliant with all applicable Legislation, Regulations, Market Rules, other Licence Conditions and Codes.

Hydro One's compliance policy will continue to require that confirmed instances of non-compliance be disclosed and mitigated as necessary including applications for exemptions from such requirements, if necessary. Any potential instances of non-compliance associated with OPDC's distribution business activities will be addressed during the integration process.

During the period after closing of the transaction and prior to full integration, service level agreements in compliance with the OEB's *Affiliate Relationships Code for Electricity Distributors and Transmitters* will be drafted between OPDC and Hydro One affiliates.

SUMMARY

For the reasons addressed in the preceding sections, both qualitative and quantitative savings and efficiencies are expected to result from this transaction. Overall, Hydro One's analysis shows the ongoing synergies will accrue as a result of this transaction, benefiting ratepayers of both utilities. These attributes allow Hydro One and OPDC to conclude that the transaction will not cause harm to ratepayers, and indeed will provide benefits to all ratepayers in the long term. Moreover, this application embodies the current regulatory policies and principles of the Board in pursuing the objectives established by section 1 of the Act.

EARNING SHARING MECHANISM

1.0 INTRODUCTION

Consistent with the Amended Report, Hydro One is proposing to implement an Earning Sharing Mechanism ("ESM") to operate during the term of the extended deferred rebasing period[1] (i.e., for years six to ten beyond the initial five-year deferral period). The ESM will ensure that customers share in the benefits from consolidation during that period.

The Handbook provides further details on the Board's expectations of an ESM, and in some instances, references details that would apply specifically to a transaction, including these key aspects:

- Consolidating entities that propose to defer rebasing beyond five years must implement an ESM for the period beyond five years. The ESM is designed to protect customers and ensure that they share in any increased benefits from consolidation during the deferred rebasing period;
- Excess earnings are shared with consumers on a 50:50 basis for all earnings that are more than 300 basis points above the consolidated entity's annual ROE;
- Earnings will be assessed each year once audited financial statements are available, and excess earnings beyond 300 basis points will be shared with customers annually;
- An ESM as set out in the 2015 Report may not achieve the intended objective of customer protection for all types of consolidation proposals. For these cases, applicants are invited to propose an ESM that better achieves the objective of protecting customer interests during the deferred rebasing period[2].

[1] EB-2014-0138, Amended Report, page 6
[2] Handbook, Pages 16-17

With these factors in mind, Hydro One is proposing an ESM that simplifies its administration, thereby keeping costs low and providing a guaranteed cost reduction to ratepayers, while adhering to the Board's principles outlined in its recent policies and decisions on consolidation applications.

2.0 PROPOSED ESM

Hydro One's ESM will guarantee a cumulative $2.6 million amount of over-earnings will be shared with former OPDC customers as a result of the implementation of the ESM in years six to ten.

The following are the key aspects of Hydro One's proposal, each of which will be discussed in detail below:

- *Term and Eligibility* - Hydro One is proposing to implement an ESM in years six through ten of the deferred rebasing period. Excess earnings above 300 basis points on the allowed ROE in that period will be shared 50:50 with customers of the former OPDC.
- *Mechanics of the ESM* - The ESM has been calculated on forecast OM&A and capital costs based upon Table 1 in the evidence, provided at **Exhibit A, Tab 2, Schedule 1**.
- *Ratepayer Refund* - The projected over-earning amounts shared with customers will be recorded in a regulatory account and interest-improved.

2.1 Term and Eligibility

Hydro One is proposing to implement an ESM in years six through ten of the deferred rebasing period, consistent with the Amended Report and the Handbook. The ESM will employ a 50:50 sharing of earnings 300 basis points over OPDC's current-approved ROE. The excess earnings will be shared with customers, who at the time of disposition will be customers of Hydro One in what is currently OPDC's service territory. The sharing of the earnings solely with OPDC's customers is consistent with the Board's direction in the Handbook, where the Board suggested that "a large distributor that acquires a small distributor may demonstrate the objective of consumer protection by proposing an ESM where excess earnings will accrue only to the benefits of the customers of the acquired distributor"[3]. This is also consistent with the comments delivered by the Board in Hydro One's Woodstock Hydro Services Inc. MAAD Decision[4] where the Board expressed concerns that the ESM as proposed by Hydro One (over-earnings based on Hydro One's Financial Statements) would not ensure that potential savings would be seen by the existing customers within the Woodstock service territory. The over-earnings will be calculated on the operations of the acquired entity opposed to the consolidated new entity's earnings.

2.2 Mechanics of the ESM

An essential aspect of consolidation is to attain as many synergies as possible to the ultimate benefit of all ratepayers of the consolidating entities. Elimination of redundant financial records, external audits and reporting is a key element to lowering cost structures. Hydro One is on record that it does not intend to provide separate financial statements for any of the acquired utilities. This was discussed during the Woodstock MAAD oral hearing[5]. To do so would not only decrease forecast synergies but would also add new one-time and ongoing costs to set up business units in Hydro One's financial systems, thus diminishing costs savings that would otherwise be available to ratepayers.

Hydro One proposes to fully integrate OPDC into its Distribution business within 18 months of the close of the transaction. Once complete, the companies will be fully integrated, both operationally and financially, including having one set of financial records. Since separate financial statements will no longer exist for OPDC, Hydro One will not be in a position to report the earnings of the acquired distributor. Instead, Hydro One proposes to calculate excess earnings in years six to ten based upon forecast costs as presented in Table 1 below.

[3] Handbook, Page 16
[4] EB-2014-0213, Page 17
[5] EB-2014-0213, Transcript, Day 2, page 48

In this Application, Hydro One proposes to commit to a pre-calculated ESM guaranteeing a defined benefit to ratepayers of the former OPDC service territory as set out in Section 2.3 below. An ESM using forecast OM&A and capital expenditures has two benefits. Firstly, it reduces both ongoing and one-time costs to serve the customers in the former OPDC service territory, maximizing their share of excess earnings. The tracking of costs required to produce financial statements would substantially reduce the savings available from consolidation activities. Secondly, it provides Hydro One with a strong incentive to achieve the forecast efficiency savings, which are significant as a percent of the existing OM&A and rate base of OPDC. Committing to a pre-calculated refund, regardless of actual costs, drives Hydro One to seek as many efficiencies as possible. Once achieved, this will result in lower ongoing cost structures[6] to the benefit of all Hydro One ratepayers.

A significant benefit to OPDC customers is that the OM&A costs used in the model are *incremental* costs only, which do not include corporate overheads. Including corporate overheads would reduce net income, thereby reducing shared earnings. Hydro One's Year-10 forecast OM&A costs are approximately 70% less compared to OPDC's status quo Year-10 OM&A forecast.

Table 1 below describes the key components used in the Hydro One ESM model.

[6] Both during and post the deferred rebasing period.

1 **Table 1: ESM Components**

Rate Base
▪ OPDC's Board-approved rate base[7] was adjusted for net in-service additions that have accumulated since its last rate rebasing to calculate rate base at the closing of the transaction. ▪ Additions to rate base during the deferred rebasing period are the forecast in-service capital additions as shown in Table 1 provided in Exhibit A, Tab 2, Schedule 1, plus working capital. ▪ The starting point for calculating OPDC's forecast rate base was OPDC's 2017 audited Financial Statements (Attachment 12 to Application) and assuming OPDC's Status Quo capital expenditures for 2018 and 2019 to bridge the rate base to 'Year 1', which is assumed to be 2020. The forecast rate base equals the NBV of Property, Plant and Equipment ("PP&E") less capital contributions plus a calculation for working capital, using the Board's methodology. During the 10 year rate rebasing deferral period, the calculated rate base includes additional in-service additions sourced from the forecast capital expenditures provided in Exhibit A, Tab 2, Schedule 1, Table 1, and applying the half-year rule. The modeling assumption used is that capital expenditures from Table 1 are treated as 100% in-serviced in the year incurred. ▪ Equity Component of rate base is 40% of the total rate base
Revenue
▪ OPDC's 2018[8] current OEB-approved base distribution rates are adjusted by the *Price Cap Incentive Rate-setting* mechanism for the extended deferral period: - The inflation rate is sourced from the IHS Global Insights February 2018 inflation forecast for Ontario. - OPDC's productivity factor is 0.3%. ▪ OPDC's distribution revenue forecast, used in the ESM model, incorporates adjustments for customer and load growth and is calculated using the above rates multiplied by the forecast load and customer profiles of the OPDC service area. ▪ The forecast load and customer profiles used to forecast revenue in Hydro One's ESM model were generated taking into account the latest information on OPDC's actual load and customer numbers as well as local and provincial demographic and economic trends.
OM&A
▪ OM&A costs during the deferred rebasing period align with the forecast provided in Table 1 provided in Exhibit A, Tab 2, Schedule 1. OM&A costs used are direct costs only. ▪ Hydro One is assuming all operational risks during the 10-year deferred rebasing period. These risks include: ▪ The risk that the OM&A forecast is not achieved; ▪ The risk that assets are not in the condition anticipated; ▪ The risk that the anticipated load and customer load profiles do not materialize. Hydro One will also need to manage, over a 10-year period, any changes to labour (collective agreements, benefits, pension) and material costs, the impact of innovation and technology on operations, and any political and regulatory changes. Irrespective of the actual results, OPDC customers will receive the ESM sharing benefit. As a result of the risks assumed by Hydro One in committing to the guaranteed ESM, a 20% risk factor has been applied to the OM&A forecast. This means that prior to calculating the forecast savings from the transaction that would be shared with customers, Hydro One has multiplied the forecast OM&A costs by 1.20.
Depreciation
▪ The acquired assets are depreciated based on their remaining useful life as determined by Hydro One. The assets purchased post-transaction in Table 2 are depreciated in accordance with Hydro One Distribution's approved depreciation rates.

[7] EB-2009-0273, Draft Rate Order
[8] EB-2017-0264

▪ Annual depreciation is calculated on the opening Gross Asset Values as of Year 1 of the Deferral period. Hydro One's OEB-approved depreciation rates are used which will also be used for financial accounting post transaction close.
Financing Costs

▪ Interest expense is calculated by applying the long and short term debt rates, outlined below, to 60% of the OPDC rate base
▪ The cost of debt is that embedded in OPDC's current approved rates:
    ▪ Long-term debt is 6.25%.
    ▪ Short-term debt is 1.33%.

Taxes
▪ Taxes are calculated using the existing provincial and federal tax rates, totalling 26.5%.
Return on Equity
▪ The ROE used to establish the 300 basis point differential is OPDC's current-approved ROE of 9.85%[9].

2.3 Ratepayer Refund

Table 2 below provides Hydro One's proposed refund to customers using the ESM as above-described. The ESM is calculated using the OM&A and capital costs identified in **Exhibit A, Tab 2, Schedule 1**, Table 1 of this Application.

Hydro One believes that the proposed ESM, based upon forecast cost savings, benefits and provides a fair return to ratepayers. OPDC ratepayers receive a guaranteed sharing of $2.6 million earned during the ESM period. Hydro One will have a strong incentive to ensure that these savings are achieved so that its ability to recover acquisition costs will not be eroded. The resultant synergy savings will then form the basis of future revenue requirements, which will benefit all of Hydro One customers through lower cost structures. Pursuing the more conventional ESM alternative of tracking costs separately and maintaining separate financial records would increase both OM&A and capital costs, which would ultimately erode the synergies of this transaction, thereby reducing the ESM share that will be available to the customers of the former OPDC.

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[9] EB-2009-0273

Table 2: Earning Sharing Mechanism Sharing - Years 6 to 10 ($000's)

	Deferral Period Year	**6**	**7**	**8**	**9**	**10**
	Calendar Year	**2025**	**2026**	**2027**	**2028**	**2029**
1	Rate Base	47,887	49,503	51,237	52,996	54,722
2	Equity Component of Rate Base	19,155	19,801	20,495	21,198	21,889
3	Revenue	9,310	9,515	9,725	9,946	10,158
4	OM&A[10]	2,075	2,120	2,166	2,212	2,260
5	Depreciation	1,442	1,211	1,274	1,340	1,408
6	Interest	1,702	1,759	1,821	1,883	1,944
7	Tax	960	983	1,005	1,029	1,049
8	**Net Profit After Tax**	3,131	3,442	3,460	3,481	3,496
9	Achieved ROE (%) (Line 8 ÷ Line 2)	16.35%	17.38%	16.88%	16.42%	15.97%
10	Less: Approved ROE% for OPDC	(9.85%)	(9.85%)	(9.85%)	(9.85%)	(9.85%)
11	ROE% above Approved ROE%	6.50%	7.53%	7.03%	6.57%	6.12%
12	Less: 300 Basis Points Threshold	(3.00%)	(3.00%)	(3.00%)	(3.00%)	(3.00%)
13	Total Over-Earnings (%)	3.50%	4.53%	4.03%	3.57%	3.12%
14	Total Over-Earnings (Line 13 x Line 2)	$670	$898	$826	$757	$683
15	50% of Overearnings Shared with to OPDC customers	$335	$449	$413	$379	$342
16	Tax Effected Earnings Sharing (26.5%)	$456	$611	$562	$515	$465
17	Cumulative Tax Effected Earnings Sharing (Years 6 to 10)					**$2,609**

[10] Includes risk factor adjustment

2.4 Ratepayer Refund

Hydro One will record the guaranteed refund due to ratepayers in a deferral account. These amounts will be interest-improved, in accordance with the OEB's prescribed interest rates. Hydro One will accrue the balance in this account until the end of the extended deferred rebasing period. At this time, OPDC customers are expected to be transitioned to an appropriate existing or new Hydro One rate class. In Year Ten of the deferral period, Hydro One will apply to the Board to dispose of the balance in this account in one of the following manners: (1) Hydro One will apply these funds to offset the cost of any rate mitigation that may be required to transition these customers to their new rates. That application will recommend the duration of the disposition period; (2) If the total balance in the deferral account is not completely required to fund rate mitigation, then Hydro One will offer rate mitigation for a defined period of time, and any remaining balance will be disposed of via a one-time credit; or (3) If no rate mitigation is required, the balance of the deferral account will be completely refunded to the customers by a one-time credit. This method of disposition ensures that there is no cross-subsidization between the legacy Hydro One customers and OPDC customers[11]. Hydro One is not opposed to refunding the ESM earnings on an annual basis in years 6 through 10, if the OEB should order such disposition, as was decided in EB-2017-0269[12]:

> "NT Power will be required to implement an ESM in a manner consistent with the 2015 Report and Handbook – i.e., … to share these earnings annually with customers once audited financial results are available."

OPDC last had its rates rebased in 2010. If this application is approved, the next rebasing of distribution rates which includes costs for OPDC would be 2030, a period of twenty (20) years. Though there will be significant savings as a result of this consolidation, the 20-year gap

[11] Hydro One at a later date will file a separate application to request the establishment of a regulatory account to track these costs.
[12] EB-2017-0269 Decision and Order, page 20

between rebasing may result in a disparity between cost structures and rates. Regardless of the rate class to which these customers will be transitioned, rate mitigation may be required. The disposition of the accumulated OPDC ESM sharing balance in years 11 and forward will help to offset any required rate mitigation. It is for this reason that Hydro One proposes recording the ESM refund amount in a deferral account for future disposition.

2.5 ESM Summary

Hydro One believes that the proposed ESM meets the objectives of the Board's policy. The guaranteed refund to customers not only accommodates the circumstances of the transaction; it also provides an incentive for Hydro One to derive increased efficiencies and provides a mechanism to help mitigate rates at the next rebasing. This allows the shareholder to continue to recover transaction costs, while ensuring that customers of the former OPDC are protected from the risk of unrealized synergies, and benefit from the efficiencies and savings that the new distributor expects to achieve from consolidation.

The proposed refund to customers is a significant amount: Hydro One is guaranteeing a total \$2.6 million refund to the former customers of OPDC. This equates to approximately 37% of OPDC's current Board-approved revenue requirement[13].

[13] EB-2009-0273

FUTURE COST STRUCTURES

1.0 PREAMBLE

In EB-2016-0276 the Board wrote in its Decision[1]:

> "The OEB is of the view that it would have been reasonable to see a forecast of costs to service Orillia customers beyond the ten year period and an explanation of the general methodology of how costs would be allocated to Orillia ratepayers after the deferral period. . . . The OEB recognizes that any forecast of cost structures and cost allocation 10 years out would include various assumptions and could not be expected to be 100% accurate. However, the OEB has highlighted its concern and its need to better understand the implications of how Orillia customers will be impacted by the consolidation beyond the ten year period. In the absence of information to address that OEB concern, the OEB cannot reach the conclusion that there will be no harm."

Based on the above, Hydro One is providing evidence on "Future Cost Structures" for OPDC in relation to revenue requirement and a general explanation as to how costs would be allocated beyond the deferred rebasing period.

2.0 UNDERLYING COST STRUCTURES TO SERVE OPDC'S SERVICE TERRITORY

To understand if the cost structures and/or rates for the acquired customers, beyond the 10-year deferral period proposed in this Application, are no higher than they would have been in absence of the transaction, (a) OPDC has calculated for Year 11 the estimated revenue requirement for

[1] Decision and Order, page 13

the Orillia service territory in the circumstances where the system continues to be owned and operated by OPDC (i.e. the “Status Quo” scenario) and (b) Hydro One has calculated the estimated revenue requirement, based on the residual cost to serve (i.e. the “Residual” scenario) this territory, after accounting for the synergies and efficiency gains that are anticipated during the deferral period under the proposed transaction.

2.1 OPDC “STATUS QUO” REVENUE REQUIREMENT

Table 1 below reflects OPDC’s Status Quo revenue requirement for Year 11.

Table 1
Orillia Distribution Status Quo Scenario
Year 11 Estimated Revenue Requirement ($000’s)

Average NBV of Assets	49,244
Working Capital	4,434
Rate Base[2]	53,678
OM&A	$6,754
Depreciation	$2,882
Cost of Capital – Debt Interest	$1,300
Cost of Capital – Equity Return	$1,932
Tax	$575
Revenue Requirement	**$13,443**

To calculate Year 11 rate base, OPDC started with their audited 2017 Financial Statements and factored the annual capital expenditures forecast in Table 1 of **Exhibit A, Tab 2, Schedule 1**. **Attachment 18** provides further details of the forecast for OPDC rate base growth, since the

[2] Rate Base is the average of the current and prior year closing NBV of assets plus the current year Working Capital

time of the last rebasing, through to Year 11. The OPDC rate base is forecast to increase from the 2010 OEB approved amount[3] of $20.8M to $53.7M by 2030, an increase of $32.9M or approximately 158% over the 20 years from the last approved rebasing in 2010.

This level of rate base increase, over a 20 year period, aligns with the increases approved by the OEB in recent 2017 and 2018 distributor rebasing applications submitted after their Incentive Rate Making ("IRM") period. **Attachment 19** shows the average OEB-approved five year increase in rate base is approximately 26% going up to over 60% for some distributors. At the time of the next proposed rebasing, in 2030, OPDC will not have rebased their rates for 20 years - a fourfold period compared to the analysis provided for the 2017 and 2018 rebasing entities in **Attachment 19**.

Further details on the assumptions used to calculate these Year-11 numbers are found in **Exhibit A, Tab 4, Schedule 1, Attachment 20**. As set out in Table 1 above, the Year 11 revenue requirement for OPDC operating Status Quo is $13.4 million.

2.1.1 LV Rates

OPDC is currently an embedded distribution customer of Hydro One. Consequently, in addition to being charged base distribution rates that reflect OPDC's revenue requirement, OPDC's customers also currently pay a Low Voltage ("LV") charge on their monthly bills. The LV charge, which is an OEB-approved rate, reflects Hydro One's upstream distribution cost to serve embedded customers. Therefore, LV charges are not part of OPDC's forecast revenue requirement, as set out in Table 1 above, however they do represent a real distribution cost to OPDC's customers. In 2017, OPDC's LV charges, payable to Hydro One, were approximately $0.7M, and Hydro One estimates these costs will be approximately $1.0M by 2030. Following rate harmonization, customers in the former OPDC service area would no longer incur LV

[3] (EB-2009-0273)

charges on their monthly bills. Rather, the ongoing upstream distribution costs necessary to provide them service would be accounted for within the revenue requirement underlying the new distribution rates proposed by Hydro One for the OPDC service area following harmonization – in other words, customers of Hydro One do not pay a separate LV rate as part of their monthly bill. Therefore to fairly compare OPDC and Hydro One distribution rates, the LV charges must be added to OPDC's Status Quo revenue requirement.

Table 2 Status Quo to Serve OPDC customers Year - 11 ($000s)	
Revenue Requirement	13,443
LV Charges	1,005
Total Cost to Serve	14,448

2.2 OPDC "RESIDUAL" REVENUE REQUIREMENT

Table 3 below reflects the scenario for Hydro One's forecast revenue requirement of the Residual Cost to Serve the OPDC territory, after accounting for the synergies and efficiency gains anticipated during the deferral period, assuming the proposed transaction is approved and the distribution system is owned and operated by Hydro One.

Table 3 Residual Cost to Serve Scenario Year 11 Estimated Revenue Requirement ($000's)	
Average NBV of Assets	49,181
Working Capital	3,725
Rate Base[4]	52,906

[4] Rate Base is the average of the current and prior year closing NBV of assets plus the current year Working Capital

OM&A	1,921
Depreciation	1,433
Cost of Capital – Debt Interest	1,373
Cost of Capital – Equity Return	1,905
Tax	687
Revenue Requirement	**7,319**

The OM&A and capital expenditures are based on the Hydro One forecast provided in Table 1 of **Exhibit A, Tab 2, Schedule 1**. Year 11 OM&A and capital expenditures are calculated by inflating the Year 10 forecast by 2%[5]. Further details on the assumptions used to calculate these numbers are found in **Attachment 20** to this exhibit. As set out in Table 3 above, the Year 11 revenue requirement for serving the OPDC service territory, under the Residual Cost to Serve scenario, is approximately $7.3M.

2.3 SUMMARY OF "STATUS QUO" COST TO SERVE VS. "RESIDUAL" COST TO SERVE

As illustrated in Tables 2 and 3 above, the Residual Cost to Serve customers of OPDC, excluding Shared Cost, would be approximately $7.1M ($14.4M SQ cost less $7.3M Residual cost) lower in Year 11 following the transaction than under the OPDC Status Quo scenario. This difference reflects the elimination of functions, resources and assets that are currently used to serve that service territory and which, for example, due to duplication, would no longer be needed to provide service. Examples of duplicated services include Board of Director's fees, executive leadership, system control staff/facilities and operations facilities that are specifically, planning, finance, regulatory, human resources, information technology etc.

[5] Ontario CPI growth rate forecast. Source: IHS Global Insight, April 2018.

The analysis in Tables 1 through 3 above provide a clear illustration of benefits the former OPDC service territory customers can expect to flow to them as a result of this transaction by lowering the cost structures of the former OPDC service territory to $7.3M, compared to the revenue requirement OPDC have forecast in their Status Quo scenario, $13.4M (not including the LV Charge).

3.0 HYDRO ONE SHARED COSTS

If the transaction is approved, the underlying cost structures for serving the former OPDC customers will be reduced by an estimated $7.1M to a revenue requirement of $7.3M under the Residual scenario. The $7.3M Residual revenue requirement does not reflect OPDC customers paying their full share of the costs for services that Hydro One would be providing to OPDC customers. Hydro One considers the costs of the functions, resources and assets used to provide such services to be its "Shared Costs". More particularly, Hydro One's Shared Costs reflect (i) shared facilities used to provide operations and maintenance services (i.e. service centres and maintenance yards), billing and IT system costs, and other miscellaneous general plant; (ii) OM&A costs associated with shared services, such as planning, finance, regulatory, human resources, information technology, customer services and corporate communications; and (iii) asset and related OM&A costs associated with upstream distribution facilities used by former OPDC customers (i.e. costs formerly captured under LV charges).

In Year 11, upon harmonizing rates for customers in the OPDC service territory with Hydro One's rates for its existing customer base, the underlying cost structures would continue, as illustrated in Table 1 of **Exhibit A, Tab 2, Schedule 1.** The synergies and efficiencies realized during the 10-year deferral period would continue to have a mitigating effect on rates for customers in the former OPDC service territory. However, through rate harmonization (post 10-year deferral period), Hydro One would have an opportunity to begin collecting a portion of its Shared Costs from customers in the former OPDC service territory. At that time, the prior Status Quo cost structures will have been reduced through synergies and efficiencies of the proposed consolidation. Given that those customers will receive benefits from the functions, resources and assets that are carried out or held centrally by Hydro One, it will be appropriate for those customers to bear responsibility for some of the Shared Costs. The manner in which Shared Costs will be allocated, and the amount that will ultimately be borne by former OPDC customers following the deferral period, will be matters for the OEB to consider and determine at such time that Hydro One proposes a rate structure and rate harmonization plan as part of its rebasing application following the 10-year deferral period.

At that time, Hydro One would determine the quantum of its Shared Costs and the appropriate methodology for allocating those Shared Costs among all of its customer groups, including its distribution customers in the former OPDC service territory, resulting in what it then believes to be an appropriate amount of Shared Costs to be collected from the former OPDC customers.

There are a number of factors that are likely to be taken into consideration at that time, both by Hydro One in developing its proposed methodology and by the panel of the OEB in considering that proposal and making a final determination on that methodology and the amount of Shared Costs to be included in rates for former OPDC customers. In particular, consideration would likely be given to factors such as the impact on rates for former OPDC customers, the impact on rates for Hydro One's other customers, the OEB's cost allocation policies and preferred cost allocation practices at the time, the outcome from the pending EB-2017-0049 Decision as it relates to Hydro One's previous Acquired Customers, as well as general principles of rate making.

3.1 PROPOSED METHODOLOGY FOR ALLOCATING COSTS AFTER DEFERRAL PERIOD

After the deferral period, Hydro One will allocate costs to serve the former OPDC customers using the OEB's cost allocation model, adjusted to reflect the cost to serve the acquired OPDC customers. Hydro One proposes within the harmonization and rebasing application following the deferral period, that it would ensure that the total cost, including a portion of Hydro One's Shared costs, to be collected from the former OPDC customers would be between, (a) the Residual Cost to Serve Scenario plus LV charges (totaling $8.3M), and (b) the Year 11 revenue requirement under the OPDC Status Quo scenario plus Year 11 LV charges (totaling $14.4M).

Table 4 below provides the calculation of these two costs.

Table 4 Calculation of Residual and Status Quo Costs ($000s)	
Revenue Requirement – OPDC Status Quo	13,443
Estimated LV Charges[6] – OPDC Status Quo	1,005
Total Cost to Serve – OPDC Status Quo	**14,448**
Revenue Requirement – Residual Cost to Serve Former OPDC	7,319
Estimated Revenue Requirement associated with providing LV services to Former OPDC	1,005
Total Residual Cost to Serve	**8,324**

As illustrated above, Hydro One could collect from the former OPDC customers a revenue requirement as low as $8.3M. This would mean that all savings from the transaction would accrue to the former customers of OPDC. Hydro One's legacy customers would not be harmed, as the former OPDC customers would be paying for their residual cost to serve. On the other hand, Hydro One could collect from the former OPDC customers a revenue requirement of up to $14.4M, and still be at or below their Status Quo cost to serve. This would mean that all savings from the transaction would accrue to Hydro One legacy customers. Any revenue requirement collected from the former OPDC customers between these two amounts (i.e. between $8.3M and $14.4M), would result in a sharing of the benefits between the two customer groups.

[6] Year 11 LV charges would reflect Hydro One's costs of providing host distributor services.

At this time, Hydro One is not in a position to determine the specific amount of costs that would be collected from OPDC's customers, as that will depend on the cost allocation and rate design proposed for the harmonized rate classes in Year 11. However, any adjustments to the OEB's cost allocation model to reflect the cost to serve the acquired OPDC customers in Year 11 would remain in place for subsequent years.

In Year 11, to calculate the status quo forecast, Hydro One would use the forecast as provided in this Application. However, that base amount would need to be adjusted to reflect any unknown or unforeseen costs at that time that would be applicable to serving the former OPDC customers if the transaction did not occur. For instance, if new legislative or OEB requirements or environmental regulations give rise to unanticipated costs, or unanticipated events such as political change (e.g. trade tariffs impacting costs) or storm damage results in the need for additional capital expenditures in the former OPDC service territory during the deferral period, those costs would have been incurred regardless of the transaction and would therefore need to be added to the OPDC status quo forecast. The base amount would also need to be adjusted to reflect the weighted average cost of capital applicable at that time.

For the ten year deferral period, Hydro One will track the incremental costs (OM&A and Capital) to serve customers in the former OPDC service territory, and have their asset plans distinguished in Hydro One's Distribution System Plan until rate integration in Year 11.

4.0 SUMMARY OF FUTURE COST STRUCTURES

Hydro One has provided evidence that the Residual cost to serve the former customers of OPDC integrated into Hydro One is less than it would have been under OPDC's Status Quo scenario. The underlying cost structures to serve the former OPDC service territory area will be reduced by approximately $6.1 million prior to an allocation of Shared Costs.

Evidence showing that the former customers of OPDC will benefit from this transaction includes:

- Former OPDC customer rates will not be rebased via a Cost of Service Rate application until 2030. This is a 20 year period from the time their rates were last rebased[7].

- As of December 2017, $20.7M capital expenditures[8] have been added to OPDC's rate base since their last rate rebasing in 2010, a period of seven years (2011 to 2017). These are not reflected in its current OEB-approved rate base, which is the basis for the rates that Orillia customers will continue to pay until Year 11.

- OPDC will continue to incur capital expenditures in 2018 and 2019 until the time the proposed acquisition is forecast to close, followed by Hydro One incurring capital expenditures to maintain service reliability and system capital requirements for the 10-year deferral period. None of these capital expenditures[9] will be reflected in the rate base that underpins the rates the former customers of OPDC will be charged, yet customers have received and will receive benefits from these capital expenditures.

- Hydro One emphasizes that under OPDC's Status Quo scenario OPDC's customers rates would increase as a result of the growth in rate base compared to the rates these customers will receive as a result of this transaction. Hydro One maintains it is a reasonable assumption to expect that rate base will increase, under both Status Quo and Residual scenarios given that the OPDC service territory's rates will not have been rebased for a 20-year period.

[7] OPDC rates were last rebased in 2010 (EB-2009-0273)
[8] 2017 OPDC F/S
[9] This excludes any capital expenditures that may be undertaken and approved by the OEB through an ICM applications

- OPDC has already made it public that its current rates are not sufficient to sustain its electricity distribution operations over the long term.

> "If the sale to Hydro One is not approved, OPDC will be required to file for a distribution rate increase (known as a Cost of Service rate application) with the OEB at least twice over the next 10 years. It is estimated that distribution rates will increase by an average annual rate of 2-4% over the next 10-year period[10]."

This message was included in a bill insert to customers from OPDC in May 2018.

- OPDC has not adjusted their rates through the Board's IRM mechanism since 2016.[11] This further confirms that OPDC ratepayers have benefited from this transaction.

- Hydro One is confident that it can produce savings and synergies operating and managing the former OPDC service territory under OPDC's OEB-approved revenue requirement, effectively reducing the cost structures for the OPDC service territory compared to the Status Quo. This benefits the ratepayers, not only by decreasing their Base Distribution Delivery Rates by 1% and freezing those reduced rates for five years, but it avoids at least two cost of service rebasing events over the ten year deferral period, that OPDC would otherwise require.

Hydro One is providing former OPDC customers a guaranteed ESM. This protects these customers to ensure they share in any increased benefits from consolidation during the deferred rebasing period. The ESM is based on only the incremental cost to serve customers in the former OPDC service territory.

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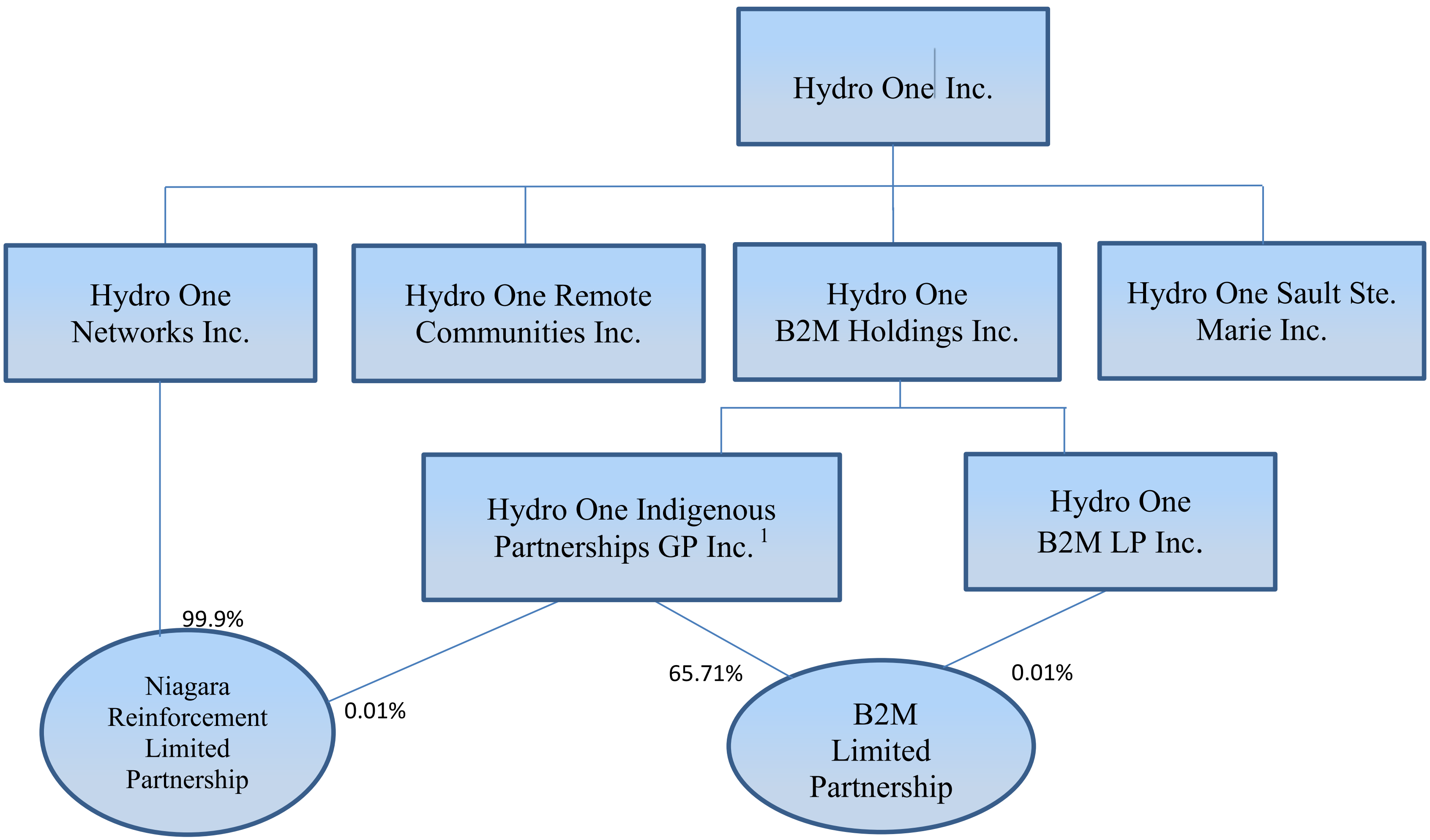
[10] Provided to Orillia customers as a bill insert by OPDC (refer to Attachment 21)
[11] EB-2015-0286

With respect to former OPDC customers, Hydro One anticipates transitioning those customers to one of its proposed new Acquired Rate Classes or to a new rate class to be proposed after the deferred rebasing period has elapsed. At the time of that rate proposal, Hydro One will determine an appropriate rate class for the former OPDC customers (e.g. taking into account density characteristics and bill impacts). Hydro One, as has been directed in previous MAAD decisions[12], will ensure the new proposed rates will reflect the cost to serve the newly acquired customers in the former OPDC service territory. To achieve this, at the time of rebasing, Hydro One will examine the cost to serve these customers to ensure that they will only be charged for the assets that are used to serve them.

Hydro One has also provided an illustration of how Shared Costs could be collected from customers of the former OPDC post the 10-year deferral period. This evidence shows that both legacy customers and the acquired customers will benefit from this transaction. If the revenue collected from the former OPDC's customers through rates is equal or less than OPDC's Status Quo revenue requirement plus LV costs, then customers will not be harmed. If Hydro One's legacy customers' rates are not increased as a result of the transaction, they too are not harmed by the transaction. The annual savings of $6.1 million expected from this transaction can be shared by these two customers groups such that each group will have rates derived from a lower revenue requirement that would have otherwise applied in Year 11 and beyond. Therefore, the transaction meets the No Harm Test.

[12] EB-2013-0187/0196/0198, EB-2013-0213, EB-2013-0244

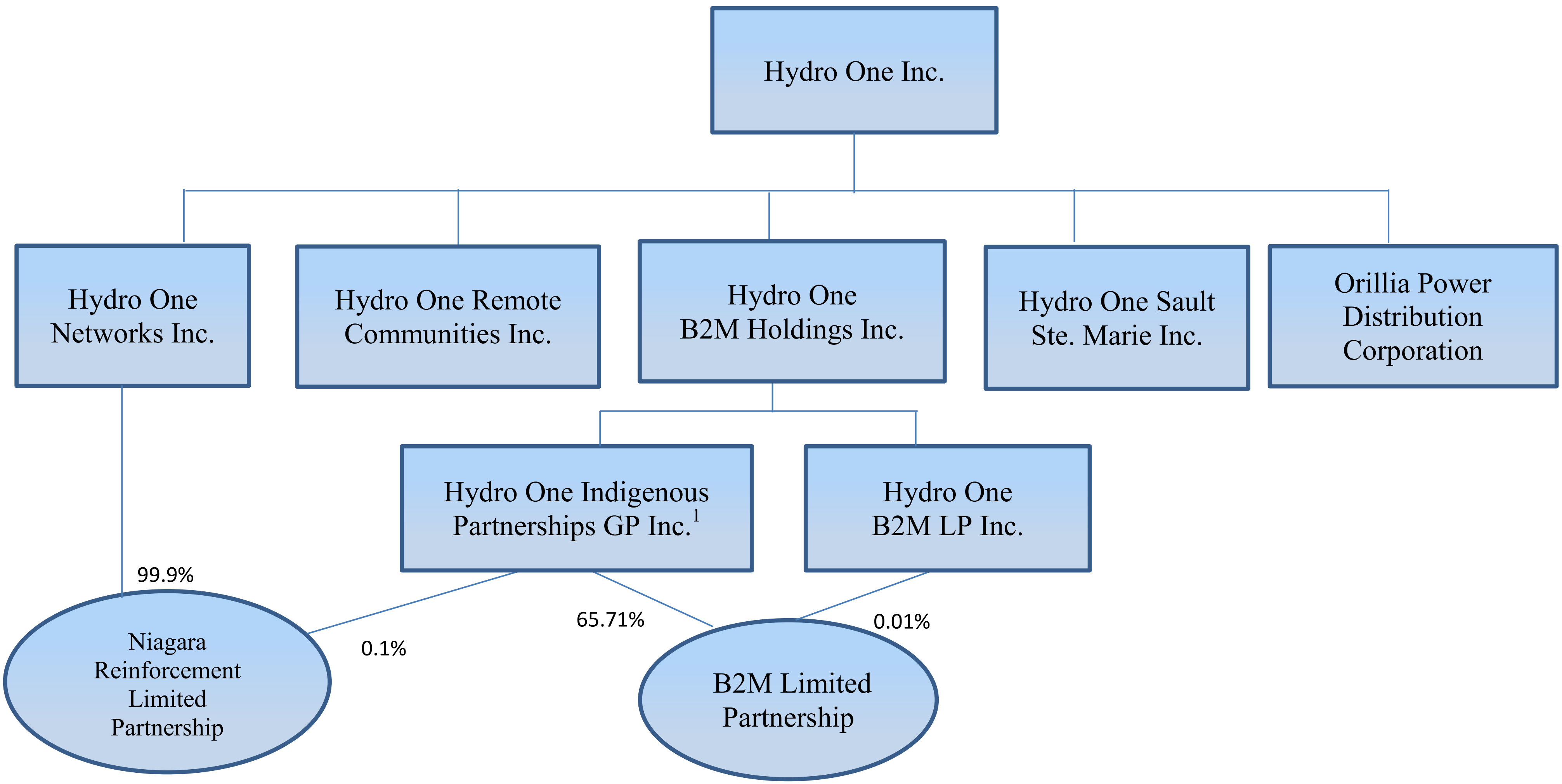
Hydro One Inc. Corporate Structure (Pre-Acquisition)*



* This diagram represents Hydro One's corporate structure **prior** to the close of the OPDC transaction.

1 – Formerly B2M GP Inc.

Hydro One Inc. Corporate Structure (Post-Acquisition)*



* This diagram represents Hydro One's corporate structure **after** the close of the OPDC transaction.

1 – Formerly B2M GP Inc.

Hydro One Customer Counts[1]

	Number of Customers
Residential	1,199,513
General Service < 50kW	111,284
General Service >= 50kW	8,744
Large User	-
Sub-Transmission	544
Total	**1,320,085**

[1] OEB 2017 Yearbook

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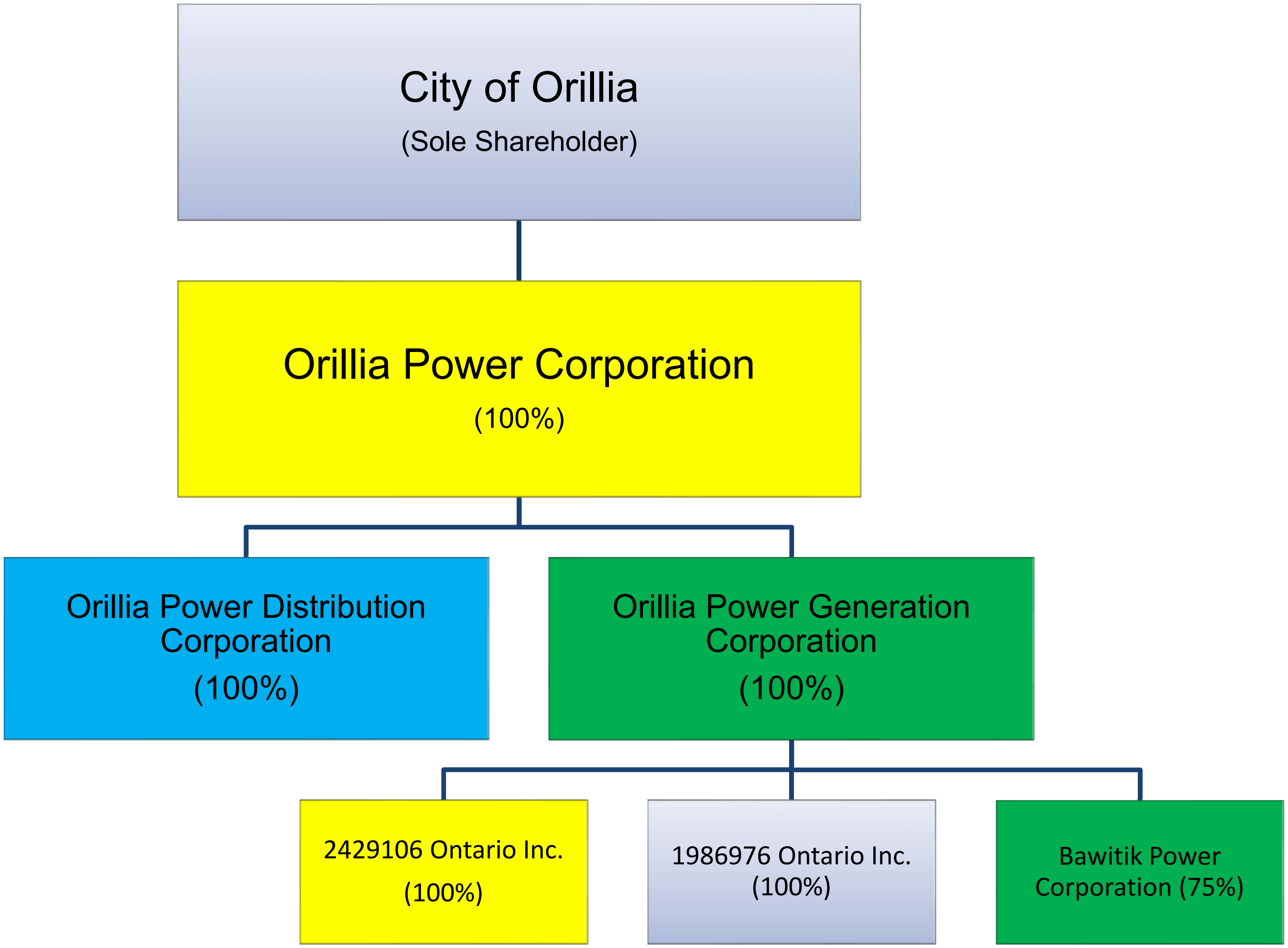
ORGANIZATION STRUCTURE



As of September 2018

OPDC Customer Counts[1]

	Number of Customers
Residential	12,284
General Service < 50kW	1,382
General Service >= 50kW	164
Large User	-
Sub-Transmission	-
Total	**13,830**

[1] 2017 OEB Yearbook

EXECUTION VERSION

THE CORPORATION OF THE CITY OF ORILLIA

- and -

ORILLIA POWER CORPORATION

- and -

HYDRO ONE INC.

SHARE PURCHASE AGREEMENT

Dated the 15th day of August, 2016

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SHARE PURCHASE AGREEMENT

THIS AGREEMENT made the 15th day of August, 2016 (the "**Effective Date**").

B E T W E E N:

THE CORPORATION OF THE CITY OF ORILLIA, a municipal corporation under the laws of Ontario, (the "**City**")

\- and -

ORILLIA POWER CORPORATION, a corporation incorporated under the laws of Ontario (the "**Vendor**")

\- and -

HYDRO ONE INC., a corporation incorporated under the laws of Ontario (the "**Purchaser**")

<u>**Recitals**</u>

1. Orillia Power Distribution Corporation (the "**Corporation**") is a local electricity distribution company incorporated under the *Business Corporations Act* (Ontario) that distributes electricity within the boundaries of the City of Orillia; and

2. The Vendor and the City wish to sell to the Purchaser, and the Purchaser wishes to purchase from the Vendor, all of the issued and outstanding shares of the Corporation, on and subject to the terms and conditions set forth herein.

THIS AGREEMENT WITNESSES THAT in consideration of the respective covenants, agreements, representations and warranties of the Parties herein contained and for other good and valuable consideration (the receipt and sufficiency of which are acknowledged by each Party), the Parties covenant and agree as follows.

ARTICLE I
INTERPRETATION

1.1 **Defined Terms.** In this Agreement, including the recitals, and schedules hereto, unless the context otherwise specifies or requires, the following terms shall have the respective meanings specified or referred to below and grammatical variations of such terms shall have corresponding meanings:

(a) "**Account 1576**" has the meaning ascribed thereto in Section 6.7.

(b) "**Advisory Committee**" has the meaning ascribed thereto in Section 6.3.

(c) "**Affiliate**" has the meaning ascribed thereto in the OBCA.

(d) "**Agreement**" means this share purchase agreement, including all schedules attached hereto, as amended, supplemented, restated and replaced from time to time in accordance with its provisions.

(e) "**Applicable Law**" means any and all applicable laws, including Environmental Laws, common law, statutes, codes, licensing requirements, directives, rules, regulations, protocols, policies, by laws, guidelines, orders, injunctions, rulings, awards, judgments or decrees or any requirement or decision or agreement with or by any Government Authority, including without limitation, the OEB.

(f) "**Auditor**" means BDO Canada LLP.

(g) "**Business**" means, the electricity distribution business carried on by the Corporation, in the City of Orillia.

(h) "**Business Day**" means a day other than a Saturday, Sunday, statutory holiday in Ontario or any other day on which the principal chartered banks located in the City of Toronto are not open for business during normal banking hours.

(i) "**Change in Applicable Law**" means:

(i) the enactment, introduction or tabling of any Canadian federal or provincial legislation (whether by statute, regulation, order in council, notice of ways and means motion or otherwise);

(ii) a ruling, order or decision of the OEB, including a ruling, order or decision of the OEB, relating to an electricity distribution utility other than the Corporation;

(iii) the issuance, modification or revision of the OEB's existing Electricity Distribution Rate Handbook, or the issuance of any rule, procedure, code, policy or directive by the OEB; and

(iv) a directive, guideline or policy statement of a Governmental Authority;

(j) "**City**" means the Corporation of the City of Orillia.

(k) "**City Property**" means the Corporation's property listed in Schedule 6.4.

(l) "**Claim**" means any demand, action, investigation, inquiry, suit, proceeding, claim, assessment, judgment or settlement or compromise relating thereto and includes any act, omission or state of fact actionable under or contrary to Applicable Law (including for clarity and without limitation, in contract, tort, or equity).

(m) "**Closing**" means completion of the Transactions contemplated herein on the Closing Date and in accordance with the provisions of this Agreement.

(n) "**Closing Date**" means the first date which is the first Business Day of a month and at least ninety (90) days following the date that the Required Approval has been obtained or such earlier or later date as may be agreed to by the Parties in writing. Notwithstanding any other provision of this Agreement, Closing is intended to occur at the very beginning the day which follows the financial period end.

(o) "**Closing Date Financial Statements**" means audited financial statements for the Corporation for the fiscal period ended on the Closing Date, prepared in accordance with GAAP consistently applied on the same basis as the Initial Financial Statements, and consisting of a balance sheet as of such date and statements of operations, retained earnings, and cash flow for such period, together with notes thereto as at such date of the Corporation's auditors, addressed to the Vendor and the Corporation, the Purchaser and the Guarantor.

(p) "**Closing Date Long Term Debt**" means the amount of Long Term Debt based on the Closing Date Financial Statements.

(q) **Closing Date NFA**" means the amount of NFA in the Closing Date Financial Statements.

(r) "**Closing Date Regulatory Accounts**" means the amount of the Net Regulatory Accounts based on the Closing Date Financial Statements.

(s) "**Closing Date Working Capital**" means the amount of Working Capital in the Closing Date Financial Statements.

(t) "**Collective Agreement**" has the meaning ascribed thereto in Section 3.1(q)(i).

(u) "**Common Shares**" means the common shares in the share capital of the Corporation.

(v) "**Confidential Disclosure Schedule**" means that confidential disclosure schedule dated as of the Effective Date which the Vendor delivered to the Purchaser contemporaneous with the execution of this Agreement.

(w) "**Confidential Information**" has the meaning ascribed thereto in Subsection 6.10(b)(i).

(x) "**Confidentiality Agreement**" means the confidentiality provisions in the Exclusivity Agreement between the Corporation, and the Purchaser dated September 22, 2015, as amended from time to time.

(y) "**Corporation**" means Orillia Power Distribution Corporation.

(z) "**Contract**" means any agreement, indenture, contract, lease, deed of trust, licence, option, instrument or other commitment, whether written or oral.

(aa) "**CTA**" means the *Corporations Tax Act* (Ontario) or the Taxation Act, 2007 (Ontario) and any regulation made thereunder.

(bb) "**Current Rates**" means those Rates specified in the Rate Order, and as presented under the column entitled "2016" in Schedule 6.6 of this Agreement.

(cc) "**Data Room**" means the data site located at https://extranet.blg.com/clients/Orillia/Pages/Collaboration/BLGClientExtranetDocuments.aspx?lang=1033 as at August 3, 2016.

(dd) "**Deductible**" has the meaning ascribed thereto in Section 12.7(a)(i).

(ee) "**Deposit**" has the meaning ascribed thereto in Section 2.3(a).

(ff) "**Direct Claim**" has the meaning ascribed thereto in Section 12.3.

(gg) "**EA**" means the *Electricity Act*, 1998 (Ontario), as amended from time to time.

(hh) "**Easements**" means the right in perpetuity to use, traverse, enjoy or have access to, over, in or under any real property, and includes those easements that are registered, unregistered or granted by operation of Applicable Law.

(ii) "**Effective Date**" means the date of this Agreement as first stated above.

(jj) "**Employee Fact Sheet**" has the meaning ascribed thereto in Section 3.1(r)(i).

(kk) "**Employee Plans**" has the meaning attributed to that term in Section 3.1(p)(i).

(ll) "**Employees**" has the meaning ascribed thereto in Section 3.1(r)(i).

(mm) "**Encumbrance**" means any encumbrance, lien, charge, hypothec, pledge, mortgage, title retention agreement, security interest of any nature, adverse claim, exception, reservation, easement, right of occupation, any matter capable of registration against title, option, right of pre-emption, privilege or any Contract to create any of the foregoing.

(nn) "**Environment**" means the environment or natural environment as defined in any Environmental Law and includes air, surface water, ground water, land surface, soil, sub surface strata and sewer system.

(oo) "**Environmental Approvals**" means all permits, certificates, licences, authorizations, consents, registrations, directions, instructions, waste generation numbers or approvals required pursuant to Environmental Laws with respect to Real Property or the operation of the Corporation or its Business.

(pp) "**Environmental Laws**" means all Applicable Law relating in whole or in part to the protection of the Environment or to public health and safety, and includes those relating to the manufacture, processing, distribution, use, treatment, storage, disposal, discharge, transportation or handling of Hazardous Substances.

(qq) "**ETA**" means Part IX of the *Excise Tax Act* (Canada) and any regulation made thereunder.

(rr) "**Five Year Fixed Payment Amount**" means $270,000.

(ss) "**Fixed Assets**" means fixed assets, furniture, furnishings, parts, tools, personal property fixtures, plants, buildings, structures, erections, improvements, appurtenances, machinery, equipment, computer hardware and software, substations, transformers, vaults, distribution lines, transmission lines, conduits, ducts, pipes, wires, rods, cables, fibre optic strands, devices, appliances, material, poles, pipelines, fittings and any other similar or related item of the Business.

(tt) "**GAAP**" means the generally-accepted accounting principles (including the methods of application of such principles and, as applicable, International Financial Reporting Standards) accepted or recommended by the Canadian Institute of Chartered Accountants which are applicable in Canada as at the date on which any calculation made hereunder is to be effective.

(uu) "**Governmental Authority**" means any domestic government, whether federal, provincial, territorial, local, regional, municipal, or other political jurisdiction, and any agency, authority, instrumentality, court, tribunal, board, commission, bureau, arbitrator, arbitration tribunal or other tribunal, or any quasi-governmental or other entity, insofar as it exercises a legislative, judicial, regulatory, administrative, expropriation or taxing power or function of or pertaining to government including the OEB.

(vv) "**Hazardous Substances**" means any hazardous substance or any pollutant or contaminant, toxic or dangerous waste, substance, or material as defined in or regulated by any Environmental Law including, without limitation, friable asbestos and poly chlorinated biphenyls.

(ww) "**HONI**" means Hydro One Networks Inc.

(xx) "**HST**" means all taxes payable under Part IX of the ETA (including where applicable both the federal and provincial portion of those taxes) or under any provincial legislation imposing a similar value added or multi staged tax.

(yy) "**IFRS**" means International Financial Reporting Standards.

(zz) "**Indemnified Party**" has the meaning ascribed thereto in Section 12.3.

(aaa) "**Indemnifying Party**" has the meaning ascribed thereto in Section 12.3.

(bbb) "**Independent Auditor**" has the meaning ascribed thereto in Section 2.4(d).

(ccc) "**Initial Financial Statements**" means the audited financial statements of the Corporation as at December 31, 2015 prepared in accordance with IFRS.

(ddd) "**Initial Long Term Debt**" means the Long Term Debt shown in the Initial Financial Statements.

(eee) "**Initial NFA**" means the NFA in the Initial Financial Statements.

(fff) "**Initial Regulatory Accounts**" means the Net Regulatory Accounts shown in the Initial Financial Statements.

(ggg) "**Initial Working Capital**" means the Working Capital calculated based on the Initial Financial Statements.

(hhh) "**Leased Property**" has the meaning ascribed thereto in Subsection 3.1(l)(i).

(iii) "**Licences**" has the meaning ascribed thereto in Subsection 3.1(z).

(jjj) "**Long Term Debt**" means long term debt as shown in the Corporation's financial statements. For greater certainty, Long Term Debt excludes the current portion of long term debt.

(kkk) "**Long Term Debt Calculation**" has the meaning ascribed thereto in subsection 2.4(a)(iii).

(lll) "**Losses**" means any and all loss, liability, damage, cost, expense (including, reasonable legal fees, accountants', investigators', engineers' and consultants' fees and expenses, interest, penalties and amounts paid in settlements), charge, fine, penalty or assessment, suffered or incurred by the Person seeking indemnification, directly resulting from or arising out of any Claim, including the costs and expenses of any action, suit, proceeding, investigation, inquiry, arbitration award, grievance, demand, assessment, judgment, settlement or compromise relating thereto, including without limitation a gross up to account for any tax payable or a reduction in the "cost amount", as defined in subsection 248(1) of the Tax Act of any property owned by the Purchaser or the Corporation or a successor entity in the taxation year as a result of receiving the indemnification amount but: (i) excluding any contingent liability until it becomes actual; (ii) reduced by any net Tax benefit; (iii) reduced by any recovery, settlement or otherwise under or pursuant to any insurance coverage; or pursuant to any claim, recovery, settlement or payment by or against any other Persons; and (iv) excluding any incidental, indirect, special or consequential loss, liability or damage and loss of profits other than damages of a Third Party in respect of a Third Party Claim.

(mmm) "**Material Adverse Effect**" means any change or effect that has a material adverse effect on the Property or obligations and liabilities of the Corporation or the operations or results of operations of the Business after taking into account any insurance which may be available with respect to such a change or effect. For greater clarity, a Material Adverse Effect does not include a Change in Law.

(nnn) "**Material Contract**" means any Contract for the supply of goods or services which has a value exceeding Fifty Thousand Dollars ($50,000.00) in annual payments excluding any collective bargaining agreements, and shall be deemed to include any software licence other than of the shrink-wrap or click-wrap variety and every Contract in relation to Employee Plans, as further described in Schedule 3.1(o).

(ooo) "**Municipality**" means The Corporation of the City of Orillia.

(ppp) "**NFA**" means the aggregate value of Corporation's property, plant, and equipment net of deferred revenue as provided in its financial statements but shall include intangible assets only to the extent recoverable in rates.

(qqq) "**Negative Rate Rider**" has the meaning ascribed thereto in Section 6.6(a)(i) of this Agreement.

(rrr) "**Net Regulatory Accounts**" means the aggregate value of the regulatory deferral account debit balances net the regulatory deferral account credit balances as provided in the Corporation's financial statements.

(sss) "**NFA Calculation**" has the meaning ascribed thereto in Section 2.4(a)(ii).

(ttt) "**NFA Index**" shall be equal to 1.1.

(uuu) "**OBCA**" means the *Business Corporations Act* (Ontario), as in effect on the date hereof.

(vvv) "**OEB**" means the Ontario Energy Board and its successors.

(www) "**OEB Act**" means the *Ontario Energy Board Act*, 1998, as in effect on the date hereof.

(xxx) "**OEB Approval**" means the approval of the OEB to the Transactions contemplated herein pursuant to the OEB Act.

(yyy) "**OEB Percentage Rate Reduction**" means the percentage by which the arithmetic average of Reduced Rates is lower than the arithmetic average of Current Rates.

(zzz) "**OMERS Plan**" means the Ontario Municipal Employees Retirement System Primary Pension Plan.

(aaaa) "**Partial Rate Rider**" means the approved negative rate rider that results in an average reduction in Current Rates of less than one percent (1%) across all Rate Classes.

(bbbb) "**Party**" means a party to this Agreement, and "**Parties**" means both of them.

(cccc) "**Permitted Encumbrance**" means the encumbrances listed in Schedule 1.1(zzz).

(dddd) "**Person**" means any individual, partnership, limited partnership, joint venture, syndicate, sole proprietorship, company or corporation with or without share capital, unincorporated association, trust, trustee, executor, administrator or other legal personal representative, regulatory body or agency, government or governmental agency, authority or entity however designated or constituted.

(eeee) "**PILs**" means payment in lieu of corporate taxes required to be made under Section 93 of the EA.

(ffff) "**Pre-Closing Tax Period**" means any Tax period ending on or before the day prior to the Closing Date, and, with respect to a Straddle Period, the portion of such Tax period ending on the day prior to the Closing Date.

(gggg) "**Property**" means the property and assets used by the Corporation to conduct its Business, including without limitation, the Real Property, the Leased Property, the Easements, the Intellectual Property and Fixed Assets.

(hhhh) "**Property Taxes**" has the meaning ascribed thereto in Section 8.4.

(iiii) "**Purchase Price**" has the meaning ascribed thereto in Section 2.2.

(jjjj) "**Purchased Shares**" has the meaning ascribed thereto in Section 2.1.

(kkkk) "**Purchaser**" means Hydro One Inc. a corporation incorporated under the laws of Ontario.

(llll) "**Purchaser Indemnified Parties**" has the meaning ascribed thereto in Section 12.1.

(mmmm) "**Purchaser's Objection**" has the meaning ascribed thereto in Section 2.4(b).

(nnnn) "**Rate**" or "**Rates**" means the rate or rates for the distribution of electricity.

(oooo) "**Rate Adjustment Difference**" means a difference equal to one percent (1%) minus the OEB Percentage Rate Reduction.

(pppp) "**Rate Adjustment Factor**" means a factor equal to the Rate Adjustment Difference divided by one percent (1%).

(qqqq) "**Rate Classes**" means those classes of Rates specified in Schedule 6.7(a) of this Agreement.

(rrrr) "**Rate Freeze Period**" means the period commencing on the Closing Date and ending on the date which is five (5) years after the Closing Date.

(ssss) "**Rate Order**" means the order issued by the OEB approving the Corporation's Rates in effect as at May 1, 2016, and as set out in matter EB-2015-0024.

(tttt) "**Real Property**" has the meaning ascribed thereto in Subsection 3.1(l).

(uuuu) "**Reduced Rates**" means the reduced Rates that result from the application of a Negative Rate Rider or a Partial Rate Rider to the Current Rates.

(vvvv) "**Regulatory Accounts Calculation**" has the meaning ascribed thereto in Section 2.4(a)(iv).

(wwww) "**Release**" has the meaning ascribed thereto in any Environmental Law and includes, without limitation, any presence, release, spill, leak, pumping, pouring, addition, emission, emptying, discharge, injection, escape, leaching, disposal, dispersal, migration, dumping, deposit, spraying, burial, abandonment, incineration, seepage or placement.

(xxxx) "**Remedial Order**" means any complaint, direction, order or sanction issued, filed or imposed by any Governmental Authority pursuant to any Environmental Law and includes any order requiring any remediation or clean-up of any Hazardous Substance or requiring that any Release or any other activity be reduced, modified or eliminated.

(yyyy) "**Representative**" means, with respect to any Party, its Affiliates and, if applicable, its and their respective directors, officers, employees, agents and other representatives and advisors.

(zzzz) "**Required Approval**" has the meaning ascribed thereto in Section 7.1.

(aaaaa) "**Statutory Plans**" means benefit plans that the Corporation are required by domestic or foreign statutes to participate in or contribute to in respect of an employee, director or officer of the Corporation or any beneficiary or dependent thereof, including the Canada Pension Plan, and plans administered pursuant to applicable health, Tax, workplace safety insurance, workers' compensation and employment insurance legislation.

(bbbbb) **Straddle Period**" means any Tax period that includes the Closing Date, but does not begin on the Closing Date or end on the day prior to the Closing Date.

(ccccc) "**Subsidiary**" has the meaning ascribed thereto in the OBCA.

(ddddd) "**Tax**" or "**Taxes**" means the PILs payable pursuant to Section 93 of the EA and all domestic and foreign federal, provincial, municipal, territorial or other taxes, imposts, rates, levies, assessments and government fees, charges or dues lawfully levied, assessed or imposed against the Corporation including, without limitation, all income, capital gains, sales, excise, use, property, capital, goods and services, business transfer and value added taxes, all customs and import duties, workers' compensation premiums, Canada Pension Plan premiums, Employment Insurance premiums, and payments pursuant to Part VI of the EA together with all interest, fines and penalties with respect thereto.

(eeeee) "**Tax Act**" means the *Income Tax Act* (Canada) and any regulations thereunder.

(fffff) "**Tax Return**" means all returns, information returns, declarations, designations, forms, schedules, elections, reports and other documents of every nature whatsoever (and includes related or supporting information) filed, or required to be filed with any Governmental Authority with respect to any Taxes, including those required pursuant to Part VI of the EA, or with respect to the administration of any Laws or administrative requirements relating to any Taxes and any amendments thereof.

(ggggg) "**Third Party Claim**" has the meaning ascribed thereto in Section 12.3.

(hhhhh) "**Time of Closing**" means the close of business on the Closing Date.

(iiiii) "**Transactions**" means the purchase and sale of the Purchased Shares and all other transactions contemplated by this Agreement.

(jjjjj) "**Vendor**" means the Orillia Power Corporation.

(kkkkk) "**Vendor's Counsel**" means Borden Ladner Gervais LLP, a limited liability partnership duly constituted under the laws of the Province of Ontario.

(lllll) "**Working Capital**" means the working capital of the Corporation, which is the amount by which the net book value of the current assets, excluding cash, exceeds the net book value of the current liabilities and customer security deposits. The current assets are the sum of accounts receivable, unbilled energy and distribution revenue, payment in lieu of taxes receivable, inventories, prepaid expenses, due from related parties and other current assets. The current liabilities are the sum of bank indebtedness, accounts payable and accrued liabilities, payment in lieu of taxes payable and current portion of long term debt, due to related parties and other current liabilities.

(mmmmm) "**Working Capital Calculation**" has the meaning ascribed thereto in Section 2.4(a)(i).

1.2 **Construction.** This Agreement has been negotiated by each Party with the benefit of legal representation, and any rule of construction to the effect that any ambiguities are to be resolved against the drafting party does not apply to the construction or interpretation of this Agreement.

1.3 **Certain Rules of Interpretation.** In this Agreement:

(a) the division into Articles and Sections and the insertion of headings and the Table of Contents are for convenience of reference only and do not affect the construction or interpretation of this Agreement;

(b) the expressions "hereof", "herein", "hereto", "hereunder", "hereby" and similar expressions refer to this Agreement and not to any particular portion of this Agreement; and

(c) unless specified otherwise or the context otherwise requires:

(i) references to any Article, Section or Schedule are references to the Article or Section of, or Schedule to, this Agreement;

(ii) "including" or "includes" means "including (or includes) but is not limited to" and is not to be construed to limit any general statement preceding it to the specific or similar items or matters immediately following it;

(iii) "the aggregate of", "the total of", "the sum of", or a phrase of similar meaning means "the aggregate (or total or sum), without duplication, of";

(iv) references to Contracts are deemed to include all present amendments, supplements, restatements and replacements to those Contracts as of the date of this Agreement;

(v) references to any legislation, statutory instrument or regulation or a section thereof are references to the legislation, statutory instrument, regulation or section as of the date of this Agreement except that with respect to Vendor's obligations to comply with Applicable Law regarding Taxes, the reference date shall be the relevant point in time prior to Closing;

(vi) words in the singular include the plural and vice versa and words in one gender include all genders.

1.4 **Knowledge.** In this Agreement, any reference to the knowledge of the Vendor or the City means to the best of the knowledge, information and belief of the Vendor or the City after making due inquiries regarding the relevant matter of all relevant Representatives of the Corporation, the City and the Vendor.

1.5 **Computation of Time.** In this Agreement, unless specified otherwise or the context otherwise requires:

(a) a reference to a period of days is deemed to begin on the first day after the event that started the period and to end at 5:00 p.m. on the last day of the period, but if the last day of the period does not fall on a Business Day, the period ends at 5:00 p.m. on the next succeeding Business Day;

(b) all references to specific dates mean 11:59 p.m. on the dates;

(c) all references to specific times are references to Toronto time; and

(d) with respect to the calculation of any period of time, references to "from" mean "from and excluding" and references to "to" or "until" mean "to and including".

1.6 **Performance on Business Days.** If any action is required to be taken pursuant to this Agreement on or by a specified date that is not a Business Day, the action is valid if taken on or by the next succeeding Business Day.

1.7 **Calculation of Interest.** In calculating interest payable under this Agreement for any period of time, the first day of the period is included and the last day is excluded.

1.8 **Currency and Payment.** In this Agreement, unless specified otherwise:

(a) references to dollar amounts or "$" are to Canadian dollars; and

(b) any payment is to be made by an official bank draft drawn on a Canadian chartered bank, wire transfer or any other method (other than cash payment) that provides immediately available funds;

1.9 **Schedules and Exhibits**. The following schedules are attached to and form part of this Agreement:

Schedule 1.1(zzz)	-	Permitted Encumbrances
Schedule 3.1(l)	-	Real Property, Leased Property and Easements
Schedule 3.1(m)	-	Intellectual Property
Schedule 3.1(n)	-	Contracts and Commitments
Schedule 3.1(o)	-	Material Contracts
Schedule 3.1(p)	-	Employee Plans
Schedule 3.1(q)	-	Collective Agreement
Schedule 3.1(s)	-	Insurance Policies
Schedule 3.1(v)	-	Taxes
Schedule 3.1(z)	-	Licences
Schedule 6.2	-	Participation in Community Events
Schedule 6.4	-	City Property
Schedule 6.6	-	Rate Classes
Schedule 9.1(c)	-	Purchaser Consents
Schedule 9.2(c)		Vendor Consents

ARTICLE II
PURCHASE AND SALE OF PURCHASED SHARES

2.1 **Purchase and Sale of Purchased Shares**. Subject to the terms and conditions hereof, the Vendor agrees to sell, assign and transfer to the Purchaser and the Purchaser agrees to purchase from the Vendor all of the issued and outstanding shares of the Corporation, as described in the table below (the "**Purchased Shares**"):

Class of Shares	Issued	Shareholder
Common Shares	1001	Orillia Power Corporation

2.2 **Purchase Price**. The purchase price payable by the Purchaser to the Vendor for the Purchased Shares (the "**Purchase Price**") shall, subject to any adjustment in accordance with Section 2.4, be the sum of twenty-six million and three hundred and fifty thousand dollars ($26,350,000).

2.3 **Payment of Purchase Price.**

The Purchase Price shall be payable as follows:

(a) concurrently with the execution and delivery of this Agreement, the sum of one million five hundred thousand dollars ($1,500,000) delivered to the Vendor's Counsel in trust, by wire transfer, which amount shall hereinafter be referred to as the "**Deposit**", and such Deposit to be held by Vendor's Counsel in trust in an interest bearing account and released in accordance with the terms and conditions of this Agreement; and

(b) the balance on Closing by wire transfer of immediately available funds to the Vendor;

(c) if applicable, the amounts payable pursuant to Section 2.4(c) and Section 2.6 below as set out therein.

The Vendor and the City shall cause the Vendor's Counsel to pay to the Purchaser immediately following Closing, all accrued interest on the Deposit.

2.4 **Adjustment to Purchase Price.**

(a) Subject to Section 2.5, within ninety (90) days following the Closing Date, the Vendor shall cause the preparation and delivery of audited financial statements for the Corporation, the Closing Date Financial Statements together with the Working Capital Calculation, the NFA Calculation, the Regulatory Accounts Calculation and the Long Term Debt Calculation, to the Parties, all of which shall be audited by the Auditors, together with the Auditors' working papers. The Purchase Price contemplated in Section 2.2 shall be increased or decreased on a dollar for dollar basis as set out below:

(i) for the difference between the Closing Date Working Capital and the Initial Working Capital as shown in the Working Capital Calculation ("**Working Capital Calculation**");

(ii) for an amount equal to the amount obtained when the NFA Index is multiplied by the difference between the Closing Date NFA and the Initial NFA as shown in the NFA Calculation ("**NFA Calculation**");

(iii) For the difference between the Closing Date Long Term Debt and the Initial Long Term Debt as shown in the Long Term Debt Calculation ("**Long Term Debt Calculation**"); and

(iv) for the difference between the Closing Date Regulatory Accounts and the Initial Regulatory Accounts as shown in the Regulatory Accounts Calculation ("**Regulatory Accounts Calculation**").

The Purchaser shall pay the Vendor, as applicable, on a dollar for dollar basis (A) the amount by which the Closing Date Working Capital exceeds the Initial Working Capital; (B) an amount equal to the amount obtained when the NFA Index is multiplied by the amount by which the Closing Date NFA exceeds the Initial NFA; (C) the amount by which the Initial Long Term Debt exceeds the Closing Date Long Term Debt; and (D) the amount by which the Closing Date Regulatory Accounts exceeds the Initial Regulatory Accounts. The Vendor shall pay the Purchaser, as applicable, on a dollar for dollar basis, (A) the amount by which the Initial Working Capital exceeds the Closing Date Working Capital; (B) an amount equal to the amount obtained when the NFA Index is multiplied by the amount by which the Closing Date NFA is less than the Initial NFA; (C) the amount by which the Closing Date Long Term Debt exceeds the

Initial Long Term Debt; and (D) the amount by which the Initial Regulatory Accounts exceeds the Closing Date Regulatory Accounts.

An illustration of the purchase price adjustments in this subsection is set out in Schedule 2.4(a) hereto.

(b) The Purchaser shall have a period of thirty (30) Business Days from the later of (i) the receipt of the Closing Date Financial Statements, the Working Capital Calculation, the NFA Calculation, Regulatory Accounts Calculation and the Long Term Debt Calculation; and (ii) the date on which the Purchaser is provided with access to the Auditor's working papers relating to the Closing Date Financial Statements, the Working Capital Calculation, the NFA Calculation, Regulatory Accounts Calculation and the Long Term Debt Calculation within which to notify the Vendor in writing that it disputes any amounts contained in the Closing Date Financial Statements, the Working Capital Calculation, the NFA Calculation, Regulatory Accounts Calculation and/or the Long Term Debt Calculation (the "**Purchaser's Objection**"), failing which the Purchaser shall be deemed to have accepted such amounts. The Purchaser's Objection shall set forth a specific description of the basis of the Purchaser's Objection and the adjustments to the Closing Date Financial Statements, the Working Capital Calculation, the NFA Calculation, Regulatory Accounts Calculation and/or the Long Term Debt Calculation which the Purchaser believes should be made. Any items not specifically disputed during such thirty (30) Business Day period shall be deemed to have been accepted by the Purchaser.

(c) Subject to Section 2.4(d), payment of the adjustment to the Purchase Price pursuant to Section 2.4(a) shall be made by the applicable Party within thirty (30) Business Days following the later of (i) the date that the Closing Date Financial Statements, the Working Capital Calculation, the NFA Calculation, Regulatory Accounts Calculation and the Long Term Debt Calculation are received by the Purchaser; and (ii) the date on which the Purchaser is provided with access to the Auditor's working papers relating to the Closing Date Financial Statements, the Working Capital Calculation, the NFA Calculation, Regulatory Accounts Calculation and the Long Term Debt Calculation.

(d) If the Vendor and the Purchaser cannot agree on the adjustment of the Purchase Price pursuant to Section 2.4(a) within the time limit for payment of the adjustment to the Purchase Price pursuant to Section 2.4(b), the Vendor and the Purchaser will submit any unresolved matter within a further five (5) day period, to an independent, nationally recognized accounting firm selected by the Vendor and the Purchaser (the "**Independent Auditor**") for resolution or, failing agreement, as appointed by the Ontario Superior Court of Justice. The Independent Auditor will be given access to all materials and information reasonably requested by it for such purpose. The rules and procedures to be followed in the arbitration proceedings will be determined by the Independent Auditor in its discretion. The Independent Auditor will make its determination as soon as practicable and, in any case, within thirty (30) days of the matter being submitted to it. The Independent Auditor determination of all such matters will be final and binding on the Parties and will not be subject to appeal by any Party. The fees and expenses of the Independent Auditor will be borne equally between the Vendor and the Purchaser. The Closing Date Financial Statements and amounts specified in Section 2.4(a) will be modified to the extent required to give effect to the Independent Auditor's determination and will be deemed to have been approved as of the date of such determination.

2.5 **Access.** Following the Closing, the Purchaser shall provide the Vendor and the Auditor with timely access to all books, records, documents, materials, and other information and Representatives of the Corporation reasonably requested by the Vendor for purposes of preparation and delivery of the Closing Date Financial Statements together with the Working Capital Calculation, the NFA Calculation, Regulatory Accounts Calculation and the Long Term Debt Calculation.

2.6 **Rate Reduction Adjustment.**

(a) In the event the OEB does not approve any negative rate rider, the Purchaser shall pay the Vendor, within five (5) Business Days after the Closing Date, a lump sum amount equal to the Five Year Fixed Payment Amount in immediately available funds.

(b) In the event that the OEB approves a Partial Rate Rider, the Purchaser will pay the Vendor, within five (5) Business Days after the Closing Date, an amount equal to the Five Year Fixed Payment Amount times the Rate Adjustment Factor.

2.7 **Deposit.** The Deposit shall be held by the Vendor's solicitor in trust, and shall be invested in an interest bearing account with interest accruing to the Purchaser except as set forth below. On Closing, the Deposit shall be applied on account of the Purchase Price and any and all interest accrued thereon shall be paid to the Purchaser forthwith following Closing. Notwithstanding the foregoing, if the conditions set forth in Section 9.1 have not been satisfied or complied with and the Purchaser does not waive compliance therewith on such terms as may be agreed in writing, the Deposit, together with any interest earned thereon shall be refunded to the Purchaser in accordance with Section 9.1. If, however, the Transactions are not completed on the Closing Date and the conditions set forth in Section 9.1 have been satisfied, complied with or waived, the Deposit, together with any interest earned thereon, may be retained by the Vendor to the extent permitted under Section 9.2.

2.8 **Valuation of Assets.** The Vendor and Purchaser agree to file the same allocation in respect of the Transactions. In the event that the Vendor and the Purchaser are unable to reach agreement on the allocation of the Purchase Price within sixty (60) days of delivery of the Closing Date Financial Statements, the parties shall appoint an independent valuator at their joint expense, to determine the appropriate allocation in accordance with this clause, whose decision shall be binding on all Parties unless manifestly incorrect.

ARTICLE III
REPRESENTATIONS AND WARRANTIES

3.1 **Representations and Warranties of the Vendor.** The Vendor represents and warrants to the Purchaser as follows and acknowledges that, except as otherwise expressly provided herein, the Purchaser is relying on such representations and warranties in connection with the transactions contemplated herein:

(a) **Organization**. The Vendor and the Corporation are duly incorporated and validly subsisting under the laws of the Province of Ontario and have the corporate power, capacity and authority to own or lease or dispose of its property and assets and to carry on the business presently carried on by it under the laws of the Province of Ontario. No proceedings have been instituted or are pending for the dissolution, winding up or liquidation of the Vendor or the Corporation.

(b) **Corporate Power of the Vendor and City and Due Authorization**. The Vendor and the City have all requisite and statutory power, authority and capacity to enter into, and to perform its obligations under this Agreement and to transfer the legal and beneficial title and ownership of the Purchased Shares to the Purchaser free and clear of all Encumbrances. Each of the Vendor and the City has duly taken, or has caused to be taken, all action required to be taken by the Vendor or the City to authorize the execution and delivery of this Agreement and any other agreement or document to be delivered pursuant hereto by the Vendor or the City in the performance of its obligations hereunder.

(c) **Binding Agreement**. This Agreement has been duly executed by the Vendor and the City and will, upon delivery, constitute valid and binding obligations of the Vendor and the City, enforceable against each in accordance with its terms, except as enforcement may be limited by bankruptcy, insolvency and other Applicable Laws affecting the rights of creditors generally and except that equitable remedies may be granted only in the discretion of a court of competent jurisdiction.

(d) **Authorized and Issued Capital of the Corporation**. The authorized share capital of the Corporation consists of an unlimited number of Common Shares, of which only the Purchased Shares have been validly allotted and issued and are outstanding as fully paid and non-assessable shares, and will be the only outstanding shares of the Corporation at Closing.

(e) **Ownership of Shares**. The Vendor is the sole beneficial and registered owner of the Purchased Shares, with good and marketable title thereto, free and clear of all Encumbrances (other than the rights of the Purchaser hereunder) and has the exclusive right to dispose of the Purchased Shares as herein provided. Without limiting the generality of the foregoing, none of the Purchased Shares is subject to any voting trust, shareholder agreement or voting agreement.

(f) **Options**. No Person (other than the Purchaser under this Agreement) has the benefit of any Contract or any right or privilege (whether by Applicable Law, pre-emptive or contractual) binding upon or which may at any time in the future become binding upon the Vendor or the City, to acquire or obtain in any other way an interest in any of the Purchased Shares.

(g) **Subsidiaries**. The Corporation has no Subsidiaries and has never had any interest in any shares of any other corporation nor any interest in any partnership or other entity, except as disclosed in Schedule 3.1(g) .

(h) **No Violations**. Neither the execution nor delivery of this Agreement nor the completion of the transactions herein contemplated will result in the violation of:

(i) any provision of the by-laws of the Vendor or the City;

(ii) any Contract to which the Vendor, the City or the Corporation is a party or by which the Vendor, the City or the Corporation or any of their respective properties is bound, which would have a material adverse effect on the Vendor's or the Corporation's ability to perform its obligations under this Agreement; or

(iii) subject to the Required Approval, to the Vendor's and the City's knowledge, any Applicable Law or requirement of a Government Authority having jurisdiction over each of the Vendor, the City or the Corporation, which would have a material adverse effect on the Vendor's or the City's ability to perform its obligations under this Agreement.

(i) **Consents and Approvals**. Other than the Required Approval, there is no requirement for the Vendor, the City or the Corporation to make any filing with, give any notice to or obtain any licence, permit, certificate, registration, authorization, consent or approval of, any Government Authority as a condition to the lawful consummation of the Transaction.

(j) **Compliance with Applicable Law**. The Corporation has complied in all material respects with all Applicable Laws relating to its Business, the failure to comply with which would have a Material Adverse Effect. The Corporation is not in violation or default under, and to the Vendor's knowledge, no event has occurred which, with the lapse of time or the giving of notice or both, would result in the violation of or default under, the terms of any judgment, decree, order injunction or writ of any court or other Government Authority with respect to the Business, which would have a Material Adverse Effect.

(k) **Corporate Records**. The corporate records and minute books of the Corporation produced by the Vendor in the Data Room are in all material respects a complete and accurate record of the material business transacted at meetings of, and contain all resolutions passed by, the directors and the sole shareholder of the Corporation held since the incorporation of the Corporation. To the Vendor's knowledge, each and all such meetings were duly called and held and all such resolutions and by laws were duly passed. The share certificate books, registers of shareholders, registers of transfers, registers of directors and other corporate registers of each are complete and accurate.

(l) **Real Property**.

(i) to the Vendor's knowledge Schedule 3.1(l) sets forth a list of lands owned in fee simple (the "**Real Property**") and property leased (the "**Leased Property**") by the Corporation and Easements held by the Corporation.

(ii) To the Vendor's knowledge, the Corporation does not own real property or have rights under any leases, and has not agreed to acquire or lease, any real property other than as listed in Schedule 3.1(l).

(iii) neither the Vendor nor the Corporation has received any, nor to the Vendor's knowledge are there any pending or threatened, notices of violation or alleged violation of any Applicable Laws against or affecting any Real Property or Leased Property.

(iv) The Real Property, Leased Property and Easements provide the required rights of occupancy, possession, use, entry and exit, as applicable, as are reasonably necessary to carry on the Business.

(v) Other than listed in Schedule 3.1(l), no Person has any right to purchase any of the Real Property and no Person other than the Corporation is using or has any right to use, is in possession or occupancy, of any part of the Real Property.

(vi) to the Vendor's knowledge there exists no option, right of first refusal, or other contractual rights with respect to any of the Real Property, except such rights as provided in this Agreement.

(vii) neither the Vendor nor the Corporation has entered into any contract to sell, transfer, encumber, or otherwise dispose of or impair the right, title and interest of the Corporation in and to Real Property, Leased Property or Easements, except any Permitted Encumbrances listed in Schedule 1.1(zzz).

(viii) Neither the Vendor nor the Corporation has received any notification of, nor are there any outstanding or incomplete work orders in respect of any Fixed Assets on such Real Property, Leased Property, Easements or of any current non-compliance (other than non-compliances which are legal non-conforming under relevant zoning by laws) with Applicable Law, including without limitation, building and zoning by laws and regulations, and no by law which would reasonably be expected to have a Material Adverse Effect on the Business is currently being contemplated by the City.

(ix) All accounts for work and services performed or materials placed or furnished upon or in respect of the construction and completion of any Fixed Assets on Real Property, Leased Property or Easements have been fully paid and no Person is entitled to claim a lien under the *Construction Lien Act* (Ontario) or other similar legislation for such work.

(x) to the Vendor's knowledge, there are no matters affecting the right, title and interest of the Corporation, as applicable, in and to the real property used in its Business which would have a Material and Adverse Effect on the ability of the Corporation to carry on its Business thereon.

(xi) The Corporation holds its interests in the Leased Property pursuant to valid leases described in Schedule 3.1(l), true copies of which have been provided to the Purchaser in the Data Room, which contain all of the rights and obligations of the parties related to the use and occupancy of each such property, have not been altered or amended and are in full force and effect and under which neither the landlord nor the tenant is in default, nor to the Vendor's knowledge are there circumstances which, but for the passing of time or giving of notice or both, would constitute a default by either party. The Corporation has not waived or omitted to take any action in respect of any material rights under any such lease.

(xii) neither the Vendor nor the Corporation has made an application for the rezoning of any Real Property or Leased Property and to the Vendor's knowledge there is no proposed or pending change to any zoning affecting the Real Property or Leased Property.

(xiii) No part of the Real Property or Leased Property is subject to any building or use restriction which would prevent or limit its current use in the Business.

(xiv) to the Vendor's knowledge, no Fixed Assets constituting a part of the Real Property, Leased Property or Easements encroaches on real property not forming part of such property.

(xv) no part of the Real Property has ever been used as a landfill or for the disposal of waste.

(xvi) Except as disclosed in the Confidential Disclosure Schedule, no asbestos, asbestos containing materials, polychlorinated biphenyls ("**PCBs**") and PCB wastes are used, stored or otherwise present in or on the Real Property except for PCBs contained in the electrical transformers which are in service and which form an integral part of, and are necessary for the operation of the Business. The Vendor has disclosed to the Purchaser in the Data Room all inspection reports received from the Ministry of the Environment in connection with the handling, transportation and storage by the Corporation of PCBs or any other Hazardous Substance; and

(xvii) Except as disclosed in the Confidential Disclosure Schedule, there are no Hazardous Substances in, on or under the Real Property owned or occupied by the Corporation, used in the Business or concerning the condition of which the Corporation is otherwise responsible and there are no underground storage tanks on the Real Property or Leased Property and any underground storage tanks formerly on the Real Property or Leased Property have been removed and any affected soil, surface water or ground water has been remediated in compliance with all Applicable Law including, without limitation, Environmental Law.

(m) **Intellectual Property**. Schedule 3.1(m) sets forth and describes all trade secrets and any licensed property or technology used in whole or in part by the Business, and all material trademarks, trade names, service marks, brand names, patents, copyrights, industrial designs and other industrial property rights, and all applications therefor, in each case specifying whether the item is owned used by the Corporation under a licence agreement or arrangement from another Person. The Corporation has valid rights to use such intellectual property in the Business

(n) **Contracts and Commitments**. Except as set forth in Schedule 3.1(n), the Corporation is not party to or bound by any of the following:

(i) any offer letter or employment contract or consulting contract in the nature of an employment contract or any other Contract with any director, officer or employee, including any agreements or arrangements relating to compensation, other than oral Contracts of indefinite hire terminable by the employer without cause on reasonable notice; or

(ii) any agreement, contract or commitment limiting the freedom of the Corporation to engage in any line of business or to compete with another Person.

(o) **Material Contracts**. The Vendor has previously delivered by placing them in the Data Room, true and complete copies of all Material Contracts, all of which are in full force and effect and unamended and no material default exists under any such Material Contract on the part of the Corporation or, to the knowledge of the Vendor, on the part of any other party to such Contracts, and there are no current or pending negotiations with respect to the renewal, repudiation or amendment of any such Material Contract.

(p) **Employee Plans**.

(i) Except as set forth in the Data Room and further described in Schedule 3.1(n) and Schedule 3.1(p), the Corporation is not party to, bound by, subject to and has no liability or contingent liability, either as purchaser or supplier, relating to any employment agreement or any agreement or arrangement relating to information provided under Section 3.1(n), salary, wages, deferred compensation, bonus, incentive or other compensation, commission, fee, profit sharing, severance, termination pay, supplementary employment insurance, vacation entitlements, insurance, health, welfare, disability, pension, retirement, hospitalization, medical, prescription drug, dental, eye care, arrangements for personal use of any corporate assets based on past practice and other similar benefits, plans or arrangements, including as may be included in any Collective Agreement (the "**Employee Plans**"), whether funded or unfunded, formal or informal, written or unwritten, that is maintained, contributed to, or required to be maintained or contributed to, by the Corporation, or to which the Corporation is a party, directly or indirectly for the benefit of the Employees and their respective beneficiaries and dependents, other than Statutory Plans.

(ii) Other than the OMERS Plan, the Purchaser has been provided access to a true and complete copy of each Employee Plan (as amended to date) together with true and complete copies of all material documents relating to each such Employee Plan excluding OMERS, including, as applicable, all booklets, summaries, notices or manuals prepared for or circulated to Employees generally concerning each such Employee Plan and all contracts through which the Corporation obtains benefits, plans and arrangements for the benefit of Employees or former employees.

(iii) All obligations of the Corporation due prior to Closing under the Employee Plans, OMERS and the Statutory Plans (whether pursuant to the terms thereof or any Applicable Law) have been or will be satisfied in all material respects.

(iv) Other than the OMERS Plan, with respect to which the Vendor makes no representation, and other than any grievance that has been resolved or settled, as applicable, all Employee Plans are, and have been, established, registered (where required), and administered, in material compliance with (i) the terms thereof; (ii) all Applicable Law; and (iii) applicable Collective Agreements and neither the Vendor nor the Corporation has received, in the last four (4) years, any notice from any Person questioning or challenging such compliance (other than in respect of any claim related solely to that Person), nor does the Vendor or the Corporation have any knowledge of any such notice from any Person questioning or challenging such compliance beyond the last four (4) years. Except as disclosed in Schedule 3.1(p) and other than the OMERS Plan or as set out in the Collective Agreement, there are no promised improvements, increases or changes to, the benefits provided under any Employee Plan, nor does any Employee Plan provide for benefit increases or the acceleration of funding obligations that are contingent upon or will be triggered by the execution of this Agreement or the Closing.

(v) Except as disclosed in Schedule 3.1(p), no Employee Plan, other than the OMERS Plan, provides benefits beyond retirement or other termination of service to employees or former employees of the Corporation or to the beneficiaries or dependants of such employees or former employees. Other than the OMERS Plan, with respect to which the Vendor makes no representation, no Employee Plan requires or permits a retroactive increase in premiums or payments.

(vi) All employee data necessary to administer the Corporation' participation in the Employee Plans is in the possession of the Corporation and is complete, correct and in a form which is sufficient for the proper administration of the Corporation' participation in the OMERS Plan and the other Employee Plans in accordance with the terms thereof and all Applicable Laws.

(vii) OMERS is the only pension or retirement plan or arrangement in which employees or former employees of the Corporation participate and/or to which the Corporation contributes as a participating employer.

(viii) All obligations of the Corporation to or under OMERS (whether pursuant to the terms thereof or Applicable Law) have been satisfied, and there are no outstanding defaults or violations thereunder by the Corporation or by any predecessor thereof.

(ix) There are no obligations of the Corporation with respect to unfunded actuarial liabilities, past service unfunded liabilities or solvency deficiencies respecting the Corporation's participation in OMERS.

(q) **Labour Matters**.

(i) Except as set forth in Schedule 3.1(q) (the "**Collective Agreement**") the Corporation is not a party to or bound by or subject to any agreement or arrangement with any labour union or employee association and has not made any commitment to or conducted any negotiation or discussion with any labour union or employee association with respect to any future agreement or arrangement.

(ii) There is no strike or lockout occurring or affecting, or to the Vendor's knowledge threatened against, the Corporation.

(r) **Employees**.

(i) The Purchaser has been provided with a complete and accurate confidential list of the names of all individuals who are employees (the "**Employees**") of the Corporation specifying title, compensation, years of service, whether they are union or non-union, and the benefits under the Employee Plans to which they are entitled (the "**Employee Fact Sheet**").

(ii) Except as disclosed in the Employee Fact Sheet, no Employee is on long term disability leave, extended absence or receiving benefits pursuant to the *Workplace Safety and Insurance Act* (Ontario).

(iii) The Corporation has been operated in material compliance with all Applicable Laws relating to employees, including employment standards and all laws relating to full or in part to the protection of employee health and safety, human rights, labour relations and pay equity. Except as disclosed in the Employee Fact Sheet:

(A) there have been no Claims nor, to the Vendor's knowledge, are there any threatened complaints, under such laws against the Corporation;

(B) to the Vendor's knowledge, nothing has occurred which might lead to a Claim or complaint against the Corporation, under any such laws; and

(C) there are no outstanding decisions or settlements or pending settlements which place any obligation upon the Corporation to do or refrain from doing any act with respect to its Employees.

(iv) All assessments under the *Workplace Safety and Insurance Act* (Ontario) in relation to the Business of the Corporation have been paid or accrued and the Corporation is not subject to any special or penalty assessment under such legislation which has not been paid.

(s) **Insurance**. Schedule 3.1(s) sets forth all insurance policies, other than those already disclosed in the Schedule 3.1(o), (specifying the insurer, the amount of the coverage, the type of insurance, the policy number and any pending claims thereunder, maintained by the Corporation on its Property or personnel, including former personnel) of the Business. The Vendor, and not the Corporation, is the subscriber to the MEARIE Reciprocal Agreement.

(t) **Environmental**.

To the knowledge of the Vendor and except as disclosed in the Confidential Disclosure Schedule

(i) the Business conducted on or at real property while occupied or used by the Corporation, has been and is now in compliance in all material respects with all applicable Environmental Laws. Any Release by the Corporation, of any Hazardous Substance into the Environment complied and complies in all material respects with all applicable Environmental Laws, and not in a manner that could reasonably be expected to have a Material Adverse Effect;

(ii) the Corporation has obtained all requisite Environmental Approvals, which Environmental Approvals are valid and in full force and effect, have been and are being complied with in all material respects and there have been and are no proceedings commenced or threatened to revoke or amend any Environmental Approvals in a manner that could reasonably be expected to have a Material Adverse Effect. The Confidential Disclosure Schedule lists all of the Environmental Approvals held by the Corporation;

(iii) the Corporation has not been and is not now the subject of any Remedial Order nor, is any investigation or evaluation threatened or commenced as to whether any such Remedial Order is necessary;

(iv) the Corporation has never been prosecuted for or convicted of any offence under Environmental Laws, nor has the Corporation been found liable in any proceeding to pay any damages, fine or judgment to any Person as a result of any Release or threatened Release of any Hazardous Substance into the Environment or as the result of any breach of any Environmental Laws. No notice has been received by the Vendor or by the Corporation of any investigation or evaluation by any Governmental Authority or of any Claims, pending or threatened, and there are no investigations or evaluations threatened or commenced as to whether any offence by any of the foregoing has occurred. There are no Claims that have been threatened or commenced against the Corporation as a result of any Release or threatened Release of any Hazardous

Substance into the Environment or as the result of the breach of any Environmental Laws.

(u) **Litigation**. Except as set out in the Confidential Disclosure Schedule, there are no Claims (whether or not purportedly on behalf of the Corporation) pending or, to the Vendor's knowledge, threatened against or affecting, the Corporation at law or in equity, or before or by any Governmental Authority, or by or before an arbitrator or arbitration board which, either individually or in the aggregate, would have a Material Adverse Effect or prevent the Vendor or the City from fulfilling any of its obligations set out in, or arising in connection with, this Agreement.

(v) **Taxes**.

(i) the Corporation is exempt from Tax under the Tax Act and the CTA but is required to make PILS payments under the EA in an amount equal to the Tax that it would be liable to pay under the Tax Act and CTA if it were not exempt from Tax under those statutes.

(ii) the Corporation has filed in the prescribed manner and within the prescribed times all Tax Returns required to be filed by it in all applicable jurisdictions with respect to taxation periods ended on or before the Closing Date. All such Tax Returns are complete and correct and disclose all Taxes required to be paid for the periods covered thereby. The Corporation has never been required to file any Tax Returns with, and has never been liable to pay or remit Taxes to, any Governmental Authority outside Ontario or Canada. The Corporation has paid in full when due all Taxes and all instalments of Taxes due on or before the Closing Date. There are no liens for unpaid Taxes on any of the Corporation's Property. Without restricting the generality of the foregoing, all Taxes shown on all Tax Returns or on any assessments or reassessments in respect of any such Tax Returns have been paid in full when due except to the extent that the Corporation has properly objected to such assessments or reassessments in accordance with Applicable Law. The Vendor has furnished to the Purchaser true, complete and accurate copies of all Tax Returns and any amendments thereto filed by the Corporation since 2012 and all notices of assessment and reassessment and all correspondence with Governmental Authorities relating thereto as well as true, complete and accurate copies of all tax returns and any amendments filed thereto, and all notices of assessment and reassessment and all correspondence with Governmental Authorities or tax advisors relating thereto. The provision for taxes in the Initial Financial Statement constitutes an adequate provision for the payment of all unpaid Taxes in respect of all periods up to and including the period to which the Initial Financial Statement relates.

(iii) Assessments under the EA and ETA have been issued to the Corporation covering all periods up to and including its fiscal year ended December 31, 2015.

(iv) There are no audits, assessments, reassessments or other Claims in progress or, to the knowledge of the Vendor, threatened against the Corporation, in respect of any Taxes and, in particular, there are no currently outstanding reassessments or written enquiries which have been issued or raised by any Governmental Authority relating to any such Taxes except for those items listed in Schedule 3.1(v). The Vendor is not aware of any contingent liability of the Corporation for Taxes or any grounds that could prompt an assessment or reassessment for Taxes, and the Corporation has not received any indication from any Governmental Authority that any assessment or reassessment is proposed with respect to taxation periods ended on or before the Closing Date.

(v) the Corporation has not entered into any agreements, waivers or other arrangements with any Governmental Authority providing for an extension of time with respect to the issuance of any assessment or reassessment, the filing of any Tax Return, or the payment of any Taxes by or in respect of the Corporation. The Corporation is not a party to any agreements or undertakings with respect to Taxes.

(vi) The Corporation is a registrant for purposes of the ETA, and the HST registration number is:

865120596RT001.

All input tax credits claimed by the Corporation pursuant to the ETA has been proper, correctly calculated and documented. The Corporation has collected and remitted when due all Taxes, including GST/HST and RST, as required by tax legislation.

(vii) The Vendor is not a non-resident for the purposes of the *Tax Act*.

(viii) The Corporation maintains its books and records in compliance with section 230 of the *Tax Act*.

(ix) The Vendor has provided to the Purchaser true, complete and accurate copies of all Canadian federal and Ontario income Tax Returns of the Corporation for the last four (4) completed taxation years and all related communications to or from all Governmental Authorities. Canadian federal and provincial income, sales (including goods and services and harmonized sales and provincial or territorial sales) and capital tax assessments have been issued to the Corporation for all taxation years or periods up to and including its taxation year ended as of Closing Date. No notice of determination of loss for the Corporation from a Governmental Authority has been requested by or issued to the Corporation.

(x) The Corporation is not party, or bound by or obligated by contract or otherwise, to any undertaking regarding any Tax allocation, indemnity or sharing contract or arrangement, and neither is it liable for the Taxes of any other Person as a transferee or successor.

(xi) The value of consideration paid or received by the Corporation for the acquisition, sale, transfer or provision of property (including intangibles) or the provision of services (including financial transactions) from or to any Person with which it was not dealing at arm's length at the relevant time was the fair market value of such property acquired, provided or sold or services purchased or provided.

(w) **Withholding**. The Corporation has deducted, withheld, collected and remitted when due to each Governmental Authority, all Taxes which it is required to deduct, withhold, collect and remit. Without limiting the generality of the foregoing, the Corporation has withheld from each amount paid or credited or deemed to have been paid or credited, and each taxable benefit conferred upon or distribution paid or deemed to have been paid to any of its past or present employees, officers or directors, and to any non-resident of Canada, the amount of all Taxes and other deductions required to be withheld therefrom, including without limitation, all employee and employer portions for Workers' Compensation, Canada Pension Plan, Employer Health Tax and Employment Insurance and has paid the same to the proper tax or other receiving officers within the time required under any applicable legislation. The Corporation has remitted to the appropriate tax authority when required by law to do so all amounts collected by it on account of sales taxes including HST. The Corporation has not received any requirement, demand or request from any Governmental Authority pursuant to section 224 of the Tax Act or any similar provision of Applicable Law that remains unsatisfied in any respect.

(x) **Ownership of Property**. The Corporation is the sole legal and beneficial, and where interests are registerable, the sole registered owner, of all of the property used in connection with, directly or indirectly, ancillary to, or reasonably necessary for the operation of the Business with good and valid title thereto (with good and marketable title to the Real Property in fee simple) free and clear of all Encumbrances other than minor easements for the supply of utilities, and those Permitted Encumbrances listed in Schedule 1.1(zzz). All of the Fixed Assets used in connection with, directly or indirectly, ancillary to, or reasonably necessary for the operation of the Business are in good working order, condition and repair subject to reasonable wear and tear, have been properly and regularly maintained and are in material compliance with all Applicable Laws. There has been no assignment, subletting or granting of any licence (of occupation or otherwise) of or in respect of any such property or any granting of any contract or right capable of becoming a Contract or option for the purchase of any of such property other than pursuant to the provisions of, or as disclosed in, this Agreement.

(y) **Financial Statements**. The Initial Financial Statements were prepared and the Closing Date Financial Statements will be prepared in accordance with IFRS applied on a basis consistent with that of the preceding period and present, or will present (in the case of the Closing Date Financial Statements), fairly:

(i) in the case of the Initial Financial Statements, all of the assets, liabilities and financial position of the Corporation as at December 31, 2015, and the sales, earnings, results of operation and changes in financial position of the Corporation for the 12 month period then ended; and

(ii) in the case of the Closing Date Financial Statements, the assets and liabilities of the Corporation as at the Time of Closing.

(z) **Licences**. Schedule 3.1(z) sets out a complete list of all licences, permits, approvals, consents, certificates, registrations and authorizations ("**Licences**") held by or granted to the Corporation, and there are no other licences, permits, approvals, consents, certificates, registrations or authorizations necessary to carry on the Business. Each Licence is valid, subsisting and in good standing and the Corporation is not in default or in breach of any Licence and, to the Vendor's knowledge, no proceeding is threatened or pending to revoke or limit any Licence.

(aa) **Bank Accounts**. The Confidential Disclosure Schedule sets forth a complete list of every financial institution in which the Corporation maintains any depository account, trust account or safety deposit box and the names of all persons authorized to draw on or who have access to such accounts or safety deposit box.

(bb) **Absence of Guarantees**. The Corporation has not given, agreed to give nor shall give, nor is a party or bound by, any guarantee or indemnity in respect of indebtedness, or other obligations, of any Person, or any other commitment by which the Corporation is, or is contingently, responsible for such indebtedness or other obligations.

(cc) **By-Laws**. Other than by laws of general application, no by law of the City exists which materially adversely affects the Corporation or the Business. Other than by laws of general application, no by law which would materially adversely affect the Corporation or the Business is currently being contemplated by the City or, to the City's or the Vendor's Knowledge, has been proposed by any Person.

(dd) **Limitation**. The Vendor and the City make no representation or warranty to the Purchaser except as specifically set forth in this Agreement and this Agreement contains all representations and warranties of the Vendor and the City relating to the Purchased Shares and the Transaction.

(ee) **Effect of Disclosure**. All disclosure contained in a particular representation and warranty set forth in this Agreement (or any Schedule referred to therein) shall be deemed for the purposes of this Agreement to have been made with respect to all of the representations and warranties in this Section 3.1 to which such disclosure might be applicable. Notwithstanding anything else contained herein, the Vendor shall have no liability to the Purchaser with respect to any failure by it to disclose the existence of any matter, document or thing, or to make any other disclosure in the context of a particular representation and warranty set out in this Section 3.1 where the existence of such matter, document or thing has been disclosed as part of another representation or warranty contained in this Agreement or in any Schedule annexed hereto.

3.2 **Representations and Warranties of the Purchaser.** The Purchaser represents and warrants to the Vendor as follows and acknowledges that the Vendor is relying on such representations and warranties in connection with the transactions contemplated herein:

(a) **Organization**. The Purchaser is a corporation duly incorporated and validly subsisting corporation under the laws of Ontario and has the corporate power to own or lease its property and assets and to carry on the business presently carried on by it.

(b) **Corporate Power of the Purchaser and Due Authorization**. The Purchaser has all requisite corporate power, authority and capacity to enter into, and to perform its obligations under this Agreement. The Purchaser has duly taken, or has caused to be taken, all corporate action required to be taken by the Purchaser to authorize the execution and delivery of this Agreement by the Purchaser in the performance of its obligations hereunder and has the financial ability to complete the Purchase and pay the Purchase Price.

(c) **Binding Agreement**. This Agreement has been duly executed by the Purchaser and will, upon delivery, constitute a valid and binding obligation of the Purchaser, enforceable against it in accordance with its terms, except as enforcement may be limited by bankruptcy, insolvency and other laws affecting the rights of creditors generally and except that equitable remedies may be granted only in the discretion of a court of competent jurisdiction.

(d) **No Violations**. Neither the execution nor delivery of this Agreement nor the completion of the transactions herein contemplated will result in the violation of:

(i) any provision of the constating documents, by laws or any unanimous shareholder agreement of the Purchaser;

(ii) any Contract to which the Purchaser is a party or by which the Purchaser or any of its property or assets is bound, which would have a material adverse effect on the Purchaser's ability to perform its obligations under this Agreement; or

(iii) subject to obtaining the regulatory approvals set forth in Article VII, any terms or provisions of any Applicable Law of any authority having jurisdiction over the Purchaser which would have a materially adverse effect on the Purchaser's ability to perform its obligations under this Agreement.

(e) **Investment Canada Act**. The Purchaser is not a "non-Canadian" within the meaning of the *Investment Canada Act* (Canada). The Purchaser is not a "non-resident" for tax purposes.

(f) **Financial Capability**. The Purchaser has sufficient funds in place to pay the Purchase Price on the Closing Date on the terms and conditions contained in this Agreement.

(g) **Consents and Approvals**. Except for the Required Approval, there is no requirement for the Purchaser to make any filing with, give any notice to or obtain any licence, permit, certificate, registration, authorization, consent or approval of, any governmental or regulatory authority as a condition to the lawful consummation of the transactions contemplated by this Agreement.

(h) **Litigation**. There is no legal proceeding in progress, pending, threatened against or affecting the Purchaser and, to the best of the knowledge and belief of the Purchaser, there are no grounds on which any such legal proceeding might be commenced with any reasonable likelihood of success and no judgment, decree, injunction, ruling, order or award of any tribunal outstanding against or affecting the Purchaser which, in any such case, might adversely affect the ability of the Purchaser to enter into this Agreement or to perform its obligations hereunder.

(i) **Limitation**. The Purchaser makes no representation or warranty to the Vendor except as specifically set forth in this Section 3.2 and this Agreement contains all representations and warranties of the Purchaser relating to the transactions contemplated hereby.

(j) **Effect of Disclosure**. All disclosure contained in a particular representation and warranty set forth in this Agreement (or any Schedule referred to therein) shall be deemed for the purposes of this Agreement to have been made with respect to all of the representations and warranties in this Section 3.2 to which such disclosure might be applicable. Notwithstanding anything else contained herein, the Purchaser shall not have any liability to the Vendor with respect to any failure by it to disclose the existence of any matter, document or thing, or to make any other disclosure in the context of a particular representation and warranty set out in this Section 3.2 where the existence of such matter, document or thing has been disclosed as part of another representation or warranty contained in this Agreement or in any Schedule annexed hereto.

ARTICLE IV
SURVIVAL OF REPRESENTATIONS AND WARRANTIES

4.1 **Survival of Representation and Warranties.**

(a) The representations and warranties of the Vendor set out in Section 3.1 shall survive the Closing and, notwithstanding such Closing or any investigation made by or on behalf of the Purchaser with respect thereto, shall continue in full force and effect for the benefit of the Purchaser provided, however, that no Claim in respect thereof (other than with respect to representations and warranties regarding Taxes, for which the limitation period shall end six (6) months after the time that the taxation period ending on the Closing Date has become statute barred or for reassessment by the Tax authority, shall be valid unless it is made within a period of one (1) year from the Closing Date and, upon the expiry of such limitation period, the Vendor shall have no further liability to the Purchaser with respect to the representations and warranties referred to in such section, except in respect of Claims which have been made by the Purchaser to the Vendor in writing prior to the expiration of such period.

(b) The representations and warranties of the Purchaser set out in Section 3.2 shall survive the Closing and, notwithstanding such Closing or any investigation made by or on behalf of the Vendor with respect thereto, shall continue in full force and effect for the benefit of the Vendor provided, however, that no Claim in respect thereof shall be valid unless it is made within a period of one (1) year from the Closing Date and, upon the expiry of such limitation period, the Purchaser shall have no further liability to the Vendor with respect to the representations and warranties referred to in such section, except in respect of Claims which have been made by the Vendor to the Purchaser in writing prior to the expiration of such period.

ARTICLE V
COVENANTS OF THE VENDOR

5.1 **Access to the Corporation.** The Vendor shall forthwith make available to the Purchaser and its authorized Representatives in the Data Room copies of all title documents, Contracts, financial statements, policies, plans, reports, licences, orders, permits, books of account, accounting records and all other material documents, information and data, relating to the Business in the possession or control of the Vendor or the Corporation. The Vendor shall afford the Purchaser and its authorized Representatives access to the property of the Corporation upon written request and at least five (5) Business Days' prior written notice during the Corporation's normal business hours and provided that the Purchaser and its Representatives shall not impede the day to day operation of the Business. The Purchaser shall not undertake any drilling or subsurface investigations under any of the Property except with the prior approval of the Vendor, such approval to be granted in the discretion of the Vendor except that the Vendor may not withhold approval where there are reasonable grounds to suspect a change in the condition of the Property since the date of this Agreement and provided that no such investigation may unreasonably interfere with Vendor's operations. The Vendor and the Purchaser shall co-operate in good faith in arranging any confidential meetings as the Purchaser should reasonably request with senior executives of the Corporation employed in the Business.

5.2 **Conduct of Business Prior to Closing.** During the period from the date of the Initial Financial Statements to the Closing Date, the Vendor has caused and shall cause the Business of the Corporation to be conducted in the ordinary course substantially consistent with past practice (except as may be otherwise required or contemplated by the provisions of this Agreement), and shall not permit or authorize the Corporation to enter into new borrowing arrangements with financing having a term longer than thirty (30) days from Closing which financing may be made secured by a general security agreement, subject to Purchaser's approval acting reasonably or sell or otherwise dispose of any of its Property other than sales or dispositions of Property in the ordinary course not exceeding two hundred and fifty thousand dollars ($250,000) in the aggregate. The Corporation shall obtain Purchaser's prior written consent, which consent may be unreasonably withheld, to any Material Contract contemplated to be entered into following the Effective Date. During such period there shall be no change in the Business, operation, affairs, personnel and/or financial condition of the Corporation, except for changes occurring in the ordinary course of business which in aggregate would not reasonably be expected to have a Material Adverse Effect. The Parties further expressly acknowledge that, notwithstanding anything herein contained, during the period from execution of this Agreement to the Closing

Date, the Corporation shall be permitted to declare and pay dividends to the Vendor out of cash on hand.

5.3 **Delivery of Books and Records.**

(a) At Closing, the Vendor shall cause to be delivered to the Purchaser all of the books and records of and relating to the Corporation and the Business including at a minimum with respect to records supporting data required to be retained by the Tax authority, records for the past seven (7) years; and

(b) Notwithstanding Section 5.3(a), the Vendor shall be entitled to retain copies of any documents or other data delivered to the Purchaser pursuant to Section 5.3(a) provided that those documents are reasonably required by the City or the Vendor to perform its obligations hereunder or under Applicable Law.

5.4 **Resignation of Directors.** The Vendor shall cause all of the directors and officers of the Corporation to resign in favour of nominees of the Purchaser, such resignation to be effective at Closing and releases from such individuals of all claims they may have against the Corporation (other than in respect of unpaid salaries and accrued vacation pay).

5.5 **Transfer of Purchased Shares.** The City shall take, and shall cause the Vendor and the Corporation to take, all necessary steps and proceedings to permit the Purchased Shares to be duly and validly transferred to the Purchaser and to have such transfers duly and validly recorded on the books of the Corporation so that the Purchaser is entered onto the books of the Corporation as the holder of the Purchased Shares and to issue share certificates to the Purchaser representing the Purchased Shares.

5.6 **Non-Assignable Assets.** The Vendor and the City will use their respective best efforts to transfer any property used in the Business but held by the Vendor or the City to the Corporation (including obtaining any required third party consents) and in the absence of any such consent or effective transfer, Vendor or City as the case may be, shall hold such asset in trust for the benefit of the Corporation or as it may direct.

5.7 **Dispositions of Property.** The Vendor covenants and agrees that between the date of this Agreement and Closing, the Vendor shall not, and shall cause the Corporation not to transfer or acquire any Property unless it is the City Property or Property acquired from, or transferred to a person dealing at arm's length with the Vendor and its subsidiaries in the ordinary course of business.

5.8 **Debt to City.** The Vendor shall retire all of the Corporation's debt to the City on or prior to Closing, provided that the Vendor may obtain replacement financing as contemplated in Section 5.2.

5.9 **Special Payments to Employees.** Vendor shall cause the Corporation to pay out in full on or prior to Closing, all obligations of the Corporation for retention bonuses, change in control provisions and like obligations arising in connection with the employment of any person.

5.10 **Continued Pole Access.** For purposes of existing and future municipal attachments on hydro poles in the City of Orillia, the City will enter into a joint use agreement with each of HONI and the Purchaser in accordance with the terms of HONI's applicable standard document, Agreement for Licensed Occupancy of Power Utility Distribution Poles Rates. Vendor will provide an inventory of municipal attachments to the Distribution Facilities, on Closing.

5.11 **15 Industrial Street Easements.** On or prior to Closing, the City shall grant the Corporation and register on title, the following easements in favour of the Corporation on terms which are assignable to HONI, in form and content satisfactory to the City and the Purchaser acting reasonably:

(a) an easement for electrical distribution over Part 2, on a draft reference plan prepared by Dearden and Stanton Ltd., Ontario Land Surveyors dated July 21, 2016 (CAD File: RF26926/D-2711, revised August 9, 2016);

(b) an easement for ingress and egress over Part 8 on a draft reference plan prepared by Dearden and Stanton Ltd., Ontario Land Surveyors dated July 21, 2016 (CAD File: RF26926/D-2711, revised August 9, 2016); and

(c) an easement for electrical distribution and ingress and egress over Part 5 on a draft reference plan prepared by Dearden and Stanton Ltd., Ontario Land Surveyors dated July 21, 2016 (CAD File: RF26926/D-2711, revised August 9, 2016).

5.12 **15 Industrial Street License Agreement.** Prior to Closing, the Corporation is permitted to enter into a license agreement on terms satisfactory to the Purchaser and the relevant parties, acting reasonably, between the Corporation, Ontario Provincial Police, Orillia Power Generation Corporation and if required, the City, relating to the use of a telecommunications tower and related equipment (including anchors and guy wires) at 15 Industrial Street, Orillia, used by Ontario Provincial Police, Orillia Power Generation Corporation, and as the case may be, the City, relating to a joint use agreement dated November 1997.

5.13 **306 Peter Street North License Agreement.** Prior to Closing, the Corporation is permitted to enter into a license agreement with Orillia Power Generation Corporation (in favour of Orillia Power Generation Corporation as licensee) relating to telecommunications equipment currently situated within the fenced in substation portion of the lands at 306 Peter Street North, on terms requiring the relocation of such telecommunications equipment to a mutually acceptable location outside of the fenced in portion of the substation lands and otherwise on terms satisfactory to the Purchaser and Orillia Power Generation Corporation, acting reasonably .

ARTICLE VI
COVENANTS OF THE PURCHASER

6.1 **Employment and Location Guarantees**. The Purchaser hereby covenants and agrees that for a period of at least one (1) year following the Closing Date, it will, subject to its rights to dismiss for just cause, guarantee the continued employment with the Corporation, Purchaser, HONI or other Affiliate of the Purchaser, in Orillia, Ontario, of each Employee who is an active Employee of the Corporation on the Closing Date, i) on the same or similar terms and conditions including Employee Plans of their current employment for so long as they remain employed by the Corporation, and ii) as of their date of transfer to HONI, calculated on the same basis as provided to employees hired by HONI on the transfer date, except that service with the Corporation will be recognized as service with the Purchaser and HONI for seniority purposes. The foregoing shall not prohibit the relocation of Employees with their prior consent. From and after the date on which the Purchaser integrates the Business within HONI, Employees may apply for positions within the Purchaser and its Affiliates and will be considered for such positions on a fair and equal basis with other employees of the Purchaser and its Affiliates. In order to receive credit for their seniority and service with the Corporation in such application, the Employee must waive the benefit of the location guarantee from and after the application date.

6.2 **Participation in Community Events**. After Closing, the community shall be eligible for the benefits of HONI's community programs as described in Schedule 6.2.

6.3 **Advisory Committee**. The Purchaser shall establish an advisory committee (the "**Advisory Committee**") as soon as practicable after Closing to provide a forum for communication between the Purchaser and the community. In establishing the Advisory Committee, the Purchaser shall select one (1) senior HONI employee and one (1) local HONI employee as its Representatives, in consultation with officials of the Vendor. The Vendor has the right to appoint at least three (3) community members to the Advisory Committee.

6.4 **Transfer of City Property**. The Purchaser acknowledges and agrees that the real property set out in Schedule 6.4 and all associated obligations associated with this real property (the "**City Property**"), shall be transferred by the Corporation to the City prior to Closing.

6.5 **Employee-Related Matters**. The Purchaser acknowledges that from and after Closing, it shall be responsible for all obligations owing to present and former employees, and the employees' respective beneficiaries of the Corporation and their predecessors and of the Business relating to such employment, including all obligations and liabilities relating to wages, severance pay, notice of termination of employment or pay in lieu of such notice, damages for wrongful dismissal or other employee benefits or claims, including vacation pay, and Employee Plans (but excluding in respect of or in connection with OMERS) regardless of whether these arose before or after Closing. From and after the Time of Closing the Purchaser shall indemnify and save harmless the Vendor from and against any and all losses, damages, expenses, liabilities, claims and demands whatsoever made or brought against the Vendor by any person or Employee, association or trade union or by any Governmental Authority or any other Person or body which in any way pertains to or arises out of such liability including, without limiting the generality of the foregoing, any and all losses, damages, expenses, liabilities, claims and demands whatsoever with respect to wages, severance pay, notice of termination of employment or pay in lieu of such notice, damages for wrongful dismissal or other employee benefits or claims, including vacation pay, and Employee Plans and including any interest, award, judgment or penalty relating thereto and any costs or expenses incurred by the Vendor in defending any such claim or demand. For greater certainty, nothing in this Section 6.5 releases Vendor from its obligations under this agreement including with respect to disclosures and representations and warranties regarding employees and liabilities.

6.6 **Rate Rider.**

(a) Notwithstanding Section 2.6, the Purchaser acknowledges, agrees and covenants to:

(i) within the time frame specified in Section 7.1 and as part of the Required Approval, seek OEB approval for a negative rate rider to reduce Current Rates by one percent (1%) across the Rate Classes ("**Negative Rate Rider**"); and

(ii) request that the Reduced Rates shall:

(A) be effective immediately following Closing or as approved by the OEB, whichever is later; and

(B) be maintained without change during the Rate Freeze Period.

(b) If the OEB does not approve the Negative Rate Rider in accordance with Subsection 6.6(a), and does not approve a Partial Rate Rider, the Purchaser acknowledges, agrees and covenants to maintain Rates at Current Rates during the Rate Freeze Period. For greater clarity, this subsection 6.6(b) shall not affect the obligations of the Purchaser under Section 2.6 which are in addition to the Purchaser's obligations under this Section 6.6(b).

6.7 **Existing Customer Rebates.** Notwithstanding Sections 2.6, 6.6(a) and 6.6(b), the Purchaser acknowledges, agrees and covenants that it will apply to the OEB in a timely manner in 2017 for a rate adder to dispose of the balance in account 1576 ("**Account 1576**") as of December 31, 2016, which adder will be effective January 1, 2018 to December 31, 2018, and that it will make a similar application in 2018 for the disposition of the balance in account 1576 as of December 31, 2017 of the preceding year if that balance is in excess of eighty thousand dollars ($80,000). More particularly, the Purchaser will seek OEB approval of a rate adder similar to that sought by the Corporation and approved by the OEB in OEB File No. EB-2015-0286, being an application to establish a rate adder, effective January 1, 2016, to dispose of the balance in OEB Account 1576 as of December 31, 2014

6.8 **Smart Grid, Conservation and Demand Management.** Following Closing, the Purchaser will place continued importance on smart grid development and conservation and demand management initiatives in the operations of the Corporation or any successor by integrating such matters into its capital program and performance of service standards contemplated (reference).

6.9 **Books and Records.** The Purchaser shall preserve the books and records delivered by the Vendor to it pursuant to Section 5.3 for a period of eight (8) years from the Closing Date, or for such longer period as is required by any Applicable Law, and will permit the Vendor or its authorized Representatives reasonable access thereto in connection with the affairs of the Vendor relating to its matters.

6.10 **Confidentiality.**

(a) Each Party hereby covenants and agrees that it shall keep confidential and not use (except for the purposes of the Transaction) or disclose except as required by Applicable Law, any and all information received by it from another Party leading up to or in connection with the execution of this Agreement and completion of the transactions contemplated hereby, whether or not received prior to or after the Effective Date, concerning the business and affairs of the other Party or its Affiliates.

(b) In the event that this Agreement is terminated in accordance with the provisions hereof,

(i) the Purchaser hereby covenants and agrees that it, and its Affiliates, shall keep confidential, in accordance with the terms of the Confidentiality Agreement, any and all information and trade secrets received by the Purchaser from the Vendor, whether or not received prior to or after the date of this Agreement, concerning the business and affairs of the Vendor and/or the Corporation (the "**Confidential Information**").

(ii) the Purchaser shall:

(A) promptly return to the Vendor all documents, computer disks, other forms of electronic storage or other materials furnished by the Vendor, or the Corporation or by any of their respective Representatives to the Purchaser or its Representatives constituting Confidential Information, together with all copies and summaries thereof in the possession or under the control of the Purchaser or its Representatives and materials generated by the Purchaser or its Representatives that include or refer to any part of the Confidential Information, without retaining a copy of any such material; or

(B) alternatively, provided that the prior written consent of the Vendor has been obtained, promptly destroy all documents or other matters constituting Confidential Information in the possession or under the control of the Purchaser or its Representatives;

and the Purchaser shall confirm such return and/or destruction of Confidential Information to the Vendor in writing and certified by two senior officers of the Purchaser;

(iii) the Purchaser shall promptly destroy the portion of the Confidential Information which consist of analyses, compilations, forecasts, studies, other material or documents prepared by the Purchaser or its Representatives and shall confirm such destruction in writing and certified by two senior officers of the Purchaser;

(iv) any oral or visual Confidential Information will continue to be subject to the terms of the Confidentiality Agreement and the terms of this Section 6.10; and

(v) the Purchaser shall not, directly, use for its own purposes, any Confidential Information discovered or acquired by the Purchaser's Representatives as a result of the Vendor, or the Corporation making available to them any Confidential Information.

6.11 **Industrial Street Substation.** In the event Purchaser desires to dispose of all or part of the real property received as part of the Transaction in connection with the Industrial St. substation, the Vendor shall be offered a first right of refusal to purchase the lands at fair market value, valued as if free from contamination, notice of which interest is permitted to be registered on title to the property.

6.12 **Survival.** The covenants contained in this Article VI shall survive the Closing Date.

ARTICLE VII
REQUIRED APPROVAL

7.1 **OEB Approval.** Each of the Purchaser and the Vendor shall as promptly as practicable after the execution of this Agreement (but in no event later than forty five (45) days after the execution of this Agreement), file or cause to be filed with the OEB an application required to be made under Subsection 86(1) and Subsection 86(2) of the *OEB Act* in respect of the OEB Approval as it relates to the sale of the Corporation to the Purchaser and the acquisition from the Purchaser of all or substantially all of Corporation's assets by Hydro One Networks Inc. (the "**Required Approval**"). Each of the Purchaser and the Vendor shall use their best efforts (which shall not be less than commercially reasonable efforts) to cooperate and assist the other, so that the Required Approval can be obtained as soon as reasonably possible, and in any event prior to the Closing Date. All the costs and expenses incurred by the Parties in connection with the application for the OEB Approval shall be borne each Party.

7.2 **Ontario Minister of Finance Notice.** The Vendor and the Corporation each shall as promptly as practicable after the execution of this Agreement (but in no event later than the day before the Closing Date), file or cause to be filed with the Ontario Minister of Finance the notification required under Subsection 4(2) of Ontario Regulation 124/99 made under the EA. If necessary, the Vendor will also file or cause to be filed with the Ontario Minister of Finance such notification as required by Applicable Law within thirty (30) days after the Closing Date.

ARTICLE VIII
TAX MATTERS

8.1 **Preparation and Filing of Tax Returns.** The Vendor shall prepare and submit on behalf of the Corporation all Tax Returns that are not due for filing until after the Closing Date to the Purchaser for approval at least thirty (30) Business Days before the filing due date thereof except for the debt retirement charge and sales tax returns, which shall be prepared and submitted to the Purchaser for approval at least seven (7) Business Days before the filing due date thereof. The Purchaser shall provide the Vendor and its Representatives access to such books and records of the Corporation relating to the period preceding Closing as the Vendor reasonably request for purposes of preparing those Tax Returns. After the Purchaser has approved those Tax Returns (which the Purchaser must approve provided that the Tax Returns are in compliance with Applicable Law and consistent with past practice of the Corporation), the Purchaser shall, on a timely basis, cause the Corporation to file the Tax Returns, and provide a copy with proof of filing to the Purchaser.

8.2 **Books and Records Relating to Taxes**. Within thirty (30) Business Days after the Closing Date, the Vendor and the City shall deliver to the Purchaser the copies of all documents relating to Taxes of the Corporation in respect of the period preceding Closing that the Vendor retained pursuant to Section 5.3(b) and all working papers, correspondence and other documents prepared after the Closing Date which relate to Taxes for such periods.

8.3 **Notification Requirements**. The Purchaser shall promptly forward to the Vendor all written notifications and other written communications from any Governmental Authority received by the Purchaser or the Corporation relating to Taxes of the Corporation for all periods preceding Closing, and shall promptly inform the Vendor of any audit proposed to be undertaken and any adjustment proposed in writing to be made by any Governmental Authority in respect of a Pre-Closing Tax Period. Notwithstanding the obligation of the Purchaser to give prompt notice as required above, the failure of the Purchaser to give that prompt notice shall not relieve the Vendor of its obligations under this Article VIII except to the extent (if any) that the Vendor shall have been prejudiced thereby.

8.4 **Vendor Indemnification.**

From and after the Closing Date, the Vendor shall be responsible for and shall indemnify and save harmless the Purchaser for all Taxes payable by the Corporation for all such periods that are a Pre-Closing Tax Period (and except to the extent such Taxes payable are recorded as a current liability on the Closing Date Financial Statements). The Purchaser shall pay to the Vendor as an increase in the purchase price any Tax refunds received by or credited to the Corporation after the Closing Date provided that such Tax refunds and credits relate a Pre-Closing Tax Period (and except to the extent that such Tax refunds and credits have been recorded as a current asset on the Closing Date Financial Statements).

8.5 **Purchaser's Contest Rights**. Subject to Section 8.6, the Purchaser shall have the sole right to control, defend, settle, compromise, or prosecute in any manner an audit, examination, investigation, and other proceeding with respect to any Tax Return of the Corporation. The Purchaser shall keep the Vendor duly informed of any proceedings in connection with any matter for which the Purchaser may have a right to indemnification pursuant to this Article VIII or Article XII and promptly provide the Vendor with copies of all correspondence and documents relating to those proceedings. The Vendor shall execute or cause to be executed such documents and shall take such action as reasonably requested by the Purchaser to enable the Purchaser to take any action the Purchaser deems appropriate with respect to any proceedings in respect of which the Purchaser has contest rights under this Agreement.

8.6 **Vendor's Contest Rights.**

(a) The Vendor may at any time by written notice to the Purchaser elect to control, defend, settle, compromise or prosecute in any manner an audit, examination, investigation, or other proceeding with respect to Taxes or Tax issues related to any matter in respect of which the Purchaser may have a right of indemnification pursuant to this Article VIII or Article XII, except that:

(i) the Vendor shall deliver to the Purchaser a written agreement that the Purchaser is entitled to indemnification for all Losses arising out of that audit, examination or other proceeding and that the Vendor shall be liable for the entire amount of those Losses;

(ii) the Vendor may not, without the written consent of the Purchaser, settle or compromise Taxes or Tax issues related to any matter which may affect Tax liabilities of the Corporation for a period following Closing; and

(iii) the Vendor shall pay to the Purchaser the amount of all Taxes (including, for greater certainty, interest and penalties) specified in the notice of assessment or other Claim from the Governmental Authority which are due and payable and to which the Purchaser's indemnity Claim relates within ten (10) Business Days before the amount is required to be paid to the Governmental Authority or within ten (10) Business Days after the Purchaser has forwarded to the Vendor a Claim for indemnity.

(b) If the consent of the Purchaser to a settlement or compromise arranged by the Vendor is not obtained for any reason, the indemnification liability of the Vendor shall be limited to the proposed settlement amount. The Purchaser and/or the Corporation, as applicable, shall execute or cause to be executed such documents or take such action as reasonably requested by the Vendor to enable the Vendor to take any action it deems appropriate with respect to any proceedings in respect of which the Vendor has contest rights under this Agreement. In addition:

(i) the Vendor shall keep the Purchaser duly informed of any proceedings in connection with any matter which may affect the Taxes payable by the Purchaser or the Corporation; and

(ii) the Purchaser shall be promptly provided with copies of all correspondence and documents relating to those proceedings and may, at its option and its own expense, participate in those proceedings through counsel of its choice.

8.7 **Indemnification Procedures**. Except to the extent expressly provided to the contrary in this Article VIII, the general procedures regarding notice and pursuit of indemnification Claims set forth in Article XII shall apply to all Claims for indemnification made under this Article VIII, except that notwithstanding any provision of Article XII to the contrary, if a Claim for indemnification involves any matter covered in this Article VIII, then the contest provisions of Sections 8.5 and 8.6, as applicable, shall control regarding the defence and handling of any such third party Claim that could give rise to an indemnification obligation on the part of the Vendor. Notwithstanding Article IV, the time period during which a Claim for indemnification may be made under this Article VIII or Section 3.1(u) shall survive Closing and continue in full force and effect until, but not beyond, the one hundred and eightieth (180th) day following the expiration of the period, if any, during which an assessment, reassessment or other form of recognized document assessing liability for Taxes under applicable Tax legislation in respect of any taxation year to which those representations and warranties and provisions under this Article VIII and Section 3.1(v) could be issued under that Tax legislation to the Corporation. Claims for indemnification regarding Tax matters shall not be subject to the limits set out in Article XII.

ARTICLE IX
CONDITIONS OF CLOSING

9.1 **Conditions of Closing in Favour of the Purchaser**. The Transaction including sale and purchase of the Purchased Shares are subject to the following conditions for the exclusive benefit of the Purchaser, to be fulfilled or performed at or prior to Closing:

(a) **Representations and Warranties**. The representations and warranties of the Vendor contained in this Agreement which are qualified as to materiality shall be true and correct and those not qualified as to materiality shall be true and correct in all material respects at Closing, with the same force and effect as if such representations and warranties were made at and as of such time, and a certificate of two (2) senior officers of the Vendor dated the Closing Date to that effect shall have been delivered to the Purchaser.

(b) **Covenants**. All of the obligations, covenants and agreements contained in this Agreement to be complied with or performed by the Vendor at or prior to Closing shall have been complied with or performed, and a certificate of two (2) senior officers of the Vendor dated the Closing Date to that effect shall have been delivered to the Purchaser.

(c) **Consents and Required Approval**. There shall have been obtained, from all appropriate Persons such consents as listed in Schedule 9.1(c), as may be required in connection with the completion of the Transaction, including without limitation, the Required Approval.

(d) **No Action to Restrain**. No order of any court of competent jurisdiction or administrative agency shall be in existence and, no action or proceeding shall be pending or threatened in writing by any Person, to restrain or prohibit:

(i) the purchase and sale of the Purchased Shares; or

(ii) any of the Corporation from carrying on the Business as the Business is being carried on as at the date hereof.

(e) **Material Adverse Effect**. There shall not have occurred any Material Adverse Effect since the date of this Agreement.

(f) **Resignation of Directors**. All directors and officers of the Corporation shall have tendered their resignations and each such individual and the Vendor shall have duly executed and delivered comprehensive releases of all their claims (other than in respect of unpaid salaries and accrued vacation pay and rights to indemnity) respectively against the Corporation.

(g) **No Transfer Tax Payable**. Neither the Vendor nor the City shall be liable for transfer tax, imposed under section 94 of the EA or similar legislation under any successor statute, in relation to the sale or purchase of the Purchased Shares.

If any of the conditions contained in this Section 9.1 shall not be performed or fulfilled at or prior to the Closing or any other timeframe specified above to the satisfaction of the Purchaser, acting reasonably, the Purchaser may, by notice to the Vendor, terminate this Agreement and the obligations of the Vendor and the Purchaser under this Agreement, or if the Vendor terminates this Agreement because of a failure of conditions 9.1(c) or (d) or because the Vendor or City would be liable for transfer tax in relation to the sale of the Purchased Shares, then in any such event the Purchaser shall be released from all obligations hereunder except those set forth in Section 6.10 and in the Confidentiality Agreement and the Vendor shall direct the Vendor's solicitor to refund the Deposit and all accrued interest thereon to the Purchaser and Purchaser shall be released from all obligations hereunder. Any such condition may be waived in whole or in part by the Purchaser without prejudice to any claims it may have for breach of such condition.

9.2 **Conditions of Closing in Favour of the Vendor**. The purchase and sale of the Purchased Shares is subject to the following terms and conditions for the exclusive benefit of the Vendor, to be fulfilled or performed at or prior to Closing:

(a) **Representations and Warranties**. The representations and warranties of the Purchaser contained in this Agreement which are qualified as to materiality shall be true and correct and those not qualified as to materiality shall be true and correct in all material respects at Closing, with the same force and effect as if such representations and warranties were made at and as of such time, and a certificate of two (2) senior officers of the Purchaser dated the Closing Date to that effect shall have been delivered to the Purchaser.

(b) **Covenants**. All of the obligations, covenants, and agreements contained in this Agreement to be complied with or performed by the Purchaser at or prior to Closing shall have been complied with or performed, and a certificate of a senior officers of the Purchaser dated the Closing Date to that effect shall have been delivered to the Vendor.

(c) **Consents and Required Approval**. There shall have been obtained, from all appropriate Persons such consents as listed in Schedule 9.2(c), as may be required in connection with the completion of the Transaction, including without limitation, the Required Approval.

(d) **No Action to Restrain**. No order of any court of competent jurisdiction or administrative agency shall be in existence and, no action or proceeding shall be pending or threatened in writing by any Person, to restrain or prohibit the purchase of the Purchased Shares.

(e) **No Transfer Tax Payable**. Neither the Vendor nor the City shall be liable for transfer tax, imposed under section 94 of the EA or similar legislation under any successor statute, in relation to the sale of the Purchased Shares.

If any of the conditions in this Section 9.2 shall not be performed or fulfilled at or prior to Closing to the satisfaction of the Vendor, acting reasonably, the Vendor may, by notice to the Purchaser, terminate this Agreement and the obligations of the Vendor and the Purchaser under this Agreement, and in such event the Vendor shall be released from all obligations hereunder except those set forth in the Confidentiality Agreement and the Vendor shall be entitled to the Deposit and accrued interest thereon only in circumstances resulting in termination for failure of performance or fulfillment by the Purchaser of the conditions listed in Section 9.2(a) and 9.2(b), as its sole and exclusive remedy for all matters arising out of this Agreement and Purchaser shall be released from all obligations hereunder. In the event of termination for failure of any other condition in Section 9.2, the Purchaser shall be entitled to the Deposit and accrued interest as if there was a failure of a condition in Section 9.1. Any such condition may be waived in whole or in part by the Vendor without prejudice to any Claims it may have for breach of such condition.

ARTICLE X
CLOSING ARRANGEMENTS

10.1 **Place of Closing**. The closing shall take place on the Closing Date at the offices of the Purchaser at Toronto, Ontario.

10.2 **Transfer**. On Closing, upon fulfilment of all the conditions set out in Article IX that have not been waived in writing by the Purchaser or the Vendor, the Vendor shall deliver to the Purchaser certificates representing all the Purchased Shares, duly endorsed in blank for transfer and will cause transfers of such shares to be duly and regularly recorded in the name of the Purchaser whereupon, subject to all other terms and conditions hereof being complied with, payment of the Purchase Price shall be paid and satisfied in the manner provided in Article II.

ARTICLE XI
ARBITRATION

11.1 **Arbitration.**

(a) Any dispute, controversy or claim arising out of or in connection with, or relating to, this Agreement, including the Confidentiality Agreement, or the performance, breach, termination or validity thereof, shall be finally settled by arbitration. Either Party may initiate arbitration within a reasonable time after any such dispute, controversy or claim has arisen, by delivering a written demand for arbitration upon the other Party. The arbitration shall be conducted in accordance with the *Arbitration Act*, 1991 (Ontario). The arbitration shall take place in Toronto, Ontario, and shall be conducted in English.

(b) The arbitration shall be conducted by a single arbitrator having no financial or personal interest in the outcome of the arbitration. The arbitrator shall be appointed jointly by agreement of the Parties. In the event the Parties are unable to agree on the appointment of the arbitrator within ten (10) days after notice of a demand for arbitration is given by either Party, then either Party shall be free to apply to the Superior Court of Ontario for an Order appointing the arbitrator. Absent agreement or an award in the arbitration to the contrary, the arbitration fees and expenses shall be paid by the Parties jointly.

(c) The arbitrator shall have the authority to award any remedy or relief that a court could order or grant in accordance with this Agreement, including, without limitation, specific performance of any obligation created under this Agreement, the issuance of an interim, interlocutory or permanent injunction, or the imposition of sanctions for abuse or frustration of the arbitration process.

(d) The arbitral award shall be in writing, stating the reasons for the award and be final and binding on the Parties with no rights of appeal. The award may include an award of costs, including reasonable legal fees and disbursements and fees and expenses of the arbitrator. Judgment upon the award may be entered by any court having jurisdiction thereof or having jurisdiction over the relevant Party or its assets.

ARTICLE XII
INDEMNIFICATION

12.1 **Indemnification by the Vendor**. Subject to the limitations contained in Section 4.1 respecting survival of the representations and warranties of the Parties and to Sections 12.5 and 12.7, the Vendor covenants and agrees to indemnify and save harmless the Purchaser and its Affiliates (the "**Purchaser Indemnified Parties**") effective as and from the Closing Time, from all Losses suffered by a Purchaser Indemnified Party as a result of all Claims which may be made or brought against a Purchaser Indemnified Party, including Claims or Losses suffered by a Purchaser Indemnified (or made or brought by a Purchaser Indemnified Party against the Vendor pursuant to this Agreement) or the Corporation as a result of or arising directly or indirectly out of or in connection with:

(a) any breach by the Vendor of or any inaccuracy of any representation or warranty contained in this Agreement or in any agreement, instrument, certificate or other document delivered pursuant hereto;

(b) any breach or non-performance by the Vendor of any covenant to be performed by it that is contained in this Agreement or in any agreement, certificate or other document delivered pursuant hereto; and

(c) any Claim or Losses in connection with the Corporation or the Business to the extent the circumstances giving rise thereto arose on or prior to Closing.

12.2 **Indemnification by the Purchaser**. Subject to the limitations contained in Section 4.1 respecting survival of the representations and warranties of the Parties and to Section 12.5 and 12.7, the Purchaser agrees to indemnify and save harmless the Vendor from all Losses suffered or incurred by the Vendor as a result of or arising directly or indirectly out of or in connection with any Claim relating to:

(a) any breach by the Purchaser of or any inaccuracy of any representation or warranty contained in this Agreement or in any agreement, instrument, certificate or other document delivered pursuant hereto;

(b) any breach or non-performance by the Purchaser of any covenant to be performed by it that is contained in this Agreement or in any agreement, certificate or other document delivered pursuant hereto; and

(c) the operations of the Business and the ownership of the Purchased Shares in respect of the period after Closing.

12.3 **Notice of Claim**. In the event that a Party (the "**Indemnified Party**") shall become aware of any Claim in respect of which the other Party (the "**Indemnifying Party**") agreed to indemnify the Indemnified Party pursuant to this Agreement, the Indemnified Party shall promptly give written notice thereof to the Indemnifying Party. Such notice shall specify whether the Claim arises as a result of a claim by a third party (a "**Third Party**") against the Indemnified Party (a "**Third Party Claim**") or whether the Claim does not so arise (a "**Direct Claim**"), and shall also specify with reasonable particularity (to the extent that the information is available):

(a) the factual basis for the Claim; and

(b) the amount of the Claim, if known.

If, through the fault of the Indemnified Party, the Indemnifying Party does not receive notice of any Claim in time to effectively contest the determination of any liability susceptible of being contested, the Indemnifying Party shall be entitled to set off against the amount claimed by the Indemnified Party the amount of any Losses incurred by the Indemnifying Party resulting from the Indemnified Party's failure to give such notice on a timely basis.

12.4 **Direct Claims**. With respect to any Direct Claim, following receipt of notice from the Indemnified Party of the Claim, the Indemnifying Party shall have thirty (30) days to make such investigation of the Claim as is considered necessary or desirable. For the purpose of such investigation, the Indemnified Party shall make available to the Indemnifying Party the information relied upon by the Indemnified Party to substantiate the Claim, together with all such other information as the Indemnifying Party may reasonably request. If both parties agree at or prior to the expiration of such thirty (30) day period (or any mutually agreed upon extension thereof) to the validity and amount of such Claim, the Indemnifying Party shall immediately pay to the Indemnified Party the full agreed upon amount of the Claim, failing which the matter shall be referred to binding arbitration in such manner as the parties may agree or shall be determined by a court of competent jurisdiction.

12.5 **Third Party Claims**. With respect to any Third Party Claim, the Indemnifying Party shall have the right, at its expense, to participate in or assume control of the negotiation, settlement or defence of the Claim and, in such event, the Indemnifying Party shall reimburse the Indemnified Party for all the Indemnified Party's out of pocket expenses as a result of such participation or assumption. If the Indemnifying Party elects to assume such control, the Indemnified Party shall have the right to participate in the negotiation, settlement or defence of such Third Party Claim and to retain counsel to act on its behalf, provided that the fees and disbursements of such counsel shall be paid by the Indemnified Party unless the Indemnifying Party consents to the retention of such counsel or unless the named parties to any action or proceeding include both the Indemnifying Party and the Indemnified Party and a representation of both the Indemnifying Party and the Indemnified Party by the same counsel would be inappropriate due to the actual or potential differing interests between them (such as the availability of different defences). If the Indemnifying Party, having elected to assume such control, thereafter fails to defend the Third Party Claim within a reasonable time, the Indemnified Party shall be entitled to assume such control and the Indemnifying Party shall be bound by the results obtained by the Indemnified Party with respect to such Third Party Claim. If any Third Party Claim is of a nature such that the Indemnified Party is required by applicable law to make a payment to any Third Party with respect to the Third Party Claim before the completion of settlement negotiations or related legal proceedings, the Indemnified Party may make such payment and the Indemnifying Party shall, forthwith after demand by the Indemnified Party, reimburse the Indemnified Party for such payment. If the amount of any liability of the Indemnified Party under the Third Party Claim in respect of which such a payment was made, as finally determined, is less than the amount that was paid by the Indemnifying Party to the Indemnified Party, the Indemnified Party shall, forthwith after receipt of the difference from the Third Party, pay the amount of such difference to the Indemnifying Party.

12.6 **Settlement of Third Party Claims**. If the Indemnifying Party fails to assume control of the defence of any Third Party Claim, the Indemnified Party shall have the exclusive right to contest, settle or pay the amount claimed. Whether or not the Indemnifying Party assumes control of the negotiation, settlement or defence of any Third Party Claim, the Indemnifying Party shall not settle any Third Party Claim without the written consent of the Indemnified Party, which consent shall not be unreasonably withheld or delayed; provided, however, that the liability of the Indemnifying Party shall be limited to the proposed settlement amount if any such consent is not obtained for any reason.

12.7 **Limitation on Claims.**

(a) Subject to Section 8.7 and notwithstanding Sections 12.1 and 12.2:

- (i) no Claim for indemnification hereunder may be made by the Purchaser against the Vendor, except for breach of a covenant contained in Article V, until the aggregate amount of Claims in respect of which the Purchaser may so claim exceeds three million dollars ($3,000,000) (the "**Deductible**"), and then only for the amount of any Claims exceeding the Deductible;

- (ii) the maximum aggregate amount of indemnification exceeding the Deductible which may be payable by the Vendor under this Agreement for matters other than breach of covenant contained in Article V or Taxes, shall not exceed an aggregate of three million dollars ($3,000,000), for any reason whatsoever; and

- (iii) if any payment made pursuant to this Article XII is subject to HST (or other applicable Tax) or is deemed by Applicable Law to be inclusive of HST (or other applicable Tax), the Indemnifying Party shall pay to the Indemnified Party an amount equal to the HST (or other applicable Tax) in connection with the payment and any additional amount hereunder.

(b) Neither Party shall be required to indemnify or save harmless the other Party in respect of any breach or inaccuracy of any representation or warranty made under Article III (except with respect to Section 3.1(x) TAX) unless notice is provided by the Indemnified Party to the Indemnifying Party in accordance with Section 12.3 on or prior to the expiration of the applicable time period related to such representation and warranty as set out in Article XII.

(c) The Indemnifying Party shall only be liable for Losses suffered by the Indemnified Party in respect of a Claim after taking into account:

(i) insurance proceeds received by the Indemnified Party in respect of the occurrence giving rise to the Claim; and

(ii) Tax benefits accruing to the Indemnified Party relating to the actions taken by the Indemnified Party in respect of the Claim.

12.8 **Exclusivity**. The provisions of this Article XII shall apply, subject to Article VIII, to any Claim for or in respect of any breach of any covenant, representation, warranty, indemnity or other provision of this Agreement or any agreement, certificate or other document delivered pursuant to this Agreement (other than a claim for specific performance or injunctive relief) with the intent that all such Claims shall be subject to the limitations and other provisions contained in this Article XII except as otherwise expressly set out.

12.9 **Special Indemnities.** The Vendor shall indemnify the Purchaser and its affiliates with respect to the following matters and shall provide such indemnity in a stand-alone form on Closing:

(a) Losses related to having formerly held registered title to or occupied the City Property;

(b) Losses associated with operations from 15 Industrial St. prior to Closing or with adverse environmental conditions in or around the property originating prior to Closing, such indemnity limited to Losses discovered within 10 years of Closing;

(c) Losses associated with the presence of chlorinated solvent known to exist in or near 188 Jarvis St.

(d) Losses associated with claims made against the Corporation arising from the transfer to the Corporation of obligations of Orillia Water Light and Power pursuant to transfer by-laws made pursuant to the EA; and

(e) With respect to the absence of valid and enforceable customary easement rights in perpetuity for Distribution Facilities (excluding stations) located on property other than the public road allowance, the cost of obtaining such easement rights according to Purchaser's schedule of costs or if Purchaser is unable to obtain such rights at such price despite reasonable good faith efforts, the cost of relocating the plant and obtaining such easement rights in the new location, provided that before relying on this indemnity, Purchaser shall apply to the OEB for a regulatory deferral account specific to the amounts for which Purchaser would otherwise be so indemnified pursuant hereto, and if successful, Vendor's obligation to indemnify shall be limited to amounts not permitted to be included in the account and amounts accruing in such deferral account but not dispositioned as a rate rider to be recovered after the ten year period following Closing. Purchaser may rely on this indemnity only to the extent Purchaser has not initiated discussions to rectify the Distribution Facility occupancy with the property owner. This indemnity obligation shall terminate ten years following Closing.

Notwithstanding any other provision of this Agreement, the provisions of Section 12.7 shall not apply to indemnities under this Section 12.9. For greater certainty, the guarantee of the City shall apply to performance of this indemnity obligation.

12.10 **Duty to Mitigate**. Nothing in this Agreement in any way restricts or limits the obligation under Applicable Laws of an indemnified party to mitigate any loss which it may suffer or incur by reason of any breach by an indemnifying party of any representation, warranty, covenant or obligation of the indemnifying party under this Agreement.

ARTICLE XIII
MISCELLANEOUS

13.1 **Further Assurances**. Each Party to this Agreement covenants and agrees that, from time to time subsequent to the Closing Date, it will, at the request and expense of the requesting Party, execute and deliver all such documents, including, without limitation, all such additional conveyances, transfers, consents and other assurances and do all such other acts and things as any other party hereto, acting reasonably, may from time to time request be executed or done in order to better evidence or perfect or effectuate any provision of this Agreement or of any agreement or other document executed pursuant to this Agreement or any of the respective obligations intended to be created hereby or thereby.

13.2 **Announcements**. The Parties shall make a joint public announcement with respect to this Agreement and the transactions herein contemplated, at such time and in such manner as may be mutually agreed upon by the Parties. Except as required by law, no other public announcement, press release, notices, statements and communications to third parties shall be made by either Party hereto without the prior consent and approval of the other Party, provided that the Parties hereby acknowledge that the Parties may be compelled to disclose details of this Agreement and the Transactions contemplated herein in respect of the OEB Approval and that the Vendor or the Purchaser may be compelled to disclose details of this Agreement and the Transactions herein contemplated pursuant to the *Municipal Freedom of Information and Protection of Privacy Act* (Ontario) or the *Freedom of Information and Protection of Privacy Act* (Ontario).

13.3 **Brokerage, Commissions, etc.** It is understood and agreed that no broker, agent or other intermediary has acted for the Vendor, the City, the Corporation or the Purchaser, in connection with the transaction herein contemplated. The Vendor agrees to indemnify and save harmless the Purchaser from and against any claim for commission or other remuneration payable or alleged to be payable to any broker, agent or other intermediary who purports to act or to have acted for the Vendor or the City in connection with the transactions herein contemplated.

The Purchaser agrees to indemnify and save harmless the Vendor from and against any claim for commission or other remuneration payable or alleged to be payable to any broker, agent or other intermediary, who purports to act or to have acted for the Purchaser in connection with the transactions herein contemplated.

13.4 **Notices.**

(a) Any notice or other communication required or permitted to be given hereunder shall be in writing and shall be delivered in person, transmitted by telecopy or sent by registered mail, charges prepaid, addressed as follows:

(i) if to the Vendor or City:

50 Andrew Street South
Suite 300
Orillia, ON L3V 7T5
Attention: Chief Administrative Officer

(ii) if to the Purchaser:

Hydro One Inc.
483 Bay Street
Toronto, ON M5G 2P5
Attention: General Counsel

Fax No.: (416) 345 6056

(b) Any such notice or other communication shall be deemed to have been given and received on the day on which it was delivered or transmitted (or, if such day is not a Business Day, on the next following Business Day) or, if mailed, on the third Business Day following the date of mailing; provided, however, that if at the time of mailing or within three Business Days thereafter there is or occurs a labour dispute or other event that might reasonably be expected to disrupt the delivery of documents by mail, any notice or other communication hereunder shall be delivered or transmitted by telecopy as aforesaid.

(c) A Party may at any time change its address for service from time to time by giving notice to the other parties in accordance with this Section 13.4.

13.5 **Best Efforts.** The Parties acknowledge and agree that, for all purposes of this Agreement, an obligation on the part of the Party to use its best efforts (which shall not be less than commercially reasonable efforts) to obtain any waiver, consent, approval, permit, licence or other document shall not require such Party to make any payment to any person for the purpose of procuring the same, other than payments for amounts due and payable to such person, payments for incidental expenses incurred by such person and payments required by any applicable law or regulation.

13.6 **Costs and Expenses**. Except as otherwise provided for herein, all costs and expenses (including, without limitation, the fees and disbursements of legal counsel) incurred in connection with this Agreement and the transactions herein contemplated shall be paid by the Party incurring such costs and expenses.

13.7 **Counterparts**. This Agreement may be executed in counterparts, each of which shall constitute an original and all of which taken together shall constitute one and the same instrument.

13.8 **Vendor Guarantee**. The City guarantees the full and prompt payment and performance by Vendor of Vendor's obligations hereunder.

[SIGNATURE PAGES FOLLOW]

IN WITNESS WHEREOF this Agreement has been executed by the Parties.

THE CORPORATION OF THE CITY OF ORILLIA

By: ______________________
Name:
Title: Mayor

By: ______________________
Name: Gayle Jackson
Title: City Clerk

ORILLIA POWER CORPORATION

By: ______________________
Name: PAT HURLEY
Title: CEO OPC

HYDRO ONE INC.

By: ______________________________________

Name: Mayo Schmidt

Title: President and Chief Executive Officer

SCHEDULE 1.1(ZZZ) – PERMITTED ENCUMBRANCES

1. Instrument No. RO1438096 registered June 2, 2000 is a Transfer of Easement;
2. Instrument No. SC877594 registered January 13, 2011 is a Transfer containing a reservation;
3. Instrument No. SC950244 registered December 6, 2011 is a Transfer of Easement;
4. Instrument No. SC950245 registered December 6, 2011 is a Transfer of Easement;
5. Instrument No. SC950246 registered December 6, 2011 is a Transfer of Easement;
6. Instrument No. RO204275 registered June 15, 1965 is a Bylaw;
7. Instrument No. RO256979 registered November 16, 1967 is a Bylaw;
8. Instrument No. RO854223 registered December 18, 1981 is a Transfer of Easement;
9. 4600 Uhtoff Line (Fittons Substation lands) – unregistered interest in favour of Rogers Communications relating to a point of presence shelter and related equipment in regards to an agreement dated July 1, 2002 between SCBN Telecommunications Inc. and Orillia Power Distribution Corporation and the rights derived therefrom;
10. 306 Peter Street North (North Substation lands) – license agreement to be entered into between Orillia Power Distribution Corporation and Orillia Power Generation Corporation (in favour of Orillia Power Generation Corporation) relating to telecommunications equipment currently situated within the fenced in substation portion of the lands, which telecommunications equipment shall be relocated to a mutually acceptable location outside of the fenced in portion of the substation lands;
11. 15 Industrial Street:

    a. use by Rogers relating to a point of presence shelter relating to a point of presence shelter and related equipment in regards to an agreement dated April 13, 2005 between SCBN Telecommunications Inc. and Orillia Power Distribution Corporation and the rights derived therefrom; and

    b. license agreement to be entered into between Orillia Power Distribution Corporation, Ontario Provincial Police, the City and Orillia Power Generation Corporation relating to the use of a telecommunications tower and related equipment (including anchors and guy wires) used by Ontario Provincial Police and the City and Orillia Power Generation Corporation (as the case may be) relating to a joint use agreement dated November 1997.

SCHEDULE 2.4(A) – PURCHASE PRICE ADJUSTMENTS

OPDC - Illustrative Purchase Price and Closing Adjustment *DRAFT July 26th, 2016*

(Note: Audited Financials as of December 31, 2015 for Orillia Power Distribution Corporation)

Purchase Price Summary			
	Purchase Price	Illustrative Purchase Price Adjustment	Illustrative Adjusted Purchase Price
Purchase Price	$26,350,000	$900,000	$27,250,000
Purchase Price Adjustment - SPA Definitions			
SPA Definitions	OPDC 2015A F/S 12/31/2015	Illustrative Closing Financial Statements	Illustrative Purchase Price Adjustment
Working Capital Calculation	$416,000	$516,000	$100,000
NFA Calculation (1.1x NFA Index Multiplier)	$22,545,000	$23,545,000	$1,100,000
Long Term Debt Calculation	$10,497,000	$10,997,000	($500,000)
Regulatory Accounts Calculation	($825,000)	($625,000)	$200,000
			$900,000
Supporting Calculations			
	OPDC 2015A F/S 12/31/2015	Illustrative Closing Financial Statements	Illustrative Purchase Price Adjustment
Working Capital Calculation - SPA Definition			
Cash	n/a	n/a	
Accounts receivable	$3,419,000	$3,419,000	
Unbilled energy and distribution revenue	$4,153,000	$4,153,000	
Payment in lieu of taxes receivable	$0	$0	
Inventories	$501,000	$501,000	
Prepaid expenses	$170,000	$170,000	
Due from related parties	$867,000	$867,000	
Other Current Assets	$0	$0	
Current Assets	$9,110,000	$9,110,000	
Bank indebtedness	$2,000,000	$2,000,000	
Accounts payable and accrued liabilities	$5,759,000	$5,659,000	
Payment in lieu of taxes payable	$217,000	$217,000	
Customer security deposits	$133,000	$133,000	
Current portion of long term debt	$210,000	$210,000	
Due to related parties	$55,000	$55,000	
Other Current Liabilities	$0	$0	
Customer security deposits	$320,000	$320,000	
Current Liabilities & Customer Deposits	$8,694,000	$8,594,000	
Working Capital - (Assets net Liabilities)	$416,000	$516,000	$100,000
NFA Calculation - SPA Definition			
Property, plant and equipment	$23,586,000	$24,586,000	
Intangable assets	$125,000	$125,000	
Less: Deferred revenue	($1,166,000)	($1,166,000)	
NFA	$22,545,000	$23,545,000	$1,000,000
NFA Index			1.1x
			$1,100,000
Long Term Debt Calculation - SPA Definition			
Long term debt	$10,497,000	$10,997,000	
Long Term Debt	$10,497,000	$10,997,000	($500,000)
Regulatory Accounts Calculation - SPA Definition			
Regulatory deferral account debit balances	$2,162,000	$2,162,000	
Regulatory deferral account credit balances	($2,987,000)	($2,787,000)	
Net Regulatory Accounts - Asset/(Liability) balance	($825,000)	($625,000)	$200,000

1

SCHEDULE 3.1(G) – SUBSIDIARIES

The Corporation held a 1.231% ownership interest in EnerConnect (a settlement services provider). The Corporation sold all of its interest in 2007.

SCHEDULE 3.1(L) - REAL PROPERTY, LEASED PROPERTY AND EASEMENTS

	Description	PIN/Postal Code
	Real Property	
1.	Westmount Substation – 347 Mississauga Street, Orillia, ON	PIN 58638-0137 (LT)
2.	Jarvis Substation – 188 Jarvis Street/Cowen Street, Orillia, ON	PIN 58663-0068 (LT)
3.	Lakeview Substation – 450 Sundial Drive, Orillia, ON	PIN 58622-0057 (LT)
4.	North Substation – 306 Peter Street North, Orillia, ON	PIN 58658-0032 (LT)
5.	Central Substation – 24 Market Street, Orillia, ON	PIN 58650-0205 (LT)
6.	Progress Park Substation – 44/45 Wood Land Drive, Orillia, ON	PIN 58569-0012 (LT)
7.	Vacant land – Couchiching Point Area	PIN 58686-0093 (LT)
8.	Fittons Substation – 4600 Uhtoff Line	PIN 58574-0037 (LT)
9.	15 Industrial St., namely Parts 6 and 9 on draft reference plan prepared by Dearden and Stanton Ltd., Ontario Land Surveyors dated July 21, 2016 (CAD File: RF26926/D-2711, revised August 8, 2016)	Part of PIN 58670-0027 (LT) re Part 6 and Part of PIN 58670-0028 (LT) re Part 9
10.	James St. Substation – 372 West St. S., namely Part 1 on draft reference plan prepared by Dearden and Stanton Ltd., Ontario Land Surveyors dated July 25, 2016 (CAD File: PT26925/C-8077)	Part of PIN 58671-0047 (LT)
	Leased Property	
1.	Nil	
	Easements	
1.	See below	
2.	Ontario Ministry of Natural Resources Underwater Electric Power Cable Licence of Occupation No. 9381 dated December 22, 1981	Part 1, Water Lot Location CL 2646, Township of Orillia Southern Division

Other Uses		
1.	4600 Uhtoff Line (Fittons Substation lands) – unregistered interest in favour of Rogers Communications relating to a point of presence shelter and related equipment in regards to an agreement dated July 1, 2002 between SCBN Telecommunications Inc. and Orillia Power Distribution Corporation and the rights derived therefrom	
2.	306 Peter Street North (North Substation lands) – license agreement to be entered into between Orillia Power Distribution Corporation and Orillia Power Generation Corporation (in favour of Orillia Power Generation Corporation) relating to telecommunications equipment currently situated within the fenced in substation portion of the lands, which telecommunications equipment shall be relocated to a mutually acceptable location outside of the fenced in portion of the substation lands	
3.	15 Industrial Street: (a) use by Rogers relating to a point of presence shelter relating to a point of presence shelter and related equipment in regards to an agreement dated April 13, 2005 between SCBN Telecommunications Inc. and Orillia Power Distribution Corporation and the rights derived therefrom (b) license agreement to be entered into between Orillia Power Distribution Corporation, Ontario Provincial Police, the City and Orillia Power Generation Corporation relating to the use of a telecommunications tower and related equipment (including anchors and guy wires) used by Ontario Provincial Police and the City and Orillia Power Generation Corporation (as the case may be) relating to a joint use agreement dated November 1997.	

EASEMENTS

Address	PIN	INSTR. No.
16 Andrew Street Orillia, ON	58650-0165 (LT) Plan 51R37619	SC950248 SC950247 R0317270

155 Atherley Road Orillia, ON	Registered Plan 388 Lot 3	N/A
161 Atherley Road Orillia, ON	Registered Plan 388 Lot 4	N/A
167 Atherley Road Orillia, ON	Registered Plan 388 Lot 6	N/A
171 Atherley Road Orillia, ON	Registered Plan 388 Lot 7	N/A
177 Atherley Road Orillia, ON	Registered Plan 388 Lot 7	N/A
181 Atherley Road Orillia, ON	Registered Plan 388 Lot 8	N/A
235 Atherley Road Orillia, ON	Registered Plan 559 Part Lot 1	N/A
354 Atherley Road	58686-0092, 58686-0076, 58686-0060 Plan 51R37559	
679 Atherley Road Orillia, ON	Registered Plan 292 Lot	246368
240 Barrie Road Orillia, ON	Registered Plan 964 Lot 77	
441 Barrie Road Orillia, ON	59012-0001 (LT) to 59012-0084 (LT) Condo Pl 12	SC1167745 (Common Elements)
1 Brammer Drive Orillia, ON	58621 - 009LT Plan 51R38579 Lot 4, Con 6 Parts 1, 3, 4, 5, 6, 7, 9, 10 & 11 58621 - 009LT Plan 51R38579 Parts 5, 7, 8, 9, 10, 11, 12 & 13	SC1063108 SC1063161
23 Brammer Drive Orillia, ON	58621 - 0033(LT) Plan 51R39957	SC1213547
24 Brammer Drive Orillia, ON	58621 - 0025(LT) Plan 51R20329	SC556451
25 Brant St. Orillia, ON	58655-0066 (LT) **Now 58655-0145 (LT)** Plan 51R-36116	SC660205 SC660206
760-770 Broadview Ave Orillia, ON	Plan 51R-5499 + 51R5129	SC560491
Canterbury Circle (591 Sundial Drive) Orillia, ON	58626-0362(LT), 58626-0339 Plan 51M973	SC925730 SC919253

4040 Carlyon Line Orillia, ON	58576-002	94922
25 Cedar Island Road Orillia, ON	Plan 51R-31235, 51R-31497	SC103275, SC103394
151 Cedar Island Road (SC613333) Orillia, ON	58669-0058(LT) Plan 51R-31235	N/A
162 Cedar Island Road Orillia, ON	Plan 51R-29599	N/A
17 Coldwater Road Orillia, ON	Plan No 180, Plan 51R-13565	N/A
26 Coldwater Street Orillia, ON	Plan 8 Lot 2 to 3 Ptd. Lot 4 Drawing X-2223	N/A
31 Coldwater Road Orillia, ON	51E-25831	SC533430
51 Coldwater Road Orillia, ON	Reg Plan 137 Lot 7 Dwg X8-994	N/A
54 + 60 Coldwater Street Orillia, ON	Plan 8, Lot 8 Part 9S	N/A
93 Coldwater Street E Orillia, ON	Plan 51R-7773	N/A
188 Coldwater Road Orillia, ON	PIN 58654-0060 & 58654-0122	SC802928
293 Coldwater Road Orillia, ON	Plan R189-B	N/A
1 Commerce Road Orillia, ON	58626-0005(LT) Plan 51R-34166	SC419149
5 Commerce Road Orillia, ON	58626-005(LT) Plan 51R-34166	N/A
77 - 111 Commerce Road + 611 Sundial Dr. Orillia, ON	Plan 51R7981	N/A
24 Colborne St Orillia, ON	58667-0088, 58667-0126, 58667-0127, 58667-0091, Plan 51R32181	N/A
170 Colborne St Orillia, ON	Plan R893	N/A
Couchiching Point Road Orillia, ON	Plan 51R-7667	637012 & 637018
440 Couchiching Point Road Orillia, ON	Plan 51R6824	RO619959

2 Elmer Ave. Orillia, ON	Plan R964, Lot 73	N/A
9 Ferguson Road Orillia, ON	58577-0125 (LT) Plan 51R386553	N/A
9 Ferguson Road Orillia, ON	58577-0125 (LT) Plan 51R38663	N/A
38 Fittons Heights Orillia, ON	N/A	N/A
52 Fittons Road East Orillia, ON	58628-0054(LT) **Now 58628-0082(LT)** Plan 51R-33634	SC331648
Fittons Road East 1/2 Lot 5 Con 4 Orillia, ON	N/A	N/A
440 Forest Avenue N Orillia, ON	58684-0029(LT) Plan 51R-34163	N/A
Forest Home - PT LT 12 Con 2 Orillia, ON	58570-0015(LT) Plan 51R-33479	N/A
282 Franklin Street Orillia, ON	58675-0211(LT) Plan 51R-30458	N/A
2 Front Street N Orillia, ON	Plan 51R-7900	N/A
2 Front Street S Orillia, ON	Plan X-2245	N/A
9 + 25 Front Street N Orillia, ON	58667-0156, 58667-0156(LT) Plan 51R13701, 51R31703	SC298176, SC6824 SC298240, RO1039171
51 Front Street N Orillia, ON	1360506 Plan 51R-27125	N/A
150 Front Street (part 11) Orillia, ON	58670-0013, 58670-0012, 58670-0010 Plan 51R-21771, 51R-29148	N/A
180 + 182 Front Street S Orillia, ON	58670-0013, 58670-0012, 58670-0010 Plan 51R-29148, 133, 51R-21771 Lot 4,8,9,11	397827
Front Street S CPR Right of Way Orillia, ON	N/A	N/A
Grape Island Lot 1 + 2 Orillia, ON	N/A	N/A
Grape Island Lot 3 Orillia, ON	N/A	N/A
Grape Island Lot 5 Orillia, ON	Plan # 948	N/A

248 Hilda Street Orillia, ON	58675-0081(LT) Plan 51R-27454	SC899053
1 Hunter Valley Road Orillia, ON	58633-0005(LT) Plan 51R-37258	SC878611
Huronia Road (Boyles Industries) Orillia, ON	Plan 51R-12544	836740
475 Huronia Road Orillia, ON	N/A	N/A
4535 Huronia Road Orillia, ON	58621-009(LT) Plan 51R38579 Plan 51R-38579	SC42568, SC1063108 RO1103668
Industrial Street Orillia, ON	58670-0112(LT) Plan 51R-36244 Part 1	SC698666
15 Industrial Street Orillia, ON	58670-0026(LT), 58670-0027(LT) 58670-0028(LT), 58574-0037(LT) Plan 51R20312	SC389000, SC389001 SC389002, RO443432
5 Invermara Court Orillia, ON	58684-0269(LT) Plan 51R-32424	N/A
10 Invermara Court Orillia, ON	58684-0348 Plan 51R34511	SC651477
1 James Street W Orillia, ON	E-26 Dwg. X-1361	N/A
175 James Street E Orillia, ON	58642-0017(LT) Plan 51R-39908	SC1220883
275 James Street Orillia, ON	58675-0211(LT) Plan 51R-30458	1461035
188 Jarvis Street Orillia, ON	58663-0027(LT), 58663-0067(LT) Plan 51R35886	SC6650272
Jarvis Street + Cowan Orillia, ON	Plan 51R33242	OR122904
100 King Street Orillia, ON	Dwg X8-1039	N/A
6 Kitchener Street Orillia, ON	58568-0034(LT) Plan 51R-36095	SC660482
338 MacIsaac Drive Orillia, ON	58684-0064(LT) Plan 51R-35590	SC623196
24 Market Street Orillia, ON	58650-0179(LT), 58650-0185(LT) Plan R51R38085	SC950249
24 Market Street Orillia, ON	58650-0046(LT) Plan R51R38085	SC950244

18 Matchedash Street North Orillia, ON	58667-0059(LT) Plan 51R-35175	SC700518
188 Memorial Ave Orillia, ON	Registered Plan #673	64297
214 Memorial Ave Orillia, ON	Registered Plan No. 671	N/A
265 Memorial Ave Orillia, ON	Registered Plan No.673, 5lR-5684, 5lR-635l	N/A
269 Memorial Ave Orillia, ON	Registered Plan 673 R-876 Part of Lot 312	737720
841 Memorial Avenue Orillia, ON	58569-0004(LT) Plan 51R-31299	SC121586
845 Memorial Avenue Orillia, ON	58569-0073(LT) Plan 51R-31495	SC121581
995 Memorial Avenue (Line 15) Orillia, ON	Plan 51R33479 Lot of Lot 12. Conc 2. City of Orillia	N/A
36 Mississaga Street E. Orillia, ON	N/A	N/A
52 Mississaga Street East Orillia, ON	58667-0023(LT) Plan 51R-38958	SC1128242
62 Mississaga Street East Orillia, ON	58667-0024(LT) Plans 51R-36596 & 51R-29760	SC759597
142 Mississaga Street W. Orillia, ON	Registered Plan No.180	N/A
177-179 Mississaga Street E. Orillia, ON	Plan 51R-13701 Dwg. XD8-1105	N/A
290 Mississaga St. W - pole line anchors Orillia, On	58848-0043 LT Plan 51R-39304	N/A
347 Mississaga Street W Orillia, ON	58638-013 51R-10539	N/A
354 Mississaga Street W Orillia, ON	Lot 59 Plan 426	N/A
1002-1028 Mississaga Street W Orillia, ON	58636-0074(LT) Plan 51R-36306	N/A
1095 Mississaga Street Orillia, ON	Plan 51R-556762, 51R-4325, 51R-18149 51R-4741 (part of plan 1147)	N/A
Mississauga Street W. - Pt Lot 3, Plan 426, Bell Canada Orillia, ON	Plan 51R-754223 (Part of Plans 426, Plan 51R-10539)	N/A

Mooney Cres Orillia, ON	Reg Plan #420, #1490 Plan 51R-6776, 51R-6824	35362, 35363, 35365
3000 Old Barrie Road Orillia, ON	*58572-0009(LT)* ***Now 58572-0345(LT)*** *Plan 51R-33239*	SC325486
3075 Old Barrie Road Orillia, ON	58570--009(LT) Plan 51R-33239	N/A
246 Oxford Street Orillia, ON	58675-0094(LT) Plan 51R-38048	SC1017699
11 Peter Street S Orillia, ON	N/A	N/A
25 Peter Street N Orillia, ON	PT LT 4/ Plan8	1430712
7975 Provincial Hwy 12 Orillia, ON	Plan 51R-30388	N/A
6 Queen St - Con 11 Lot 67 Ramara	PIN 58688-0041 Plan 22194 - Part 1, Plan 40R-28	N/A
478 Regent Street Orillia, ON	58682-0186 (LT) Plan 51R-33828	SC502940
316 Rodger Road Orillia, On	58684-0052 (LT) Plan 51R-40244	SC1270221
Rynard Dr + , Coldwater Road Closing Orillia, ON	58654-0001 (LT) Plan 51R-35160	RO247674
Rynard Dr Lots 1, 2, 3, 4 Orillia, ON	Plan-1, Section 51M-468	
Rynard Farm - 1967 Orillia, ON	N/A	247674
Rynard Farm and Collegiate Drive Orillia, ON	58654-0001(LT) Plan 51R-35160	N/A
3 Shellswell Crescent Orillia, ON	58571-0058(LT) Plan 51R-31974	SC274231
24 Simcoe Street Orillia, ON	Plan 51R-35247, Pl 432	SC559950
N/S Simcoe Street Orillia, ON	58678-0034(LT) Plan 51R-35247	SC559950
Taylor Drive Orillia, ON	Plan 51R-38188	SC1146424
University Avenue (anchors) Orillia, ON	58570-0009(LT), 58572-0345(LT) Plan 51R-37234	SC821572
University Avenue (anchors) Orillia, ON	58572-0340(LT), 58572- 0479(LT) Plan 51R-37508	N/A

University Avenue Orillia, ON	58572-0479(LT) 58572-0483(LT) Plan 51R-37508	SC979274
500 University Avenue Orillia, ON	58572-0344(LT) 58572-0347(LT) Plan 51R-37247	SC814296
735 University Avenue Orillia, ON	58572 -0478(LT) Part 9 and 10 Plan 51R37508	SC876707
469 to 499 Victoria Cres Orillia, ON	N/A	N/A
9 Westmount Drive Orillia, ON	58638-0268(LT) Plan 51R-1707	N/A
451 West Street N Orillia, ON	Plan R01348881 (A999)	303275
West Street - Southwood Estates Orillia, ON	Plan 1472	192022
8 West Street Orillia, ON	Reg. Plan No. 8 (OR351)	N/A
26 West Street N. Orillia, ON	R-944	N/A
29 West Street Orillia, ON (24 Market St Opera House Txfr)	PLAN 180, 51R-38085	SC950249, SC950250
29 West St & Nottawasaga St Orillia, ON	51R-38085	SC950246
56 West Street North Orillia, ON	Lot #7 Conc. 9 Dwg X-1369	N/A
62 West Street N. Orillia, ON	50-439 Plan R-949	N/A
65 West Street N. Orillia, ON	Plan of Easement Dwg. X-2234	N/A
174 West Street - pole line anchors Orillia, On	58671-0099 (LT)	N/A
175 West Street South Orillia, ON	58671-0099(LT) Plan 51R-39305	SC1127920
384 West Street N. Orillia, ON	Plan R-949	N/A
450 West Street N Orillia, ON	58626-0343(LT) Plan 51R-3416	N/A
451 West Street N Orillia, ON	Reg No. 01348881 Doc. No. 303275	N/A
466 West Street North	58625-0011(R)	RO1469482

Orillia, ON	**Now 58625-0014(LT)** Plan 51R-34166	
800 West Ridge Blvd. Orillia, ON	58572-0180 LT Plan 51 M843	SC489951
59 William Street Orillia, ON	58651-0189(LT) Plan 51R-35177	SC633608
146 Line #15 North Oro-Medonte, ON	58571-0059(LT) Plan 51R-31974	SC323483
204 Line 15N Oro-Medonte, ON	58571-0033(LT) Plan 51R-32103	SC248937
NARROWS - Atherley Bridge	Plan 51R-9969	N/A
Leacock Property Lot 10 Con 6	Lot 10 Con 6 Town of Orillia	N/A

SCHEDULE 3.1(M) – INTELLECTUAL PROPERTY

- Orillia Power Trademark No. 921963

SCHEDULE 3.1(N) – CONTRACTS AND COMMITMENTS

Nil.

SCHEDULE 3.1(O) – MATERIAL CONTRACTS

1.	Infrastructure Ontario Financing Agreement dated June 15, 2009
2.	General Security Agreement dated October 31, 2000
3.	Liabilities Assumption Agreement dated November 1, 2000
4.	Infrastructure Ontario Debenture dated May 3, 2010
5.	Promissory Note due to the City of Orillia dated December 1, 2000
6.	TD Operating Line dated July 21, 2014
7.	TD Credit Facility dated November 2, 2014
8.	TD IESO Letter of Credit dated April 15, 2002
9.	TD General Security Agreement dated April 15, 2002
10.	Harris Licence Maintenance Agreements dated February 25, 2010 and July 29, 2010
11.	Harris Escrow Agreement dated February 23, 2010
12.	Swift Wheeling Agreement dated June 23, 1993 with Ontario Hydro as amended by an amending agreement dated May 9, 2005
13.	Minden Wheeling Agreement dated January 2, 1990 with Ontario Hydro as amended by an amending agreement dated May 5, 2009
14.	Services Agreement between Orillia Power Distribution Corporation and Orillia Power Generation Corporation dated January 1, 2001
15.	Independent Electricity Market Operator Participation Agreement dated January 3, 2002
16.	Smart Metering Agreement for Distributors dated April 26, 2013 with Independent Electricity System Operator
17.	CHEC Group Mutual Assistance Agreement revised February 27, 2013
18.	Group of Seven Emergency Mutual Assistance Plan revised dated September 25, 2013
19.	Emergency Mutual Assistance Plan for Use with Ontario's LDCs dated March 2004
20.	OWLP/OPP Joint Use 200' Communications Tower Agreement with Her Majesty the Queen in Right of the Province of Ontario as represented by the Ministry of the Solicitor General and Correctional Services on behalf of the Ontario Provincial Police dated

	November 24, 1997
21.	Master CDM Program Agreement with the Ontario Power Authority dated May 1, 2007
22.	Energy Conservation Agreement with Ontario Power Authority dated December 24, 2014
23.	Letter of Credit No. 0596-9764646-05 with the Toronto Dominion Bank (undated)
24.	EBT Hub Connector License Agreements with SPI Group Inc. dated October 1, 2010 and August 31, 2010
25.	Subdivision Agreements – Stone Ridge Subdivision PH 3, 4, 5
26.	Sudbury Hydro Emergency Mutual Assistance Plan dated March 31, 2006
27.	Greater Sudbury Hydro and OPDC Emergency Mutual Assistance Plan dated December 2015
28.	Canada Post License Agreement dated January 30, 1951
29.	Revenue Sharing and License Agreement dated April 18, 2013
30.	Cable Control Systems Inc. Locate Agreement dated December 2, 2015
31.	City Fuel Agreement dated February 7, 2006
32.	Advanced Metering Infrastructure Sale and Services Agreements (various dates)
33.	IESO Smart Meter Agreement dated April 26, 2013
34.	After Hours Answering Service Agreement dated October 26, 2015 with The Corporation of the City of Orillia
35.	Hydro One Supply Agreement with Ontario Hydro dated February 1, 1999
36.	IMO Participation Agreement dated January 3, 2002
37.	Service Provider Agreement with ITM Group Inc. dated September 1, 2006 and new rates email dated March 9, 2015
38.	OPA Energy Conservation Agreement dated October 31, 2014
39.	Great Plains Dynamics C/S Master Software License Agreement dated 1999
40.	Rodan Cooperation Agreement dated January 1, 2011 with Rodan Energy Solutions Inc.
41.	SCADA License Agreement dated May 18, 1988

42.	One Call Service Agreement with Ontario One Call Ltd. dated March 6, 2003; after hours call answering service agreement dated November 26, 2012
43.	Westmount Station Purchase Order #POD020106 dated September 29, 2015
44.	Westmount Station Purchase Order #POD020338 dated February 5, 2016
45.	Westmount Station Purchase Order #POD020339 dated February 5, 2016
46.	Westmount Station Purchase Order #POD020346 dated February 5, 2016
47.	Costello Utility Consultants Confidentiality Agreement dated October 16, 2015
48.	Employee Plans referred to in Schedule 3.1(P)
49.	CCDC 2 Stipulated Price Contract Westmount Substation with K-Line Maintenance Construction Limited dated June 3, 2016

SCHEDULE 3.1(P) – EMPLOYEE PLANS

1.	Benefits Administration Agreement with MEARIE
2.	OMERS Participation Certificate Group Number 422091 dated November 1, 2000
3.	MEARIE Employee Benefit Booklet Inside Distribution Employees September 5, 2014
4.	MEARIE Employee Benefit Booklet Outside Distribution Employees September 19, 2014
5.	MEARIE Employee Benefit Booklet Salaried Employees January 2016

SCHEDULE 3.1(Q) – COLLECTIVE AGREEMENT

1.	Collective Agreement for Inside Employees between Orillia Power Distribution Corporation and Local Union No. 636 of the International Brotherhood of Electrical Workers dated between September 1, 2014 and August 31, 2018
2.	Collective Agreement for Outside Employees between Orillia Power Distribution Corporation and Local Union No. 636 of the International Brotherhood of Electrical Workers dated between September 1, 2014 and August 31, 2018

SCHEDULE 3.1(S) – INSURANCE POLICIES

1.	MEARIE Comprehensive Liability Insurance Policy No. L2015ORIL1 dated January 1, 2016
2.	MEARIE Vehicle Insurance Policy No. V2015ORIL1 dated January 1, 2016
3.	MEARIE Property Program Policy No. P2015ORIL1 dated January 1, 2016
4.	Euler Hermes Bad Debt Insurance Policy dated December 31, 2016
5.	MEARIE Directors and Officers Liability Policy No. L2015ORIL1 dated January 1, 2016
6.	CHUBB Commercial Excess Insurance Policy No. 37112045 dated March 20, 2016
7.	Liberty International Underwriters Commercial Crime Policy dated May 11, 2015 Policy No. CMTOAAZMGY002
8.	Lloyd's Non-Owned Aviation Facility Insurance Policy No. NOA0052-15 dated May 5, 2015
9.	Group Accident Insurance Program for Orillia Power Corporation – Board of Directors AD&D coverage January 01, 2016

SCHEDULE 3.1(V) – TAXES

1.	2010 T2 Tax Return
2.	2011 T2 Tax Return
3.	2012 T2 Tax Return
4.	2013 T2 Tax Return
5.	2014 T2 Tax Return
6.	2015 T2 Tax Return
7.	Canadian Revenue Agency Notice of Re-Assessment 2010
8.	Canadian Revenue Agency Notice of Assessment 2011
9.	Canadian Revenue Agency Notice of Assessment 2012
10.	Canadian Revenue Agency Notice of Assessment 2013
11.	Canadian Revenue Agency Notice of Assessment 2014
12.	Ontario Ministry of Revenue Notice of Assessment 2010
13.	Ontario Ministry of Revenue Notice of Assessment 2011
14.	Ontario Ministry of Revenue Notice of Assessment 2012
15.	Ontario Ministry of Revenue Notice of Assessment 2013
16.	Ontario Ministry of Revenue Notice of Assessment 2014
17.	Ontario Ministry of Revenue Notice of Assessment 2015

SCHEDULE 3.1(Z) – LICENCES

1.	Ontario Energy Board Electricity Distribution License ED-2002-0530 valid until March 31, 2023
2.	Independent Electricity Market Operator Licence ID 104319
3.	Ontario Ministry of Transportation Motor Vehicle Inspection Station Licence No. 26-44229 (expired December 12, 2015)
4.	Electrical Contractor Registration Agency of the Electrical Safety Authority Electrical Contractor License #7008088 dated September 29, 2010
5.	HWIN Licences NAICS Code 1 – 221122 and NAICS Code 2 – 221111
6.	Ontario Ministry of Environment Certificate of Approval (Air) No. 8-1160-98-006 dated October 20, 1998
7.	Ontario Ministry of Environment Certificate of Approval (Waste) No. A-800924 dated August 25, 1998 as amended on March 28, 2001
8.	Environment Canada Chemicals Management Plan dated May 14, 2007
9.	Software License Agreement with Quindar Products Ltd. dated May 18, 1988
10.	Great Plains Dynamics C/S Master Software License Agreement dated 1999
11.	Software Escrow Agreement No. 2718 with N. Harris Computer Corporation Multi-User Plan dated May 18, 2007 and dated Jul 30, 2010
12.	Emergency Restoration Plan with Rodan dated August 5, 2004

SCHEDULE 6.2 – PARTICIPATION IN COMMUNITY EVENTS

1. Community Events: The Purchaser shall introduce itself to the community by working with the Advisory Committee to determine the optimum community events to participate in over a three year transition period from closing.

2. Community Promotion / Economic Development: The Purchaser shall make available to the City, at no cost, space on distribution poles in prominent commercial areas for the installation of vertical banners promoting tourism, community events or other messages approved by the City. To participate in this initiative, the City shall sign the Purchaser's municipal attachments agreement and accept responsibility and the terms and conditions for such attachments, and the location of such vertical banners and the associated hardware to install them must be pre-approved by the Purchaser.

3. Community "Ribbon Cutting" Event: The Purchaser commits to holding a special customer appreciation event to celebrate the opening of its Orillia facilities, which would give customers the opportunity to speak with local staff about their work, see specialized work equipment, receive information on energy conservation and electrical safety, including electrical safety demonstrations and give-aways for children.

4. School Electrical Safety Presentations: The Purchaser will integrate all Orillia publicly-funded schools into its rotational schedule for Electrical Safety Presentations targeted at Grade 5 students.

5. School Tree Planting Event and Environmental Talk: As part of its annual Arbour week school educational talks and tree planting events, the Purchaser commits to holding one event each year at a Orillia school for a minimum of three years following Closing.

6. Participation at career fairs held at local high schools, or post-secondary institutions to encourage students to consider furthering their education in the trades or in Science, Technology, Engineering and Math (STEM) programs that would prepare them for a career in the electricity industry.

In addition to the above, the City and community charitable and non-profit organizations will have access to the Purchaser's community investment programs, which currently include:

- Sponsorship of community-based events organized by municipalities and local not-for-profit organizations.

- Employee Volunteer Grant Program of up to $1000 per employee for charitable or non-profit organizations with whom individual employees volunteer 50 or more hours in a year. Employees can re-apply for this grant annually.

- Annual Charity Campaign contributions to local United Ways and Hydro One Employees' and Pensioners' Charity Campaign contributions to over 800 charities of their choice across Ontario ($1,2 million raised in the 2015 campaign). All employees can designate any local registered charity for payroll deduction.

Hydro One's Safe Communities Donations Program – up to $25,000 for projects being implemented by municipal, non-profit or charitable community groups to help enhance community safety and security (for example, to install security barriers, enhance walking trails for seniors, improve playground structures, etc.). Applications are reviewed twice a year.

SCHEDULE 6.4 – CITY PROPERTY

1. Queen and Creighton (All of PIN: 58688--0041 (LT))

2. 175 West Street South (All of PIN: 58643--0057 (LT))

3. 15 Industrial Street properties:

   a. Part of PIN: 58670--0026 (LT), being Parts 1, 2 and 3 on draft reference plan prepared by Dearden and Stanton Ltd., Ontario Land Surveyors dated July 21, 2016 (CAD File: RF26926/D-2711, revised August 8, 2016)

   b. Part of PIN: 58670--0027 (LT), being Parts 4, 5 and 7 on draft reference plan prepared by Dearden and Stanton Ltd., Ontario Land Surveyors dated July 21, 2016 (CAD File: RF26926/D-2711, revised August 8, 2016)

   c. Part of PIN: 58670--0028 (LT), being Parts 8, 10 and 11 on draft reference plan prepared by Dearden and Stanton Ltd., Ontario Land Surveyors dated July 21, 2016 (CAD File: RF26926/D-2711, revised August 8, 2016)

4. 360/370 West Street South (All of PIN: 58671--0046 (LT))

5. 372 West Street South:

   a. Part of PIN: 58671--0047 (LT), being Part 2 on draft reference plan prepared by Dearden and Stanton Ltd., Ontario Land Surveyors dated July 25, 2016 (CAD File: PT26925/C--8077)

6. 700 Harvey Settlement Road - (All of PIN: 58572--0333 (LT))

SCHEDULE 6.6 – RATE CLASSES

Rate Class	**Dx Charges**	**2016**
Residential	Service Charge ($/month)	17.68
	Distribution Volumetric Rate ($/kWh)	0.0127
GS < 50 kW	Service Charge ($/month)	37.42
	Distribution Volumetric Rate ($/kWh)	0.0165
GS 50 to 4999 kW	Service Charge ($/month)	340.60
	Distribution Volumetric Rate ($/kW)	3.5825

2016 Rates Approved per EB-2015-0024

SCHEDULE 9.1(C) – PURCHASER CONSENTS

Nil.

3. Section 6.7 of the SPA is hereby deleted and replaced with the following:

6.7 **Existing Customer Rebates.** Notwithstanding Sections 2.6, 6.6(a) and 6.6(b), the Purchaser acknowledges, agrees and covenants that it will apply to the OEB in a timely manner in 2020 for a rate adder to dispose of the balance in account 1576 ("Account 1576") as of December 31, 2019, which adder will be effective starting January 1, 2021, and that it will make a similar application in 2021 for the disposition of the balance in account 1576 as of December 31, 2020, if that balance is in excess of $80,000. More particularly, the Purchaser will seek OEB approval of a rate adder similar to that sought by the Corporation and approved by the OEB in OEB File No. EB-2015-0286, being an application to establish a rate adder, effective January 1, 2016, to dispose of the balance in OEB Account 1576 as of December 31, 2014.

IN WITNESS WHEREOF this Amending Agreement has been executed by the Parties as of the date first written above.

THE CORPORATION OF THE CITY OF ORILLIA

By: ________________________________
Name:
Title: Mayor

By: ________________________________
Name:
Title: City Clerk

ORILLIA POWER CORPORATION

By: ________________________________
Name:
Title:

HYDRO ONE INC.

By: ________________________________
Name: PAUL DOBSON.
Title: President and Chief Executive Officer

THE CORPORATION OF THE CITY OF ORILLIA

- and –

ORILLIA POWER CORPORATION

- and –

HYDRO ONE INC.

AMENDING AGREEMENT FOR THE SHARE PURCHASE AGREEMENT

Dated the 26th day of September, 2018

WHEREAS the above-named Parties entered into a Share Purchase Agreement dated the 15th day of August, 2016 ("the SPA");

AND WHEREAS the Transactions contemplated by the SPA have not yet occurred;

AND WHEREAS the passing of time has resulted in the need for the Parties to amend the SPA to ensure that their mutual intent in entering to the SPA is realized;

NOW THEREFORE THIS AGREEMENT WITNESSES that in consideration of the respective covenants, agreements, representations and warranties of the Parties herein contained and for other good and valuable consideration (the receipt and sufficiency of which are acknowledged by each Party), the Parties covenant and agree to the terms of this Amending Agreement for the Share Purchase Agreement ("Amending Agreement"), as follows.

1. Capitalized terms herein have the same meaning as in the SPA.

2. Section 1.1(bb) of the SPA is hereby deleted and replaced with the following:

   "Current Rates" means those Rates presented under the column entitled "2016" in Schedule 6.6 of this Agreement as then adjusted for the move to a monthly, fully-fixed charge for residential customers (as documented in the OEB's report "A New Distribution Rate Design for Residential Electricity Customers" issued on April 2, 2015, in the OEB's proceeding EB-2012-0410).

3. Section 6.7 of the SPA is hereby deleted and replaced with the following:

6.7 **Existing Customer Rebates.** Notwithstanding Sections 2.6, 6.6(a) and 6.6(b), the Purchaser acknowledges, agrees and covenants that it will apply to the OEB in a timely manner in 2020 for a rate adder to dispose of the balance in account 1576 ("Account 1576") as of December 31, 2019, which adder will be effective starting January 1, 2021, and that it will make a similar application in 2021 for the disposition of the balance in account 1576 as of December 31, 2020, if that balance is in excess of $80,000. More particularly, the Purchaser will seek OEB approval of a rate adder similar to that sought by the Corporation and approved by the OEB in OEB File No. EB-2015-0286, being an application to establish a rate adder, effective January 1, 2016, to dispose of the balance in OEB Account 1576 as of December 31, 2014.

IN WITNESS WHEREOF this Amending Agreement has been executed by the Parties as of the date first written above.

THE CORPORATION OF THE CITY OF ORILLIA

By: ______________________________
Name:
Title: Mayor

By: ______________________________
Name:
Title: City Clerk

ORILLIA POWER CORPORATION

By: ______________________________
Name:
Title:

HYDRO ONE INC.

By: ______________________________
Name: PAUL DOBSON.
Title: President and Chief Executive Officer

THE CORPORATION OF THE CITY OF ORILLIA

- and –

ORILLIA POWER CORPORATION

- and –

HYDRO ONE INC.

AMENDING AGREEMENT FOR THE SHARE PURCHASE AGREEMENT

Dated the 26th day of September, 2018

WHEREAS the above-named Parties entered into a Share Purchase Agreement dated the 15th day of August, 2016 ("the SPA");

AND WHEREAS the Transactions contemplated by the SPA have not yet occurred;

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1. Capitalized terms herein have the same meaning as in the SPA.

2. Section 1.1(bb) of the SPA is hereby deleted and replaced with the following:

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3. Section 6.7 of the SPA is hereby deleted and replaced with the following:

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IN WITNESS WHEREOF this Amending Agreement has been executed by the Parties as of the date first written above.

THE CORPORATION OF THE CITY OF ORILLIA

By: ____________________
Name:
Title: Mayor

By: ____________________
Name:
Title: City Clerk

ORILLIA POWER CORPORATION

By: ____________________
Name: Grant Hipgrave
Title: Interim President

HYDRO ONE INC.

By: ____________________
Name:
Title: President and Chief Executive Officer

**CERTIFIED COPY OF RESOLUTION
OF THE BOARD OF DIRECTORS OF
HYDRO ONE INC.
(the "Corporation")**

The undersigned hereby certifies that set out below is a true copy of a resolution passed by all of the Directors at the meeting of the Board of Directors of Hydro One Inc. held on August 12, 2016.

**HYDRO ONE INC.
(the "Corporation")**

RESOLUTIONS OF THE BOARD OF DIRECTORS

RESOLVED THAT:

Orillia Power Acquisition

1. The acquisition by the Corporation of Orillia Power at up to the maximum purchase price of **[intentionally deleted]** and otherwise on such terms as management may in its discretion determine, be and is hereby approved. The President and Chief Executive Officer or his delegate(s), is hereby authorized and directed, for and on behalf of the Corporation to negotiate, finalize, execute and deliver any and all further documents, agreements, authorizations, elections or other instruments and to take any and all such further action as such officer or delegate(s), in such person's sole direction may deem necessary or desirable in order to give effect to the matters contemplated in this resolution, the execution and delivery of any such documents, agreements, authorizations, elections or other instruments or the doing of any such other act or thing by such person to be conclusive evidence of such determination.

Certified at Toronto, Ontario this 7th day of September, 2016.

Maureen Wareham

Maureen Wareham
Corporate Secretary
Hydro One Inc.

RESOLUTION OF THE DIRECTORS OF ORILLIA POWER CORPORATION

WHEREAS The Corporation of the City of Orillia (the "City") is the sole shareholder of Orillia Power Corporation ("OPC") which is the sole shareholder of Orillia Power Distribution Corporation ("OPDC");

AND WHEREAS the City implemented a shareholder declaration (the "Declaration") on April 2, 2001 as Schedule "A" to By-Law Number 2001-48 which governs the relationship between the City, OPC, OPDC and Orillia Power Generation Corporation ("OPGC");

AND WHEREAS the City's prior approval is required to authorize OPC's sale of "substantially all of the assets of" OPDC pursuant to the provisions of the Declaration;

AND WHEREAS Hydro One Inc. ("HOI"), OPC and the City entered into a letter of intent dated September 22, 2015 whereby the City agreed to grant HOI the exclusive right to evaluate a potential transaction whereby HOI would acquire all of the issued and outstanding shares of OPDC (the "Shares") from OPC;

AND WHEREAS the City and OPC may wish to sell and HOI may wish to acquire the Shares on the terms and conditions of a share purchase agreement (the "SPA") to be entered into between OPC, HOI and the City;

AND WHEREAS in connection with the draft provisions of the SPA, OPC and OPGC are anticipated to agree to provide certain services to OPDC following closing of the SPA, as further contemplated by a Services Agreement which is anticipated to be entered into between OPC, OPDC and OPGC as of August 15, 2016 (the "Services Agreement");

AND WHEREAS in connection with the draft provisions of the SPA, Hydro One Networks Inc. ("HONI") is anticipated to agree to extend the benefits received by OPDC's customers from two wheeling agreements between OPDC and HONI each dated May 9, 2005 concerning the Swift Rapids GS and Minden GS respectively, by entering into two amending agreements between OPGC, HONI and OPDC as of August 15, 2016 (the "Wheeling Agreements");

AND WHEREAS in connection with the draft provisions of the SPA, the City is anticipated to agree to acquire and lease back the premises located at 360 West Street South to OPDC (the "Lease");

AND WHEREAS in connection with the draft provisions of the SPA, the City is anticipated to agree to acquire certain properties from OPDC at fair market value through a purchase and sale agreement ("Purchase Agreement") and dividend in-kind transaction to be entered into between the City and OPDC (the performance of the Purchase Agreement, Lease, Wheeling Agreements, Services Agreement and the SPA, shall collectively be referred to as the "Transaction" and these documents shall collectively be referred to as the "Transaction Documents");

AND WHEREAS the SPA is subject to approval by the Ontario Energy Board pursuant to section 86 of the *Ontario Energy Board Act, 1998* and the Ontario Energy Board's

Preliminary Filing Requirements for Mergers, Acquisitions, Amalgamations and Divestitures in the Ontario Electricity Transmission and Distribution Sector (the "MAADs Application");

AND WHEREAS the City is expected to approve the Transaction and submission of the MAADs Application to the Ontario Energy Board and this resolution will have no force or effect until the City approves the Transaction and submission of the MAADs Application to the Ontario Energy Board.

AND WHEREAS upon the City's approval of the Transaction, the City is expected to authorize OPC, and each of its subsidiaries OPDC and OPGC, to proceed with the Transaction.

BE IT RESOLVED THAT:

1. The performance of OPC's obligations under the SPA and Services Agreement are hereby approved, ratified and confirmed and the execution and delivery of the SPA and Services Agreement by Patrick Hurley and/or Grant Hipgrave, each an authorized signing officer, for and on behalf of OPC, is hereby approved, ratified and confirmed.

2. Patrick Hurley and/or Grant Hipgrave, each an authorized signing officer, are hereby authorized for and on behalf of OPC, in its own capacity, to execute and deliver all such other agreements, consents, notices, amendments, instruments, certificates and other documents including but not limited to amendments to the SPA and Services Agreement and all documents required to effect the closing of the SPA and Services Agreement and the performance of the SPA and Services Agreement and to do all acts and things necessary or advisable in connection with the SPA and Services Agreement.

THIS resolution is consented to in writing by the undersigned.

Per: ______________________
Greg Gee – Chair

Per: ______________________
Ray Hayhurst – Vice – Chair

Per: ______________________
Aubrey Ford – Director

Per: ______________________
Geoff Hewett – Director

Per: ______________________
Tom Hussey - Director

Customer Bill Impacts

	Residential					
	Volume	**Current Rates**	**Current Charges ($)**	**Rates as per Acquisition Agreement**	**Charges as per Acquisition Agreement ($)**	**% Change**
Monthly Consumption (kWh)	**750**					
Total Loss Factors	**1.0561**					
TOU - Off Peak Consumption	488	0.065	$31.69	0.065	$31.69	
TOU - Mid Peak Consumption	128	0.094	$11.99	0.094	$11.99	
TOU - On Peak Consumption	135	0.132	$17.82	0.132	$17.82	
Total: Commodity			**$61.49**		**$61.49**	**0.00%**
DX Fixed Charge ($)	1	24.48	$24.48	24.2400	$24.24	
DX Fixed Charge Rate Riders ($)	1	2.48	$2.48	2.48	$2.48	
DX Vol. Charge ($/kWh)	750	0.0043	$3.23	0.00426	$3.20	
DX Low Voltage Charge ($/kWh)	750	0.0006	$0.45	0.0006	$0.45	
DX Vol. Rate Riders ($/kWh)	750	0.0011	$0.83	0.0011	$0.83	
Distribution Base Rates Only			**$28.16**		**$27.89**	**-0.96%**
Smart Meter Entity Charge ($)	1	0.57	$0.57	0.57	$0.57	
Cost of Losses ($/kWh)	42	0.0820	$3.45	0.0820	$3.45	
Distribution Pass-through Charges			**$4.02**		**$4.02**	**0.00%**
Total: Distribution			**$35.48**		**$35.21**	**-0.76%**
TX-Network ($/kWh)	792	0.0054	$4.28	0.0054	$4.28	
TX-Connection ($/kWh)	792	0.0043	$3.41	0.0043	$3.41	
Total: Transmission			**$7.68**		**$7.68**	**0.00%**
WMSC ($/kWh)	792	0.0036	$2.85	0.0036	$2.85	
RRRP ($/kWh)	792	0.0003	$0.24	0.0003	$0.24	
SSA ($)	1	0.25	$0.25	0.25	$0.25	
Total: Regulatory			**$3.34**		**$3.34**	**0.00%**
Total Bill (Before Taxes)			$107.99		$107.72	
HST		13%	$14.04	13%	$14.00	
OREC		-8%	-$8.64	-8%	-$8.62	
Total Bill (Including HST)			**$113.39**		**$113.11**	**-0.25%**

Customer Bill Impacts

	General Service Less Than 50kW					
	Volume	Current Rates	Current Charges ($)	Rates as per Acquisition Agreement	Charges as per Acquisition Agreement ($)	% Change
Monthly Consumption (kWh)	**2,000**					
Total Loss Factors	**1.0561**					
TOU - Off Peak Consumption	1,300	0.0650	$84.50	0.0650	$84.50	
TOU - Mid Peak Consumption	340	0.0940	$31.96	0.0940	$31.96	
TOU - On Peak Consumption	360	0.1320	$47.52	0.1320	$47.52	
Total: Commodity			**$163.98**		**$163.98**	**0.00%**
DX Fixed Charge ($)	1	37.42	$37.42	37.05	$37.05	
DX Fixed Charge Rate Riders ($)	1	7.48	$7.48	7.48	$7.48	
DX Vol. Charge ($/kWh)	2,000	0.0165	$33.00	0.0163	$32.60	
DX Low Voltage Charge ($/kWh)	2,000	0.0006	$1.20	0.0006	$1.20	
DX Vol. Rate Riders ($/kWh)	2,000	0.0010	$2.00	0.0010	$2.00	
Distribution Base Rates Only			**$71.62**		**$70.85**	**-1.08%**
Smart Meter Entity Charge ($)	1	0.57	$0.57	0.57	$0.57	
Cost of Losses ($/kWh)	112	0.0820	$9.20	0.0820	$9.20	
Distribution Pass-through Charges			**$9.77**		**$9.77**	**0.00%**
Total: Distribution			**$90.87**		**$90.10**	**-0.85%**
TX-Network ($/kWh)	2,112	0.0045	$9.50	0.0045	$9.50	
TX-Connection ($/kWh)	2,112	0.0040	$8.45	0.0040	$8.45	
Total: Transmission			**$17.95**		**$17.95**	**0.00%**
WMSC ($/kWh)	2,112	0.0036	$7.60	0.0036	$7.60	
RRRP ($/kWh)	2,112	0.0003	$0.63	0.0003	$0.63	
SSA ($)	1	0.25	$0.25	0.25	$0.25	
Total: Regulatory			**$8.49**		**$8.49**	**0.00%**
Total Bill (Before Taxes)			$281.29		$280.52	
HST		13%	$36.57	13%	$36.47	
OREC		-8%	-$22.50	-8%	-$22.44	
Total Bill (Including HST)			**$295.36**		**$294.55**	**-0.27%**

Customer Bill Impacts

	General Service 50 to 4,999 kW					
	Volume	**Current Rates**	**Current Charges ($)**	**Rates as per Acquisition Agreement**	**Charges as per Acquisition Agreement ($)**	**% Change**
Monthly Consumption (kWh)	**73,000**					
Peak (kW)	**100**					
Total Loss Factors	**1.0561**					
Commodity Charges	77,095	0.1101	$8,488.19	0.1101	$8,488.19	
Total: Commodity			**$8,488.19**		**$8,488.19**	**0.00%**
DX Fixed Charge ($)	1	340.60	$340.60	337.19	$337.19	
DX Fixed Charge Rate Riders ($)	1	0.00	$0.00	0.00	$0.00	
DX Vol. Charge ($/kW)	100	3.5825	$358.25	3.5467	$354.67	
DX Low Voltage Charge ($/kW)	100	0.2230	$22.30	0.2230	$22.30	
DX Vol. Rate Riders ($/kW)	100	0.3917	$39.17	0.3917	$39.17	
DX Vol. GA Rate Riders ($/kWh)	73,000	-0.0006	($43.80)	-0.0006	($43.80)	
Distribution Base Rates Only			**$721.15**		**$714.16**	**-0.97%**
Total: Distribution			**$716.52**		**$709.53**	**-0.98%**
TX-Network ($/kW)	100	2.0112	$201.12	2.0112	$201.12	
TX-Connection ($/kW)	100	1.6106	$161.06	1.6106	$161.06	
Total: Transmission			**$362.18**		**$362.18**	**0.00%**
WMSC ($/kWh)	77,095	0.0036	$277.54	0.0036	$277.54	
RRRP ($/kWh)	77,095	0.0003	$23.13	0.0003	$23.13	
SSA ($)	1	0.25	$0.25	0.25	$0.25	
Total: Regulatory			**$300.92**		**$300.92**	**0.00%**
Total Bill (Before Taxes)			$9,867.81		$9,860.82	
HST		13%	$1,282.82	13%	$1,281.91	
Total Bill (Including HST)			**$11,150.63**		**$11,142.73**	**-0.07%**

Determination of Rate Riders as Per Acquisition Agreement

Rate Class	Distribution Charges	Rate Rider	
		OPDC Distribution Rates Effective May 1, 2018 EB 2017 0264	Proposed Rate Riders as per Acquisition Agreement
		A	B = A x (-0.01)
Residential	Service Charge ($)	24.48	-0.24
	Distribution Volumetric Rate ($/kWh)	0.0043	-0.00004
General Service < 50kW	Service Charge ($)	37.42	-0.37
	Distribution Volumetric Rate ($/kWh)	0.0165	-0.0002
General Service 50 to 4,999kW	Service Charge ($)	340.6	-3.41
	Distribution Volumetric Rate ($/kWh)	3.5825	-0.0358

RESIDENTIAL SERVICE CLASSIFICATION

This classification applies to an account taking electricity at 750 volts or less where the electricity is used exclusively in a separate metered living accommodation. Customers shall be residing in single-dwelling units that consist of a detached house or one unit of a semi-detached, duplex, triplex or quadruplex house, with a residential zoning. Separately metered dwellings within a town house complex or apartment building also qualify as residential customers. Class B consumers are defined in accordance with O. Reg. 429/04. Further servicing details are available in the distributor's Conditions of Service.

APPLICATION

The application of these rates and charges shall be in accordance with the Licence of the Distributor and any Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, which may be applicable to the administration of this schedule.

No rates and charges for the distribution of electricity and charges to meet the costs of any work or service done or furnished for the purpose of the distribution of electricity shall be made except as permitted by this schedule, unless required by the Distributor's Licence or a Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, or as specified herein.

Unless specifically noted, this schedule does not contain any charges for the electricity commodity, be it under the Regulated Price Plan, a contract with a retailer or the wholesale market price, as applicable. In addition, the charges in the MONTHLY RATES AND CHARGES - Regulatory Component of this schedule do not apply to a customer that is an embedded wholesale market participant.

It should be noted that this schedule does not list any charges, assessments, or credits that are required by law to be invoiced by a distributor and that are not subject to Ontario Energy Board approval, such as the Debt Retirement Charge, the Global Adjustment and the HST.

MONTHLY RATES AND CHARGES - Delivery Component

Service Charge	$	24.48
Rate Rider for Smart Meter Incremental Revenue Requirement - in effect until the effective date of the next cost of service-based rate order	$	2.56
Smart Metering Entity Charge - effective until December 31, 2022	$	0.57
Fixed Acquisition Rate Rider – in effect for five years from the beginning of the rate deferral period	$	(0.24)
Distribution Volumetric Rate	$/kWh	0.0043
Low Voltage Service Rate	$/kWh	0.0006
Volumetric Acquisition Rate Rider – in effect for five years from the beginning of the rate deferral period	$/kWh	(0.00004)
Retail Transmission Rate - Network Service Rate	$/kWh	0.0054
Retail Transmission Rate - Line and Transformation Connection Service Rate	$/kWh	0.0043

MONTHLY RATES AND CHARGES - Regulatory Component

Wholesale Market Service Rate (WMS) - not including CBR	$/kWh	0.0032
Capacity Based Recovery (CBR) - Applicable for Class B Customers	$/kWh	0.0004
Rural or Remote Electricity Rate Protection Charge (RRRP)	$/kWh	0.0003
Standard Supply Service - Administrative Charge (if applicable)	$	0.25

Hydro One Orillia
TARIFF OF RATES AND CHARGES
Effective and Implementation Date XXX X, 2020
This schedule supersedes and replaces all previously approved schedules of Rates, Charges and Loss Factors

EB-2018-XXXX

GENERAL SERVICE LESS THAN 50 KW SERVICE CLASSIFICATION

This classification refers to a non residential account taking electricity at 750 volts or less whose average monthly maximum demand is less than, or is forecast to be less than, 50 kW. Class B consumers are defined in accordance with O. Reg. 429/04. Further servicing details are available in the distributor's Conditions of Service.

APPLICATION

The application of these rates and charges shall be in accordance with the Licence of the Distributor and any Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, which may be applicable to the administration of this schedule.

No rates and charges for the distribution of electricity and charges to meet the costs of any work or service done or furnished for the purpose of the distribution of electricity shall be made except as permitted by this schedule, unless required by the Distributor's Licence or a Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, or as specified herein.

Unless specifically noted, this schedule does not contain any charges for the electricity commodity, be it under the Regulated Price Plan, a contract with a retailer or the wholesale market price, as applicable. In addition, the charges in the MONTHLY RATES AND CHARGES - Regulatory Component of this schedule do not apply to a customer that is an embedded wholesale market participant.

It should be noted that this schedule does not list any charges, assessments, or credits that are required by law to be invoiced by a distributor and that are not subject to Ontario Energy Board approval, such as the Debt Retirement Charge, the Global Adjustment and the HST.

MONTHLY RATES AND CHARGES - Delivery Component

Service Charge	$	37.42
Rate Rider for Smart Meter Incremental Revenue Requirement - in effect until the effective date of the next cost of service-based rate order	$	7.48
Smart Metering Entity Charge - effective until December 31, 2022	$	0.57
Fixed Acquisition Rate Rider – in effect for five years from the beginning of the rate deferral period	$	(0.37)
Distribution Volumetric Rate	$/kWh	0.0165
Low Voltage Service Rate	$/kWh	0.0006
Volumetric Acquisition Rate Rider – in effect for five years from the beginning of the rate deferral period	$/kWh	(0.0002)
Retail Transmission Rate - Network Service Rate	$/kWh	0.0045
Retail Transmission Rate - Line and Transformation Connection Service Rate	$/kWh	0.0040

MONTHLY RATES AND CHARGES - Regulatory Component

Wholesale Market Service Rate (WMS) - not including CBR	$/kWh	0.0032
Capacity Based Recovery (CBR) - Applicable for Class B Customers	$/kWh	0.0004
Rural or Remote Electricity Rate Protection Charge (RRRP)	$/kWh	0.0003
Standard Supply Service - Administrative Charge (if applicable)	$	0.25

Hydro One Orillia

TARIFF OF RATES AND CHARGES

Effective and Implementation Date XXX X, 2020

This schedule supersedes and replaces all previously approved schedules of Rates, Charges and Loss Factors

EB-2018-XXXX

GENERAL SERVICE 50 TO 4,999 KW SERVICE CLASSIFICATION

This classification applies to a non residential account whose average monthly maximum demand used for billing purposes is equal to or greater than, or is forecast to be equal to or greater than, 50 kW but less than 5,000 kW. Class A and Class B consumers are defined in accordance with O.Reg.429/04. Further servicing details are available in the distributor's Conditions of Service.

APPLICATION

The application of these rates and charges shall be in accordance with the Licence of the Distributor and any Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, which may be applicable to the administration of this schedule.

No rates and charges for the distribution of electricity and charges to meet the costs of any work or service done or furnished for the purpose of the distribution of electricity shall be made except as permitted by this schedule, unless required by the Distributor's Licence or a Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, or as specified herein.

Unless specifically noted, this schedule does not contain any charges for the electricity commodity, be it under the Regulated Price Plan, a contract with a retailer or the wholesale market price, as applicable. In addition, the charges in the MONTHLY RATES AND CHARGES - Regulatory Component of this schedule do not apply to a customer that is an embedded wholesale market participant.

The rate rider for the disposition of Global Adjustment is only applicable to non-RPP Class B customers. It is not applicable to wholesale market participants (WMP), customers that transitioned between Class A and Class B during the variance account accumulation period, or to customers that were in Class A for the entire period. Customers who transitioned are to be charged or refunded their share of the variance disposed through customer specific billing adjustments. This rate rider is to be consistently applied for the entire period to the sunset date of the rate rider. In addition, this rate rider is applicable to all new non-RPP Class B customers.

It should be noted that this schedule does not list any charges, assessments, or credits that are required by law to be invoiced by a distributor and that are not subject to Ontario Energy Board approval, such as the Debt Retirement Charge, the Global Adjustment and the HST.

MONTHLY RATES AND CHARGES - Delivery Component

Service Charge	$	340.60
Fixed Acquisition Rate Rider – in effect for five years from the beginning of the rate deferral period	$	(3.41)
Distribution Volumetric Rate	$/kW	3.5825
Low Voltage Service Rate	$/kW	0.2230
Volumetric Acquisition Rate Rider – in effect for five years from the beginning of the rate deferral period	$/kWh	(0.0358)
Retail Transmission Rate - Network Service Rate	$/kW	2.0112
Retail Transmission Rate - Line and Transformation Connection Service Rate	$/kW	1.6106

MONTHLY RATES AND CHARGES - Regulatory Component

Wholesale Market Service Rate (WMS) - not including CBR	$/kWh	0.0032
Capacity Based Recovery (CBR) - Applicable for Class B Customers	$/kWh	0.0004
Rural or Remote Electricity Rate Protection Charge (RRRP)	$/kWh	0.0003
Standard Supply Service - Administrative Charge (if applicable)	$	0.25

UNMETERED SCATTERED LOAD SERVICE CLASSIFICATION

This classification applies to an account taking electricity at 750 volts or less whose average monthly maximum demand is less than, or is forecast to be less than, 50 kW and the consumption is unmetered. Such connections include cable TV power packs, bus shelters, telephone booths, traffic lights, railway crossings, etc. The level of the consumption will be agreed to by

Issued XXXX XX, 2018

the distributor and the customer, based on detailed manufacturer information/documentation with regard to electrical consumption of the unmetered load or periodic monitoring of actual consumption. Class B consumers are defined in accordance with O. Reg. 429/04. Further servicing details are available in the distributor's Conditions of Service.

APPLICATION

The application of these rates and charges shall be in accordance with the Licence of the Distributor and any Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, which may be applicable to the administration of this schedule.

No rates and charges for the distribution of electricity and charges to meet the costs of any work or service done or furnished for the purpose of the distribution of electricity shall be made except as permitted by this schedule, unless required by the Distributor's Licence or a Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, or as specified herein.

Unless specifically noted, this schedule does not contain any charges for the electricity commodity, be it under the Regulated Price Plan, a contract with a retailer or the wholesale market price, as applicable. In addition, the charges in the MONTHLY RATES AND CHARGES - Regulatory Component of this schedule do not apply to a customer that is an embedded wholesale market participant.

It should be noted that this schedule does not list any charges, assessments, or credits that are required by law to be invoiced by a distributor and that are not subject to Ontario Energy Board approval, such as the Debt Retirement Charge, the Global Adjustment and the HST.

MONTHLY RATES AND CHARGES - Delivery Component

Service Charge (per connection)	$	10.59
Distribution Volumetric Rate	$/kWh	0.0095
Low Voltage Service Rate	$/kWh	0.0006
Retail Transmission Rate - Network Service Rate	$/kWh	0.0045
Retail Transmission Rate - Line and Transformation Connection Service Rate	$/kWh	0.0040

MONTHLY RATES AND CHARGES - Regulatory Component

Wholesale Market Service Rate (WMS) - not including CBR	$/kWh	0.0032
Capacity Based Recovery (CBR) - Applicable for Class B Customers	$/kWh	0.0004
Rural or Remote Electricity Rate Protection Charge (RRRP)	$/kWh	0.0003
Standard Supply Service - Administrative Charge (if applicable)	$	0.25

SENTINEL LIGHTING SERVICE CLASSIFICATION

This classification refers to accounts that are unmetered lighting load supplied to a sentinel light. Class B consumers are defined in accordance with O. Reg. 429/04. Further servicing details are available in the distributor's Conditions of Service.

APPLICATION

The application of these rates and charges shall be in accordance with the Licence of the Distributor and any Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, which may be applicable to the administration of this schedule.

No rates and charges for the distribution of electricity and charges to meet the costs of any work or service done or furnished for the purpose of the distribution of electricity shall be made except as permitted by this schedule, unless required by the Distributor's Licence or a Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, or as specified herein.

Unless specifically noted, this schedule does not contain any charges for the electricity commodity, be it under the Regulated Price Plan, a contract with a retailer or the wholesale market price, as applicable. In addition, the charges in the MONTHLY RATES AND CHARGES - Regulatory Component of this schedule do not apply to a customer that is an embedded wholesale market participant.

It should be noted that this schedule does not list any charges, assessments, or credits that are required by law to be invoiced by a distributor and that are not subject to Ontario Energy Board approval, such as the Debt Retirement Charge, the Global Adjustment and the HST.

MONTHLY RATES AND CHARGES - Delivery Component

Service Charge (per connection)	$	3.88
Distribution Volumetric Rate	$/kW	10.1477
Low Voltage Service Rate	$/kW	0.1698
Retail Transmission Rate - Network Service Rate	$/kW	1.4891
Retail Transmission Rate - Line and Transformation Connection Service Rate	$/kW	1.2261

MONTHLY RATES AND CHARGES - Regulatory Component

Wholesale Market Service Rate (WMS) - not including CBR	$/kWh	0.0032
Capacity Based Recovery (CBR) - Applicable for Class B Customers	$/kWh	0.0004
Rural or Remote Electricity Rate Protection Charge (RRRP)	$/kWh	0.0003
Standard Supply Service - Administrative Charge (if applicable)	$	0.25

STREET LIGHTING SERVICE CLASSIFICATION

This classification applies to an account for roadway lighting with a Municipality, Regional Municipality, Ministry of Transportation and private roadway lighting, controlled by photo cells. The consumption for these customers will be based on the calculated connected load times the required lighting times established in the approved Ontario Energy Board street lighting load shape template. Class B consumers are defined in accordance with O. Reg. 429/04. Further servicing details are available in the distributor's Conditions of Service.

APPLICATION

The application of these rates and charges shall be in accordance with the Licence of the Distributor and any Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, which may be applicable to the administration of this schedule.

No rates and charges for the distribution of electricity and charges to meet the costs of any work or service done or furnished for the purpose of the distribution of electricity shall be made except as permitted by this schedule, unless required by the Distributor's Licence or a Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, or as specified herein.

Unless specifically noted, this schedule does not contain any charges for the electricity commodity, be it under the Regulated Price Plan, a contract with a retailer or the wholesale market price, as applicable. In addition, the charges in the MONTHLY RATES AND CHARGES - Regulatory Component of this schedule do not apply to a customer that is an embedded wholesale market participant.

It should be noted that this schedule does not list any charges, assessments, or credits that are required by law to be invoiced by a distributor and that are not subject to Ontario Energy Board approval, such as the Debt Retirement Charge, the Global Adjustment and the HST.

MONTHLY RATES AND CHARGES - Delivery Component

Service Charge (per connection)	$	4.56
Distribution Volumetric Rate	$/kW	15.1656
Low Voltage Service Rate	$/kW	0.1663
Retail Transmission Rate - Network Service Rate	$/kW	1.4815
Retail Transmission Rate - Line and Transformation Connection Service Rate	$/kW	1.2009

MONTHLY RATES AND CHARGES - Regulatory Component

Wholesale Market Service Rate (WMS) - not including CBR	$/kWh	0.0032
Capacity Based Recovery (CBR) - Applicable for Class B Customers	$/kWh	0.0004
Rural or Remote Electricity Rate Protection Charge (RRRP)	$/kWh	0.0003
Standard Supply Service - Administrative Charge (if applicable)	$	0.25

STANDBY POWER SERVICE CLASSIFICATION

This classification applies to an account with load displacement facilities that contracts with the distributor to provide emergency standby power when its load displacement facilities are not in operation. The level of billing demand will be agreed to by the distributor and the customer, based on detailed manufacturer information/documentation such as nameplate rating of the load displacement facility. Further servicing details are available in the distributor’s Conditions of Service.

APPLICATION

The application of these rates and charges shall be in accordance with the Licence of the Distributor and any Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, which may be applicable to the administration of this schedule.

No rates and charges for the distribution of electricity and charges to meet the costs of any work or service done or furnished for the purpose of the distribution of electricity shall be made except as permitted by this schedule, unless required by the Distributor’s Licence or a Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, or as specified herein.

Unless specifically noted, this schedule does not contain any charges for the electricity commodity, be it under the Regulated Price Plan, a contract with a retailer or the wholesale market price, as applicable.

It should be noted that this schedule does not list any charges, assessments, or credits that are required by law to be invoiced by a distributor and that are not subject to Ontario Energy Board approval, such as the Debt Retirement Charge, the Global Adjustment and the HST.

MONTHLY RATES AND CHARGES - Delivery Component - APPROVED ON AN INTERIM BASIS

Distribution Volumetric Rate - $/kW of contracted amount	$/kW	1.0713

microFIT SERVICE CLASSIFICATION

This classification applies to an electricity generation facility contracted under the Independent Electricity System Operator's microFIT program and connected to the distributor's distribution system. Further servicing details are available in the distributor's Conditions of Service.

APPLICATION

The application of these rates and charges shall be in accordance with the Licence of the Distributor and any Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, which may be applicable to the administration of this schedule.

No rates and charges for the distribution of electricity and charges to meet the costs of any work or service done or furnished for the purpose of the distribution of electricity shall be made except as permitted by this schedule, unless required by the Distributor's Licence or a Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, or as specified herein.

Unless specifically noted, this schedule does not contain any charges for the electricity commodity, be it under the Regulated Price Plan, a contract with a retailer or the wholesale market price, as applicable.

It should be noted that this schedule does not list any charges, assessments, or credits that are required by law to be invoiced by a distributor and that are not subject to Ontario Energy Board approval, such as the Debt Retirement Charge, the Global Adjustment and the HST.

MONTHLY RATES AND CHARGES - Delivery Component

Service Charge	$	5.40

ALLOWANCES

Transformer Allowance for Ownership - per kW of billing demand/month	$/kW	(0.60)
Primary Metering Allowance for transformer losses - applied to measured demand and energy	%	(1.00)

SPECIFIC SERVICE CHARGES

The application of these rates and charges shall be in accordance with the Licence of the Distributor and any Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, which may be applicable to the administration of this schedule.

No charges to meet the costs of any work or service done or furnished for the purpose of the distribution of electricity shall be made except as permitted by this schedule, unless required by the Distributor's Licence or a Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, or as specified herein.

It should be noted that this schedule does not list any charges, assessments, or credits that are required by law to be invoiced by a distributor and that are not subject to Ontario Energy Board approval, such as the Debt Retirement Charge, the Global Adjustment and the HST.

Customer Administration

Arrears certificate	$	15.00
Easement charge for unregistered rights	$	15.00
Returned cheque charge (plus bank charges)	$	15.00
Account set up charge	$	30.00
Special meter reads	$	30.00
Meter dispute charge plus Measurement Canada fees (if meter found correct)	$	30.00

Non-Payment of Account

Late Payment - per month	%	1.50
Late Payment - per annum	%	19.56
Collection of account charge - no disconnection/Load Limiter	$	30.00
Collection/Disconnect/Load Limiter/Reconnect trip (at meter) - during regular hours	$	65.00
Collection/Disconnect/Load Limiter/Reconnect trip (at meter) - after regular hours	$	185.00
Collection/Disconnect/Load Limiter/Reconnect trip (at pole) - during regular hours	$	185.00
Collection/Disconnect/Load Limiter/Reconnect trip (at pole) - after regular hours	$	415.00

Other

Temporary service install & remove	$	500.00
Specific Charge for Cable and Telecom Companies Access to the Power Poles - $/pole/year	$	41.28
Specific Charge for LDCs Access to the Power Poles - $/pole/year	$	see below
Specific Charge for Generator Access to the Power Poles - $/pole/year	$	see below
Service Layout Fee – Basic	$	640.00
Service Layout Fee – Complex	$	850.00
Crossing Application – Pipeline	$	2,555.00
Crossing Application –Water	$	3,250.00
Crossing Application – Railroad	$	6,120.00
Line Staking - $/meter	$	4.95
Central Metering – New Service < 45 kW	$	120.00
Conversion to Central Metering < 45 kW	$	1,050.00
Conversion to Central Metering > 45 kW	$	930.00
Tingle Voltage Test in excess of 4 hours – per hour (average 2 additional hours)	$	140.00
Standby Administration Charge – per month	$	520.00
Connection Impact Assessment (CIA) Charge – CAE Small DG & Net Metering	$	5,655.00
Connection Impact Assessment (CIA) Charge – Greater than CAE Small DG & Net Metering	$	12,130.00
Sentinel Lights Rental Rate – per month	$	9.51
Sentinel Lights Pole Rental Rate – per month	$	4.15
Joint Use for Municipality Streetlights	$	2.04

Specific Charge for LDCs Access to the Power Poles ($/pole/year)

LDC Rate for 10’ of power space	$	47.82
LDC Rate for 15’ of power space	$	57.38
LDC Rate for 20’ of power space	$	64.08
LDC Rate for 25’ of power space	$	67.90
LDC Rate for 30’ of power space	$	71.73
LDC Rate for 35’ of power space	$	74.60
LDC Rate for 40’ of power space	$	76.51
LDC Rate for 45’ of power space	$	78.42
LDC Rate for 50’ of power space	$	79.38
LDC Rate for 55’ of power space	$	81.29
LDC Rate for 60’ of power space	$	82.25

Specific Charge for Generator Access to the Power Poles ($/pole/year)

Generator Rate for 10’ of power space	$	47.82
Generator Rate for 15’ of power space	$	57.38
Generator Rate for 20’ of power space	$	64.08
Generator Rate for 25’ of power space	$	67.90
Generator Rate for 30’ of power space	$	71.73
Generator Rate for 35’ of power space	$	74.60
Generator Rate for 40’ of power space	$	76.51
Generator Rate for 45’ of power space	$	78.42
Generator Rate for 50’ of power space	$	79.38
Generator Rate for 55’ of power space	$	81.29
Generator Rate for 60’ of power space	$	82.25

RETAIL SERVICE CHARGES (if applicable)

The application of these rates and charges shall be in accordance with the Licence of the Distributor and any Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, which may be applicable to the administration of this schedule.

No rates and charges for the distribution of electricity and charges to meet the costs of any work or service done or furnished for the purpose of the distribution of electricity shall be made except as permitted by this schedule, unless required by the Distributor's Licence or a Code or Order of the Ontario Energy Board, and amendments thereto as approved by the Ontario Energy Board, or as specified herein.

Unless specifically noted, this schedule does not contain any charges for the electricity commodity, be it under the Regulated Price Plan, a contract with a retailer or the wholesale market price, as applicable.

It should be noted that this schedule does not list any charges, assessments, or credits that are required by law to be invoiced by a distributor and that are not subject to Ontario Energy Board approval, such as the Debt Retirement Charge, the Global Adjustment and the HST.

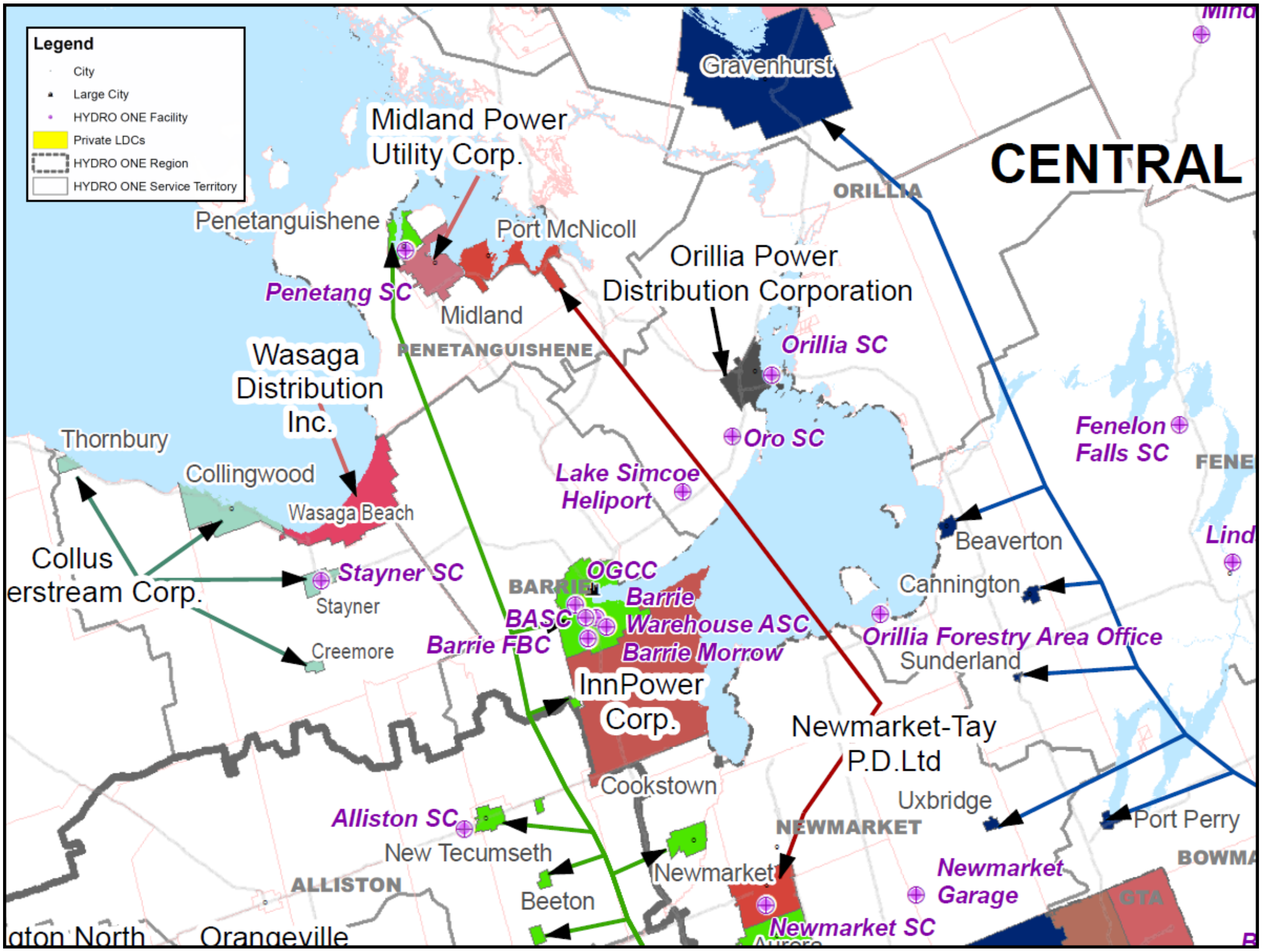
Retail Service Charges refer to services provided by a distributor to retailers or customers related to the supply of competitive electricity.

One-time charge, per retailer, to establish the service agreement between the distributor and the retailer	$	100.00
Monthly fixed charge, per retailer	$	20.00
Monthly variable charge, per customer, per retailer	$/cust.	0.50
Distributor-consolidated billing monthly charge, per customer, per retailer	$/cust.	0.30
Retailer-consolidated billing monthly credit, per customer, per retailer	$/cust.	(0.30)
Service Transaction Requests (STR)		
Request fee, per request, applied to the requesting party	$	0.25
Processing fee, per request, applied to the requesting party	$	0.50
Request for customer information as outlined in Section 10.6.3 and Chapter 11 of the Retail Settlement Code directly to retailers and customers, if not delivered electronically through the Electronic Business Transaction (EBT) system, applied to the requesting party		
Up to twice a year	$	no charge
More than twice a year, per request (plus incremental delivery costs)	$	2.00

LOSS FACTORS

If the distributor is not capable of prorating changed loss factors jointly with distribution rates, the revised loss factors will be implemented upon the first subsequent billing for each billing cycle.

Total Loss Factor - Secondary Metered Customer < 5,000 kW	1.0561
Total Loss Factor - Primary Metered Customer < 5,000 kW	1.0455


Legend
City
Large City
HYDRO ONE Facility
Private LDCs
HYDRO ONE Region
HYDRO ONE Service Territory
CENTRAL
Gravenhurst
Midland Power Utility Corp.
Penetanguishene
Port McNicoll
Orillia Power Distribution Corporation
ORILLIA
Penetang SC
Midland
PENETANGUISHENE
Orillia SC
Wasaga Distribution Inc.
Oro SC
Fenelon Falls SC
Thornbury
Collingwood
Wasaga Beach
Lake Simcoe Heliport
Beaverton
Collus erstream Corp.
Stayner SC
Stayner
Creemore
OGCC
BARRIE
Barrie
BASC
Warehouse ASC
Barrie FBC
Barrie Morrow
Cannington
Orillia Forestry Area Office
Sunderland
InnPower Corp.
Newmarket-Tay P.D.Ltd
Cookstown
Uxbridge
Port Perry
Alliston SC
New Tecumseth
NEWMARKET
Newmarket Garage
ALLISTON
Beeton
Newmarket
Newmarket SC
BOWMA
GTA
Orangeville

c.

Ontario Electric Distribution Utility Sector

GIS Date Prepared: Thursday, September 06, 2018
Time: 2:17:23 PM

Orillia Power Distribution Corporation

FINANCIAL STATEMENTS

December 31, 2017

ORILLIAPOWER
Energizing Our Community®

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17310 Yonge Street, Unit 11
Newmarket ON L3Y 7R9 Canada

Independent Auditor's Report

To the Shareholder of Orillia Power Distribution Corporation

We have audited the accompanying financial statements of Orillia Power Distribution Corporation, which comprise the statement of financial position as at December 31, 2017 and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Orillia Power Distribution Corporation as at December 31, 2017, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

BDO Canada LLP

Chartered Professional Accountants, Licensed Public Accountants

Newmarket, Ontario
April 25, 2018

STATEMENT OF FINANCIAL POSITION

As at (in thousands of Canadian dollars)	Notes	**December 31 2017** **$**	December 31 2016 $
ASSETS			
Current Assets			
Cash and cash equivalents	5	**482**	-
Accounts receivable	6	**3,664**	4,347
Unbilled energy and distribution revenue	7	**3,597**	4,396
Inventories	8	**569**	527
Prepaid expenses		**118**	107
Due from related parties	25	**646**	786
Current assets		**9,076**	10,163
Non-current Assets			
Property, plant and equipment	9	**30,230**	27,969
Intangible assets	10	**61**	86
Deferred income tax asset	14	**2,306**	2,754
Non-current assets		**32,597**	30,809
Total assets		**41,673**	40,972
Regulatory deferral account debit balances	11	**1,455**	1,757
Total assets and regulatory deferral account debit balances		**43,128**	42,729

The accompanying notes are an integral part of these financial statements

STATEMENT OF FINANCIAL POSITION

As at (in thousands of Canadian dollars)	Notes	**December 31 2017** $	December 31 2016 $
LIABILITIES AND SHAREHOLDER'S EQUITY			
Current Liabilities			
Bank indebtedness	12	**5,000**	6,137
Accounts payable and accrued liabilities	13	**6,837**	6,562
Payments in lieu of taxes payable	14	**631**	572
Customer security deposits	15	**262**	141
Current portion of long term debt	18	**210**	210
Due to related parties	25	**122**	154
Current liabilities		**13,062**	13,776
Non-current Liabilities			
Customer security deposits	15	**596**	472
Post-retirement benefits	16	**578**	578
Deferred revenue	17	**1,830**	1,526
Long term debt	18	**10,077**	10,287
Non-current liabilities		**13,081**	12,863
Shareholder's Equity			
Share capital	19	**8,236**	8,236
Retained earnings		**6,425**	5,808
Accumulated other comprehensive loss		**(90)**	(90)
Shareholder's equity		**14,571**	13,954
Total liabilities and shareholder's equity		**40,714**	40,593
Regulatory deferral account credit balances	11	**2,414**	2,136
Total equity, liabilities and regulatory deferral account credit balances		**43,128**	42,729

The accompanying notes are an integral part of these financial statements

On Behalf of the Board of Directors:

Director Director

STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31
(in thousands of Canadian dollars)

	Notes	2017 $	2016 $
Revenue			
Recovered energy purchases		**36,974**	40,346
Operating revenue	20	**8,748**	8,633
		45,722	48,979
Expenses			
Energy purchases		**36,877**	40,573
Operating expenses	21	**4,870**	5,122
Depreciation and amortization		**1,187**	1,144
(Gain) loss on disposal of property plant and equipment		**(93)**	77
		42,841	46,916
Operating profit		**2,881**	2,063
Finance income	22	**7**	10
Finance costs	22	**(808)**	(740)
Profit before provision for payments in lieu of taxes		**2,080**	1,333
Provision for payments in lieu of taxes			
Current provision	14	**59**	913
Deferred provision	14	**448**	(1,680)
		507	(767)
Profit for the year before net movement in regulatory deferral account balances		**1,573**	2,100
Net movement in regulatory balances including related deferred taxes	11	**(356)**	(547)
Profit for the year		**1,217**	1,553
Other comprehensive income:			
Items that will not be reclassified subsequently to profit and loss:			
Actuarial loss on defined benefit plans net of deferred taxes		**-**	15
Comprehensive income for the year		**1,217**	1,568

The accompanying notes are an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY

Year ended December 31 (in thousands of Canadian dollars)	Share Capital	Retained Earnings	Other Comprehensive Income (Loss)	Equity Totals
	$	$	$	$
SUMMARY OF CHANGES IN EQUITY				
Balance at December 31, 2015	8,236	4,505	(105)	12,636
Changes in equity during 2016				
Total comprehensive income for the year	-	1,553	15	1,568
Dividends paid to the City of Orillia	-	(250)	-	(250)
Balance at December 31, 2016	8,236	5,808	(90)	13,954
Changes in equity during 2017				
Total comprehensive income for the year	**-**	**1,217**	**-**	**1,217**
Dividends paid to the City of Orillia	**-**	**(600)**	**-**	**(600)**
Balance at December 31, 2017	**8,236**	**6,425**	**(90)**	**14,571**

The accompanying notes are an integral part of these financial statements

STATEMENT OF CASH FLOWS

Year ended December 31
(in thousands of Canadian dollars)

	Notes	2017 $	2016 $
Operating activities			
Profit for the year		**1,217**	1,553
Adjustments to reconcile profit to net cash used in operating activities			
Depreciation and amortization (non-cash)		**1,187**	1,144
Other non-cash or non-operating items included in profit	23	**1,534**	505
		3,938	3,202
Net changes in non-cash working capital	24	**855**	1,349
Payments in lieu of income taxes - current provision	14	**(59)**	(913)
Net cash from operating activities including tax provision		**4,734**	3,638
Investing activities			
Purchase of property, plant, equipment and intangible assets	9, 10	**(3,549)**	(5,565)
Proceeds on disposal of property, plant & equipment		**218**	-
Interest received	22	**7**	10
Changes in regulatory deferral account balances	11	**225**	(1,029)
Net cash used in investing activities		**(3,099)**	(6,584)
Financing activities			
Borrowing on term debt facility	12	**-**	3,000
Repayment of long term debt	18	**(210)**	(210)
Deferred revenue	17	**349**	396
Customer security deposits	15	**124**	152
Post retirement benefits payments	16	**(30)**	(29)
Interest paid	22	**(786)**	(715)
Dividends paid in cash		**(600)**	(250)
Net cash from financing activities		**(1,153)**	2,344
Net decrease in cash and cash equivalents during the year		**482**	(602)
Cash and cash equivalents, beginning of the year		**-**	602
Cash and cash equivalents, end of the year		**482**	-

The accompanying notes are an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
(in thousands of Canadian dollars unless otherwise noted)

1. CORPORATE INFORMATION

Orillia Power Distribution Corporation ("OPDC") owns and operates an electricity distribution system, which delivers electricity to approximately 13,900 customers located in Orillia, Ontario. The address of OPDC's corporate office and principal place of business is 360 West Street South, Orillia, Ontario, Canada L3V 6J9.

Orillia Power Corporation is the sole shareholder of OPDC. The common shares of Orillia Power Corporation are 100% owned by the Corporation of the City of Orillia ("City"), the ultimate parent.

OPDC was incorporated under the Business Corporations Act (Ontario) on October 26, 2000. OPDC operates under license issued by the Ontario Energy Board ("OEB"). OPDC is regulated by the OEB and adjustments to OPDC's distribution and power rates require OEB approval.

2. BASIS OF PREPARATION

2.1 Statement of compliance

The Financial Statements of OPDC have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations as issued by the International Financial Reporting Interpretations Committee of the IASB.

The Financial Statements were authorized for issue by the Board of Directors on April 25, 2018.

2.2 Basis of measurement

The Financial Statements have been prepared on a historical cost basis.

2.3 Presentation currency

The Financial Statements are presented in Canadian dollars, which is also OPDC's functional currency, and all values are rounded to the nearest one thousand dollars, unless when otherwise indicated.

2.4 Explanation of activities subject to rate regulation

The Ontario government enacted the Energy Competition Act, 1998 ("ECA"), to introduce competition to the Ontario energy market. The OEB was granted a legislative mandate including broad powers relating to licensing, standards of conduct and service quality and the regulation of rates charged by OPDC and other electricity distributors in Ontario.

OPDC as an electricity distributor, is licensed and regulated by the OEB. The OEB exercises statutory authority through setting or approving all rates charged by the distribution company and establishing standards of service quality for its customers. OPDC's distribution rates are set by the OEB on an annual basis for May 1 to April 30.

2.5 Regulatory risk

Regulatory risk is the risk that the Province and its regulator, the OEB, could establish a regulatory regime that imposes conditions that restrict the electricity distribution business from achieving an acceptable rate of return that permits financial sustainability of its operations including the recovery of expenses incurred for the benefit of other market participants in the electricity industry such as transition costs and other regulatory assets. All requests for changes in electricity distribution charges require the approval of the OEB.

2. BASIS OF PREPARATION (continued)

2.6 Recovery risk

Regulatory developments in Ontario's electricity industry, including current and possible future consultations between the OEB and interested stakeholders, may affect distribution rates and other permitted recoveries in the future. OPDC is subject to a cost of service regulatory mechanism under which the OEB establishes the revenues required (i) to recover the forecast operating costs, including depreciation and amortization and income taxes, of providing the regulated service, and (ii) to provide a fair and reasonable return on utility investment, or rate base. As actual operating conditions may vary from forecast, actual returns achieved can differ from approved returns.

2.7 Potential sale of OPDC

The City and Orillia Power Corporation had signed a share purchase agreement ("SPA") with Hydro One Inc. ("Hydro One") to sell OPDC. The agreement was signed on August 15, 2016 subject to review and approval by the OEB. On September 27, 2016, Hydro One filed an application with the OEB requesting approval to acquire all of the shares of the Company. On April 12, 2018 the OEB issued its decision denying the application. The Company intends to appeal the decision within the twenty-day time limit.

2.8 Comparative Figures

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted for the current year.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The preparation and presentation of financial statements can be significantly affected by the accounting policies selected by OPDC. The financial statements reflect the following significant accounting policies, which are an integral part of understanding the financial results and financial position presented within.

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements unless otherwise indicated.

3.1 Regulatory deferral accounts

Regulatory deferral account debit balances represent future revenues associated with certain costs incurred in the current period or in prior period(s), which are expected to be recovered from consumers in future periods through the rate-setting process. Regulatory deferral account credit balances are associated with the collection of certain revenues earned in the current period or in prior period(s), which are expected to be returned to consumers in future periods through the rate-setting process.

Regulatory deferral account balances can arise from differences in amounts collected from customers (based on regulated rates) and the corresponding cost of non-competitive electricity service incurred by OPDC in the wholesale market administered by the Independent Electricity System Operator (the "IESO") after May 1, 2002. These amounts have been accumulated pursuant to regulation underlying the ECA and deferred in anticipation of their future recovery (payment) from (to) distribution customers.

Explanation of Recognized Amounts

Regulatory deferral account balances are recognized and measured initially and subsequently at cost. They are assessed for impairment on the same basis as other non-financial assets as described below. Management continually assesses the likelihood of recovery of regulatory assets. If recovery through future rates is no longer considered probable, the amounts would be charged to the results of operations in the period that the assessment is made.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Revenue

Revenue is recognized to the extent that it is probable that economic benefits will flow to OPDC and that the revenue can be reliably measured. Revenue is comprised of recovered energy purchases, distribution of energy, pole use rental, collection charges, investment income and other miscellaneous revenues.

Recovered energy purchases and distribution of energy

OPDC is licensed by the OEB to distribute electricity. As a licensed distributor, OPDC is responsible for billing customers for electricity generated by third parties and the related costs of providing electricity service, such as transmission services and other services provided by third parties. OPDC is required, pursuant to regulation, to remit such amounts to these third parties, irrespective of whether OPDC ultimately collects these amounts from customers. OPDC has determined that they are acting as a principal for the electricity distribution and, therefore, have presented the electricity revenues on a gross basis.

Revenues from recovered energy purchases and distribution of electricity is recognized on an accrual basis, including unbilled revenues accrued in respect of electricity delivered but not yet billed. Recovered energy purchases and distribution of energy revenue is comprised of customer billings based on actual monthly meter readings.

Other

Other revenues, which include revenues from pole use rental, collection charges, contributions in aid of construction and other miscellaneous revenues are recognized at the time services are provided.

Deferred revenue

Where OPDC has an ongoing obligation to provide services, revenues are recognized as the service is performed and amounts billed in advance are recognized as deferred revenue.

Certain assets may be acquired or constructed with financial assistance in the form of contributions from customers when the estimated revenue is less than the cost of providing service or where special equipment is needed to supply the customers' specific requirements. Since the contributions in aid of construction will provide customers with ongoing access to the supply of electricity, these contributions are classified as deferred revenue and are amortized as revenue on a straight-line basis over the useful life of the constructed or contributed asset.

3.3 Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held at call with financial institutions and other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and subject to an insignificant risk of change in value.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.4 Financial instruments

Recognition, initial measurement and derecognition

Financial assets and liabilities are recognized when OPDC becomes a party to the contractual provisions of the financial instrument and are measured initially at fair value adjusted for transaction costs, except for those carried at fair value through comprehensive income which are measured initially at fair value. Subsequent measurement of financial assets and financial liabilities is described below.

Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and substantially all the risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled or expires.

Classification and subsequent measurement of financial assets

For the purpose of subsequent measurement of financial assets, they are classified into the following categories upon initial recognition, loans and receivables and available-for-sale financial assets. OPDC currently does not have assets that would be classified as available for sale. All financial assets classified as loans and receivables are reviewed for impairment at least at each reporting date to identify whether there is any objective evidence of impairment. All income and expenses relating to financial assets that are recognized in profit or loss are presented within finance costs or finance income, except for impairment of trade receivables which is presented within operating expenses.

Financial assets classified as loans and receivables

Financial assets classified as loans and receivables include cash and cash equivalents, accounts receivable, unbilled energy and distribution revenue and due from related parties. Collectability of accounts receivable is reviewed on an ongoing basis. Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default. Receivables that are not considered to be individually impaired are reviewed for impairment in groups, which are determined by reference to the industry and region of the counterparty and other shared credit risk characteristics. The impairment loss estimate is then based on recent historical counterparty default rates for each identified group. Accounts receivable which are known to be uncollectible are written off. A provision for doubtful receivables is established when there is objective evidence that OPDC will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the asset’s carrying amount and the present value of future cash flows. The amount of the provision is recognized in the Statement of Comprehensive Income.

Classification and subsequent measurement of financial liabilities

All of OPDC’s financial liabilities are classified as other financial liabilities, and include bank indebtedness, accounts payable and accrued liabilities, customer deposits, due to related parties and long term debt. Other financial liabilities are measured subsequently at amortized cost using the effective interest method. All interest-related charges are reported in profit or loss and included within finance costs or finance income.

Customer Security Deposits

Customers may be required to post security to obtain electricity or other services, which are refundable. Cash and securities lodged with OPDC by counterparties under electricity supply agreements are also included in this balance. Where the security posted is in the form of cash or cash equivalents, these amounts are recorded in the accounts as customer security deposits. Interest rates paid on customer deposits are based on the Bank of Canada’s prime business rate less 2%.

(in thousands of Canadian dollars unless otherwise noted)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.5 Property, plant and equipment

Recognition and measurement

Property, plant and equipment ("PP&E") are recognized at cost, being the purchase price and directly attributable cost of acquisition or construction required to bring the asset to the location and condition necessary to be capable of operating in the manner intended by OPDC, including eligible borrowing costs.

Depreciation of PP&E is recorded in the Statement of Comprehensive Income on a straight-line basis over the estimated useful life of the related asset. The estimated useful lives, residual values and depreciation methods are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

The estimated useful lives for PP&E are as follows:

Buildings and fixtures	10 - 50 years
Substations	15 - 60 years
Sub-transmission lines	45 - 60 years
Distribution system	40 - 60 years
Smart meters	15 years
Other capital assets	15 - 20 years
Land	not depreciated

When parts of an item of PP&E have different useful lives, they are accounted for as separate items (major components) of PP&E.

Major spare parts

Major spares such as spare transformers and other items kept as standby/back up equipment are accounted for as PP&E since they support OPDC's distribution system reliability.

Contributions in aid of construction

When an asset is received as a capital contribution, the asset is initially recognized at its fair value, with the corresponding amount net of payments to the developer recognized as deferred revenue (contributions in aid of construction).

Gains and losses on disposal

Gains and losses on disposal of an item of PP&E are determined by comparing the net proceeds from disposal with the carrying amount of the asset, and are included in the Statement of Comprehensive Income when the asset is disposed of. When an item of PP&E with related contributions in aid of construction is disposed, the remaining deferred revenue is recognized in full in the Statement of Comprehensive Income.

3.6 Borrowing costs

OPDC capitalizes interest expenses and other finance charges directly relating to the acquisition, construction or production of assets that take a substantial period of time to get ready for its intended use. Capitalization commences when expenditures are being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalization is suspended during periods in which active development is interrupted and ceases when substantially all of the activities necessary to prepare the asset for its intended use or sale are complete.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.7 Intangible assets

Computer software and land rights

Computer software that is acquired or developed by OPDC, including software that is not integral to the functionality of equipment purchased, which has finite useful lives, is measured at cost less accumulated amortization and accumulated impairment losses.

Payments to obtain rights to access land ("land rights") are classified as intangible assets. These include payments made for easements, right of access and right of use over land for which OPDC does not hold title. Land rights are measured at cost less accumulated amortization and accumulated impairment losses.

Amortization

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. Amortization methods and useful lives of all intangible assets are reviewed at each reporting date.

The estimated useful lives for intangible assets are:

Land rights	40 years
Computer software	5 years

3.8 Impairment of non-financial assets

OPDC conducts annual internal assessments of the values of PP&E, intangible assets and regulatory deferral account debit balances to determine whether there are events or changes in circumstances that indicate that their carrying amount may not be recoverable. Where the carrying value exceeds its recoverable amount, which is the higher of value in use and fair value less costs to sell, the asset is written down accordingly.

Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets to which the asset belongs for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets. The entire Company is considered one cash-generating unit for which impairment testing is performed. An impairment loss is charged to the Statement of Comprehensive Income, except to the extent it reverses gains previously recognized in other comprehensive income.

3.9 Provisions

A provision is recognized if, as a result of a past event, OPDC has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.10 Post retirement benefits

Defined contribution plan

The employees of OPDC participate in the Ontario Municipal Employees Retirement System ("OMERS"). OPDC also makes contributions to the OMERS plan on behalf of its employees. The plan has a defined benefit option at retirement available to some employees, which specifies the amount of the retirement benefit plan to be received by the employees based on length of service and rates of pay. OPDC is only one of a number of employers that participates in the plan and the financial information provided to OPDC on the basis of the contractual agreements is insufficient to measure OPDC's proportionate share in the plan assets and liabilities on defined benefit accounting requirements. As insufficient information is available to account for the plan as a defined benefit plan, the contribution payable in exchange for services rendered during a period is recognized as an expense during that period.

Defined benefit plans

A defined benefit plan is a post employment benefit plan other than a defined contribution plan. OPDC's net obligation on behalf of its retired employees unfunded life insurance, extended medical and dental benefits is calculated by estimating the amount of future benefits that are expected to be paid out discounted to determine its present value. Any unrecognized past service costs are deducted.

The calculation is performed by a qualified actuary using the projected unit credit method every third year or when there are significant changes to workforce. When the calculation results in a benefit to OPDC, the recognized asset is limited to the total of any unrecognized past service costs and the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. An economic benefit is available to OPDC if it is realizable during the life of the plan, or on settlement of the plan liabilities.

Defined benefit obligations are measured using the projected unit credit method discounted to its present value using yields available on high quality corporate bonds that have maturity dates approximating to the terms of the liabilities. Remeasurements of the defined benefit obligation include actuarial gains and losses and are recognized directly within equity in other comprehensive income. Service costs are recognized in the Statement of Comprehensive Income in operating expenses, and include current and past service costs as well as gains and losses on curtailments.

Net interest expense is recognized the Statement of Comprehensive Income in finance expense, and is calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the balance of the net defined benefit obligation, considering the effects of benefit payments during the period. Gains or losses arising from changes to defined benefits or plan curtailment are recognized immediately in the Statement of Comprehensive Income. Settlements of defined benefit plans are recognized in the period in which the settlement occurs.

Other long-term service benefits

Other employee benefits that are expected to be settled wholly within 12 months after the end of the reporting period are presented as current liabilities. Other employee benefits that are not expected to be settled wholly within 12 months after the end of the reporting period are presented as non-current liabilities and calculated using the projected unit credit method and then discounted using yields available on high quality corporate bonds that have maturity dates approximating to the expected remaining period to settlement.

NOTES TO THE FINANCIAL STATEMENTS

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.11 Payment in lieu of taxes payable

Tax status

Prior to August 15, 2016, OPDC was an Municipal Electricity Utility (“MEU”) for purposes of the payments in lieu of taxes (“PILs”) regime contained in the ECA. As an MEU, OPDC was exempt from tax under the Federal Income Tax Act (Canada) and the Corporations Tax Act (Ontario) (“Tax Act”).

Under the ECA, OPDC was required to make, for each taxation year, PILs to the Ontario Electricity Financial Corporation, commencing October 1, 2001. These payments were calculated in accordance with the rules for computing taxable income and taxable capital and other relevant amounts contained in the Tax Act as modified by the ECA, and related regulations.

On August 15, 2016 OPDC became party to a share purchase agreement with Hydro One, a company taxable under the Tax Act. Consequently, under section 149(1.1) of the Tax Act, OPDC ceased to be exempt under the ITA as of the date of signing the Share Purchase Agreement. Pursuant to section 149(10) of the Tax Act, as of the date it ceased to be exempt, OPDC became liable to pay both federal and provincial income tax, with its first tax year starting at that time.

Current and deferred tax

Income tax expense is comprised of current and deferred tax. Current tax and deferred tax are recognized in comprehensive income except to the extent that it relates to items recognized directly in equity or regulatory deferral account balances. Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base. The amount of the deferred tax asset or liability is measured at the amount expected to be recovered from or paid to the taxation authorities. This amount is determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date and are expected to apply when the liabilities / (assets) are settled / (recovered). OPDC recognized deferred tax arising from temporary difference on regulatory deferral account balances, post retirement benefits and PP&E and intangible assets.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available against which the deferred tax asset can be utilized.

At the end of each reporting period, OPDC reassesses both recognized and unrecognized deferred tax assets. OPDC recognizes a previously unrecognized deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

3.12 Leased assets

Leases in terms of which OPDC assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other leases are operating leases and the leased assets are not recognized on OPDC's balance sheet. Payments made under operating leases are recognized in the Statement of Comprehensive Income on a straight-line basis over the lease term.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.13 Finance income and finance costs

Finance income is comprised of interest income on funds invested such as cash and cash equivalents. Interest income is recognized as it accrues in the Statement of Comprehensive Income, using the effective interest method. Finance costs are comprised of interest payable on debt, post retirement benefits and impairment losses recognized on financial assets.

3.14 Inventories

Cost of inventories comprise of direct materials, which typically consists of distribution assets not deemed as major spares, unless purchased for specific capital projects in process or as spare units. Costs, after deducting rebates and discounts, are assigned to individual items of inventory on the basis of weighted average cost. Decommissioned assets that are transferred to inventory are tested for impairment once they are removed from service and placed in inventory. Inventory is recognized at the lower of cost and net realizable value.

Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

3.15 Standards, amendments and interpretations not yet effective

At the date of authorization of these Financial Statements, certain new standards, amendments and interpretations to existing standards have been published by the IASB but are not yet effective, and have not been adopted early by OPDC.

Management anticipates that all of the relevant pronouncements will be adopted in OPDC’s accounting policies for the first period beginning after the effective date of the pronouncement. Information on new standards, amendments and interpretations that are expected to be relevant to OPDC’s Financial Statements is provided below. Certain other new standards and interpretations have been issued but are not expected to have a material impact on OPDC’s Financial Statements.

IFRS 9 Financial Instruments replaces IAS 39 Financial Instruments: Recognition and Measurement

IFRS 9 amends the requirements for classification and measurement of financial assets, impairment, and hedge accounting. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortized cost, fair value through profit or loss, and fair value through other comprehensive income. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The effective date for IFRS 9 is January 1, 2018. OPDC is in the process of evaluating the impact of the new standard.

IFRS 15, Revenue from Contracts with Customers

IFRS 15 is based on the core principle to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. IFRS 15 focuses on the transfer of control. IFRS 15 replaces all of the revenue guidance that previously existed in IFRS. The effective date for IFRS 15 is January 1, 2018. OPDC is in the process of evaluating the impact of the new standard.

IFRS 16, Leases

IFRS 16 requires a lessee to recognize a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The liability accrues interest. This will typically produce a front-loaded expense profile whereas operating leases under IAS 17 would typically have had straight-line expenses. The new Standard is effective for annual reporting periods beginning on or after January 1, 2019, with early application permitted but only if the entity is also applying IFRS 15, Revenue from contracts with customers. OPDC is in the process of evaluating the impact of the new standard.

4. USE OF ESTIMATES AND JUDGEMENTS

OPDC makes certain estimates and assumptions regarding the future. Estimates and judgements are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Employee future benefits

The cost of post employment life insurance, medical and dental benefits are determined using actuarial valuations. An actuarial valuation involves making various assumptions. Due to the complexity of the valuation, the underlying assumptions and its long term nature, post employment medical and insurance benefits are highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date.

PILs payable

OPDC has been required to make payments in lieu of tax calculated on the same basis as income taxes on taxable income earned until August 15, 2016. Subsequent to that date, OPDC is required to pay income taxes under the Tax Act. Significant judgement is required in determining the provision for income taxes. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain. OPDC recognizes liabilities for anticipated tax audit issues based on OPDC's current understanding of the tax law. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred tax provisions in the period in which such determination is made.

Accounts receivable impairment

In determining the allowance for doubtful accounts, OPDC considers historical loss experience of account balances based on the aging and arrears status of accounts receivable balances.

Regulatory deferral account debit and credit balances

In assessing the proper accounting treatment and determining the future disposition of regulatory deferral account debit and credit balances, OPDC considers historical industry precedent and follows the latest available and reliable guidance as well as direction through written orders issued by the regulator.

5. CASH AND CASH EQUIVALENTS

OPDC's bank accounts are held with a Canadian chartered bank and earn interest based upon its average monthly balance at the bank's prime less 1.9%. Prime rate as of December 31, 2017 was 3.20% (December 31, 2016 – 2.70%).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
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6. ACCOUNTS RECEIVABLE

Accounts receivable	**2017**	2016
	$	$
Due from distribution customers	**3,106**	3,946
Recoverable work	**257**	313
Conservation and feed in tariff initiatives	**290**	25
Other	**80**	141
	3,733	4,425
Allowance for doubtful accounts	**(69)**	(78)
	3,664	4,347
ACCOUNTS RECEIVABLES BY AGE		
0 - 60 days	**3,402**	4,028
61 - 90 days	**31**	59
Over 90 days	**300**	338
	3,733	4,425
CONTINUITY OF ALLOWANCE FOR DOUBTFUL ACCOUNTS		
Balance, beginning of year	**(78)**	(88)
Bad debt expense provision included in comprehensive income	**(83)**	(88)
Written off	**92**	98
Balance, end of year	**(69)**	(78)

Due to its short term nature, the carrying amount of the accounts receivable approximates its fair value.

NOTES TO THE FINANCIAL STATEMENTS

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7. UNBILLED ENERGY AND DISTRIBUTION REVENUE

Unbilled energy and distribution revenue represents amounts for which OPDC has a contractual right to receive cash through future billings and are unbilled at year end. All accounts are billed on a monthly basis based on power consumed in the previous month. The amount of allowance for doubtful accounts that has been provided as at December 31, 2017 for unbilled revenues is $NIL (December 31, 2016 – $NIL).

Unbilled energy and distribution revenue	2017	2016
	$	$
Unbilled energy and distribution revenue	3,597	4,396
	3,597	4,396

8. INVENTORIES

Inventories	2017	2016
	$	$
Balance, beginning of year	527	501
Inventory purchased	496	657
Inventory used in:		
Capital projects (capitalized)	(271)	(467)
Operations and maintenance (expensed)	(119)	(96)
Recoverable work	(62)	(64)
Other adjustments	(2)	(4)
Balance, end of year	569	527

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9. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment	2017	2016
	$	$
COST		
Balance, beginning of year	**31,077**	25,637
Purchase of property, plant, equipment	**3,541**	5,559
Disposals	**(305)**	(119)
Balance, end of year	**34,313**	31,077
ACCUMULATED DEPRECIATION		
Balance, beginning of year	**3,108**	2,051
Depreciation	**1,154**	1,099
Disposals	**(179)**	(42)
Balance, end of year	**4,083**	3,108
CARRYING AMOUNTS		
Balance, beginning of year	**27,969**	23,586
Purchase of property, plant, equipment	**3,541**	5,559
Depreciation	**(1,154)**	(1,099)
Disposals	**(126)**	(77)
Balance, end of year	**30,230**	27,969
SUMMARY OF CARRYING AMOUNTS BY CATEGORY		
Land and buildings	**1,060**	1,127
Distribution plant and equipment	**28,632**	26,184
Other	**538**	635
Work in progress	**-**	23
Balance, end of year	**30,230**	27,969

The amount of impairment loss that has been provided as at December 31, 2017 for PP&E is $NIL (December 31, 2016 – $NIL).

NOTES TO THE FINANCIAL STATEMENTS

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10. INTANGIBLE ASSETS

Intangible assets	2017	2016
	$	$
COST		
Balance, beginning of year	**181**	208
Purchase of intangibles	**8**	6
Disposals	**(26)**	(33)
Balance, end of year	**163**	181
ACCUMULATED AMORTIZATION		
Balance, beginning of year	**95**	83
Amortization	**33**	45
Disposals	**(26)**	(33)
Balance, end of year	**102**	95
CARRYING AMOUNTS		
Balance, beginning of year	**86**	125
Purchase of intangibles	**8**	6
Amortization	**(33)**	(45)
Balance, end of year	**61**	86
SUMMARY OF CARRYING AMOUNTS BY CATEGORY		
Land rights	**22**	16
Computer software	**39**	70
Balance, end of year	**61**	86

The amount of impairment loss that has been provided as at December 31, 2017 for intangible assets is $NIL (December 31, 2016 – $NIL).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
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11. REGULATORY DEFERRAL ACCOUNT BALANCES

All amounts deferred as regulatory deferral account balances are subject to approval by the OEB. As such, amounts subject to deferral could be altered by the regulators. Remaining recovery periods are those expected and the actual recovery or settlement periods could differ based on OEB approval. Carrying charges are applied to deferral variance accounts unless indicated otherwise using simple interest at the rate prescribed by the OEB applied to monthly opening balances in the account exclusive of accumulated interest.

11.1 Regulatory deferral account balances net of deferred income tax impacts

Due to previous, existing or expected future regulatory articles or decisions, OPDC has the following amounts expected to be recovered by customers (returned to customers) in future periods and as such regulatory deferral account balances are presented on the statement of financial position net of deferred tax impacts:

Regulatory deferral account balances		**2017**	2016
	Note	**$**	$
REGULATORY DEFERRAL ACCOUNT DEBIT BALANCES NET OF DEFERRED TAXES			
Regulatory deferral account debit balances	11.3	**1,980**	2,391
Deferred tax impact		**525**	634
		1,455	1,757
REGULATORY DEFERRAL ACCOUNT CREDIT BALANCES NET OF DEFERRED TAXES			
Regulatory deferral account credit balances	11.3	**3,284**	2,906
Deferred tax impact		**870**	770
		2,414	2,136

(in thousands of Canadian dollars unless otherwise noted)

11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.2 Regulatory deferral account impacts on Statements of Comprehensive Income and Cash Flows

The following schedule summarizes the net movement in regulatory deferral account balances adjusted for related deferred tax impacts included in the Statement of Comprehensive Income and reducing profit for the year:

Net movement in regulatory balances including related deferred taxes	2017	2016
	$	$
Regulatory debit reallocated from other income - change in PP&E useful lives	**(694)**	(664)
Retail settlement variances between energy purchased and recovered from customers	**(97)**	226
Lost revenue adjustment reallocated from other revenue	**239**	90
Amortization of stranded meters reallocated from other revenue	**(34)**	(34)
Regulatory interest and other	**21**	9
Net movement in regulatory balances before related deferred taxes	**(565)**	(373)
Deferred taxes related to changes in regulatory balances	**209**	(174)
	(356)	(547)

All of the above amounts are non-cash accruals added back to profit in order to arrive at cash flows from operating activities on the Statement of Cash Flows (see note 23).

The following schedule summarizes the net movement in regulatory deferral account balances impacting cash and included in the investing activities section of the Statement of Cash Flows:

Changes in regulatory deferral account balances on cash flow statement	2017	2016
	$	$
NET REGULATORY DEFERRAL ACCOUNT BALANCES		
Regulatory deferral account debit balances	**1,980**	2,391
Regulatory deferral account credit balances	**3,284**	2,906
Net regulatory deferral account debit (credit) balances	**(1,304)**	(515)
CHANGES IN REGULATORY DEFERRAL ACCOUNT BALANCES (CASH FLOW STATEMENT)		
Net change in deferral account debit (credit) balances	**789**	(656)
Net movement in regulatory balances before related deferred taxes	**(565)**	(373)
Other	**1**	-
Changes in regulatory deferral account balances - cash flow	**225**	(1,029)
RECONCILED TO ABOVE AS FOLLOWS:		
Disposition of approved regulatory deferral account balances	**228**	361
Interim disposition of account 1576 balance	**(4)**	(1,390)
Other	**1**	-
Changes in regulatory deferral account balances - cash flow	**225**	(1,029)

NOTES TO THE FINANCIAL STATEMENTS

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11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.3 Detail for regulatory deferral account balances

Regulatory deferral account debit balances are comprised of the following accounts:

Regulatory deferral account debit balances		2017	2016
	Account #'s	$	$
Low voltage	1550	**1,392**	1,153
Stranded meter capital	1555	**206**	240
Lost revenue variance	1568	**242**	392
Network services - transmission	1584	**5**	100
Connection services - transmission	1586	**19**	222
Global adjustment	1589	**24**	108
Disposition / recoveries	1595	**54**	134
Other		**38**	42
		1,980	2,391

Regulatory deferral account credit balances are comprised of the following accounts:

Regulatory deferral account credit balances		2017	2016
	Account #'s	$	$
Retail costs	1518 / 1548	**69**	67
IFRS - CGAAP Transitional PP&E amounts	1575	**14**	14
Change in PP&E useful lives estimates	1576	**1,900**	1,210
Wholesale market services	1580	**1,073**	1,364
Power	1588	**219**	243
Other		**9**	8
		3,284	2,906

NOTES TO THE FINANCIAL STATEMENTS

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11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.4 Continuity schedules for regulatory deferral account balances

A continuity schedule for regulatory deferral account debit balances from 2016 to 2017 follows below:

		Est. Years to recover or reverse	December 31	Recovery / reversal	Balances arising in the period	December 31
Regulatory deferral account debit balances			**2017**			2016
	Account #'s		**$**			**$**
Low voltage	1550	1 - 4	**1,392**	(489)	728	1,153
Stranded meter capital	1555	1 - 4	**206**	(34)	-	240
Lost revenue variance	1568	1 - 4	**242**	(393)	243	392
Network services - transmission	1584	1 - 4	**5**	(8)	(87)	100
Connection services - transmission	1586	1 - 4	**19**	(108)	(95)	222
Global adjustment	1589	1 - 4	**24**	(188)	104	108
Disposition / recoveries	1595	1	**54**	148	(228)	134
Other		1 - 4	**38**	(21)	17	42
			1,980	(1,093)	682	2,391

A continuity schedule for regulatory deferral account credit balances from 2016 to 2017 follows below:

		Est. Years to recover or reverse	December 31	Recovery / reversal	Balances arising in the period	December 31
Regulatory deferral account credit balances			**2017**			2016
	Account #'s					**$**
Retail costs	1518 / 1548	1 - 4	**69**	-	2	67
IFRS - CGAAP Transitional PP&E amounts	1575	1 - 4	**14**	-	-	14
Change in PP&E useful lives estimates	1576	1 - 4	**1,900**	(4)	694	1,210
Wholesale market services	1580	1 - 4	**1,073**	(922)	631	1,364
Power	1588	1 - 4	**219**	(132)	108	243
Other		1 - 4	**9**	(4)	5	8
			3,284	(1,062)	1,440	2,906

11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.5 Description of regulatory deferral account balances

A description of the nature of the regulatory deferral account debit and credit balances listed in the schedules are described below referenced by account number.

Account 1518 - Retail Cost Variance Account – Services

This account records the net of revenue derived from establishing retail service agreements, distributor-consolidated and retailer-consolidated billing and the costs of entering into retail service agreements and related administration, monitoring and other expenses necessary to maintain the contract, as well as the incremental costs incurred and any avoided costs credits to provide the related billing services.

Account 1548 - Retail Cost Variance Account – STR

This account records the net of revenue derived from service transaction requests (“STR”) in the form of a request fee, processing fee, and information request fee and the incremental cost of labour, internal information system maintenance costs and delivery costs related to the provision of these services.

Account 1550 – Low Voltage Charges Variance Account

This account records the net of revenue derived from amounts billed to customers through an OEB-approved rate for low voltage services and the amounts paid to Hydro One Networks Inc. (“Networks”) for the related low voltage services provided to OPDC.

Account 1555 – Stranded Meters Account

Conventional meters were replaced by smart meters during the smart meter deployment from 2009 to 2011 and OPDC recorded the disposition of these stranded assets in PP&E and a regulatory deferral debit balance in accordance with OEB Guidelines. This account records the net book value of the stranded conventional meters, to be amortized to depreciation expense until the next cost of service rate application. Carrying charges are not applied to this account.

Account 1568 – LRAM Variance Account

The OEB established a Lost Revenue Adjustment Mechanism variance account (“LRAMVA”) to capture the differences between the results of actual, verified impacts of authorized Conservation and Demand Management (“CDM”) activities undertaken by electricity distributors under the Legacy CDM Framework (2011 to 2014) and the Conservation First Framework (2015 to 2020) net of the level of CDM program activities included in the distributor’s load forecast (i.e. the level embedded into rates). Lost revenues are recorded annually and are included in the net movement in regulatory deferral account balances on the statement of comprehensive income. The OEB approved the disposition of an LRAMVA debit balance of $394 related to CDM programs up to December 31, 2015 in its Decision and Order for rates effective May 1, 2017 issued on March 30, 2017.

NOTES TO THE FINANCIAL STATEMENTS

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11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.5 Description of regulatory deferral account balances (continued)

Account 1575 – IFRS-CGAAP Transitional PP&E Amounts

This account records the PP&E difference arising as a result of an accounting policy change recognizing capital contributions as deferred revenue upon transition from previously adopted Canadian Generally Accepted Accounting Principles ("CGAAP") to IFRS on January 1, 2014. The balance in this account represents the amortization of the transition year capital contributions previously expensed in 2014. The associated net book value is recorded as deferred revenue and will be amortized to income over a period that matches the remaining useful lives of the related PP&E. Carrying charges are not applied to this account.

Account 1576 – Accounting Changes under CGAAP

This account records the financial differences arising as a result of changes OPDC made to accounting depreciation under CGAAP effective January 1, 2013. OPDC adopted new asset useful lives based on the 2010 "Kinectric's Report", part of an asset depreciation study initiated by the OEB for use by electricity distributors. Carrying charges are not applied to this account.

OPDC filed an application on October 19, 2015 for 2016 distribution rates (EB-2015-0286) related to the disposition of the regulatory deferral credit balance in account 1576 as of December 31, 2014. On January 14, 2016, the OEB approved on an interim basis the disposition of regulatory deferral credit of $1,481 over a one year period January 1, 2016 to December 31, 2016. The balance approved for disposition included a rate of return component of $96 calculated according to OEB filing requirements, reducing operating revenue on the statement of comprehensive income.

Account 1580 – Retail Settlement Variance Account - Wholesale Market Services

This account records the net of revenue derived from amounts billed to consumers through an OEB-approved rate for the cost of services required to operate the provincial electricity system and run the wholesale market and the amounts paid to the IESO for these system costs.

Account 1584 – Retail Settlement Variance Account – Retail Transmission Network Services

This account records the net of revenue derived from amounts billed to consumers through an OEB-approved rate for retail transmission network services and the amounts paid to Networks for the related network costs.

Account 1586 – Retail Settlement Variance Account – Retail Transmission Connection Services

This account records the net of revenue derived from amounts billed to consumers through an OEB-approved rate for retail transmission connection services and the amounts paid to Networks for the related connection costs.

Account 1588 – Retail Settlement Variance Account – Power

This account records the net of revenue derived from amounts billed to consumers for electricity costs and the amounts paid to the IESO and embedded generators for electricity purchased. OPDC purchases power on behalf of the customer and passes these costs on to the customer with no markup. This account captures variances due to theft of power and unaccounted-for energy as well as the difference between estimated and actual distribution line losses.

Account 1589 – Retail Settlement Variance Account – Global Adjustment

This account records the net of revenue derived from amounts billed to non-Regulated Price Plan ("non-RPP") consumers for global adjustment costs and an allocation of amounts paid to the IESO for global adjustment charged on electricity purchased for non-RPP consumers. This account captures variances due to the timing of bills and difference between global adjustment rates billed to consumers and final charges billed to OPDC each month.

11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.5 Description of regulatory deferral account balances (continued)

Account 1595 – Disposition of Regulatory Account Balances

This account records the net of the disposition of regulatory deferral account balances approved for recovery (or refund) in rates as part of the regulatory process and the amounts recovered (or refunded) through OEB-approved regulatory deferral account rate riders from the following OEB applications:

OPDC filed an Incentive Regulation Mechanism ("IRM") application on October 19, 2015 for 2016 distribution rates (EB-2015-0024). On March 17, 2016, the OEB approved the disposition of regulatory deferral debits of $1,690 and regulatory deferral credits of $1,198 over a one year period May 1, 2016 to April 30, 2017. The net disposition balance of $492 consisted of principal balances as of December 31, 2014, with carrying charges projected to April 30, 2016.

OPDC filed an IRM application on October 31, 2016 for 2017 distribution rates (EB-2016-0321). On March 30, 2017, the OEB approved the disposition of regulatory deferral debits of $890 and regulatory deferral credits of $1,136 over a one year period May 1, 2017 to April 30, 2018. The net disposition balance of $246 consisted of principal balances as of December 31, 2015, with carrying charges projected to April 30, 2017.

11.6 2018 Rate Application

OPDC filed an IRM application on October 16, 2017 for 2018 distribution rates (EB-2017-0264) which included a request seeking disposition of regulatory deferral balances. On March 22, 2018, the OEB approved the disposition of regulatory deferral debits of $883 and regulatory deferral credits of $646 over a one year period May 1, 2018 to April 30, 2019. The net disposition balance of $237 consisted of principal balances as of December 31, 2016, with carrying charges projected to April 30, 2018.

12. BANK INDEBTEDNESS

OPDC has executed certain credit facilities currently with a Canadian chartered bank. The facilities are subject to the borrower meeting certain covenant thresholds in order to pay dividends without bank permission. The agreement also includes financial covenants related to debt service coverage ratios and debt to capitalization ratios that must be met by the borrower. OPDC is in compliance with all covenant requirements. Facilities are as follows:

OPDC has a committed revolving operating loan available at the borrower's option by way of prime based loans, banker's acceptances and standby letters of guarantee ("L/G"), utilized to finance ongoing working capital requirements and letter of guarantee requirements. The operating loan is secured by a General Security Agreement on the assets of OPDC. Advances are at prime with a standby fee for the unused portion at 0.15%. L/G are issued at a cost of 0.50% per annum.

OPDC has a committed reducing term (multiple draw) loan available at the borrower's option by way of fixed rate terms up to five years and floating prime based loans. Utilized to finance prior year capital expenditures and replenish working capital. The operating loan is secured with a General Security Agreement on the assets of OPDC. Cash advances are at prime less 0.25%. Currently, draws on this facility are interest only and have not been locked in to a fixed term or rate.

OPDC has an uncommitted prime based operating loan available at the borrower's option subject to receiving OEB approval of the sale of the utility to Hydro One. The operating loan was established in order to facilitate the payout of the promissory note due to the City of Orillia and the debenture owing to Ontario Infrastructure Projects Corporation prior to the sale closing date.

(in thousands of Canadian dollars unless otherwise noted)

12. BANK INDEBTEDNESS (continued)

The following table outlines facilities available and utilized:

Bank indebtedness	**2017**	2016
	$	$
AMOUNTS BORROWED AND OUTSTANDING		
OPDC - revolving operating loan for working capital purposes	**-**	1,137
OPDC - committed reducing term facility for capex	**5,000**	5,000
	5,000	6,137
IRREVOCABLE LETTERS OF CREDIT OUTSTANDING		
OPDC - IESO prudential support power purchase guarantee	**2,035**	2,035
	2,035	2,035
BORROWING LIMITS ON CREDIT FACILITIES		
OPDC - revolving operating loan for working capital purposes	**8,000**	8,000
OPDC - committed reducing term facility for capex	**5,000**	5,000
OPDC - uncommitted operating loan pending OEB approval of sale of utility to Hydro One	**10,500**	-
	23,500	13,000

13. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities	**2017**	2016
	$	$
Power purchases	**3,059**	3,288
Accounts payable and accrued liabilities	**2,395**	2,383
Customer credit balances	**1,383**	891
	6,837	6,562

Due to its short term nature, the carrying amount of the accounts payable and accrued liabilities approximates its fair values.

(in thousands of Canadian dollars unless otherwise noted)

14. CURRENT AND DEFERRED INCOME TAXES (PILS)

14.1 Current income tax expense included in Statement of Comprehensive Income

Combined statutory federal and provincial tax rates for Ontario are 26.5% on active business. Income tax expense varies from amounts which would be computed by applying OPDC's combined statutory income tax rate as follows:

Current provision	2017	2016
	$	$
Profit for the year	**1,217**	1,553
Add back provision for PILs	**507**	(767)
	1,724	786
Statutory federal and provincial combined rate	**26.5%**	26.5%
Provision for PILs at statutory rates	**457**	208
Increase (decrease) in PILs resulting from differences in tax base vs carrying values:		
PP&E and intangibles	**(448)**	(267)
Regulatory and other reserves	**-**	19
Departure tax estimate due to exit from PILs regime - August 14, 2016	**(73)**	1,065
Other	**123**	(112)
	59	913

On August 15, 2016 OPDC became party to a share purchase agreement with Hydro One, a company taxable under the Tax Act. Consequently, under section 149(1.1) of the Tax Act, OPDC ceased to be exempt under that Act as of the date of signing the Share Purchase Agreement. Pursuant to section 149(10) of the Tax Act, as of the date it ceased to be exempt, OPDC became liable to pay both federal and provincial income tax, with its first tax year starting at that time.

OPDC has been deemed to have disposed of all of its assets, and reacquired them, at fair market value for income tax purposes immediately prior to August 15, 2016 and has been required to file a final tax return as of August 14, 2016 with the Ministry of Finance for Ontario. As a result of the fair market value "bump" OPDC is subject to applicable taxes from income and losses up to this date including the impact of the deemed disposition ("departure taxes") payable to the Ministry of Finance estimated at $992.

OPDC is carrying the newly adjusted cost bases for all of its assets forward into the Tax Act regime and will be maintaining a December 31'st year end.

14.2 Payment in lieu of taxes payable

Payments in lieu of taxes payable (PILS)	2017	2016
	$	$
PILs payable	**631**	572
	631	572

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
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14. CURRENT AND DEFERRED INCOME TAXES (PILS) (continued)

14.3 Deferred income tax expense included in Statement of Comprehensive Income

Deferred income taxes recognized in the Statement of Comprehensive Income are as follows:

Deferred provision	2017	2016
	$	$
Included in profit for the year		
PP&E and intangibles	**200**	539
Goodwill estimated as a result of exiting PILs tax regime on SPA signing	**248**	(2,214)
Post retirement benefits and sick pay accrual	**-**	(5)
	448	(1,680)
Included in net movement in regulatory balances		
Deferred taxes related to changes in regulatory balances	**(209)**	174
	(209)	174
Included in other comprehensive income for the year		
Post retirement benefits and sick pay accrual	**-**	5
	-	5

14.4 Deferred income tax assets

Deferred income tax assets are provided for temporary differences between the financial statement carrying values of existing assets and liabilities and their respective tax bases. The following table outlines OPDC's position with respect to deferred tax assets. The utilization of this tax asset is dependent on future taxable profits in excess of profits arising from the reversal of existing taxable temporary differences. OPDC believes that this asset should be recognized as it will be utilized through future activities.

Deferred income tax asset	2017	2016
	$	$
Net deferred tax asset due to excess of tax basis over carrying values:		
PP&E	**155**	355
Goodwill estimated as a result of exiting PILs tax regime on SPA signing	**1,966**	2,214
Post retirement benefits	**153**	153
Sick pay accrual	**32**	32
	2,306	2,754

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
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14. CURRENT AND DEFERRED INCOME TAXES (PILS) (continued)

14.5 Deferred tax balances related to regulatory deferral accounts

Deferred tax balances related to regulatory deferral account debit and credit balances are netted against the applicable regulatory deferral account debit or credit balances. They are not included with the other deferred income tax asset balances related to PP&E, intangibles, post retirement benefits and loss carry forward.

Deferred income tax assets (liabilities) included with regulatory balances	2017	2016
	$	$
Asset (liability) due to excess (shortfall) of tax basis over carrying values:		
Asset included with regulatory deferral account credit balances	**870**	770
Liability included with regulatory deferral account debit balances	**(525)**	(634)
	345	136

15. CUSTOMER SECURITY DEPOSITS

Customer deposits represents cash deposits from electricity distribution customers and retailers, as well as construction deposits from customers and developers. Deposits from electricity distribution customers are refundable to customers demonstrating an acceptable level of credit risk as determined by OPDC in accordance with policies set out by the OEB or upon termination of their electricity distribution service. Construction deposits represent cash prepayments for the estimated cost of capital projects recoverable from customers and developers. Upon completion of the capital project, these deposits are transferred to contributions in aid of construction.

Customer security deposits	2017	2016
	$	$
Customer deposits	**450**	402
Construction deposits	**408**	211
	858	613
Allocated to:		
Current	**262**	141
Long term	**596**	472
	858	613

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
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16. POST RETIREMENT BENEFITS

Defined contribution plan

The employees of OPDC participate in the Ontario Municipal Employees Retirement System ("OMERS"). Although the plan has a defined retirement benefit plan for employees, the related obligation of the corporation cannot be identified. The OMERS plan has several unrelated participating municipalities and costs are not specifically attributed to each participant. The employer portions of amounts paid to OMERS made for current service and recognized in comprehensive income are as follows:

Contributions to OMERS on behalf of employees	2017	2016
	$	$
Contributions to OMERS on behalf of employees	**326**	355

Defined benefit plan

OPDC provides certain unfunded health, dental and life insurance benefits on behalf of its retired employees. These benefits are provided through a group defined benefit plan. OPDC has reported its share of the defined benefit costs and related liabilities, as calculated by an actuary, in these Financial Statements.

The accrued benefit liability and the expense for the year ended December 31, 2017 were based on results and assumptions determined by actuarial valuation as at December 31, 2016 are as follows:

Post retirement benefits	2017	2016
	$	$
Defined benefit obligation, beginning of year	**578**	648
Amounts recognized in profit for the year		
Current service costs	**8**	11
Finance costs on obligation	**22**	25
	30	36
Benefit payments	**(30)**	(29)
Costs reallocated across companies due to employee transfers	**-**	(36)
Experience loss included in other comprehensive income	**-**	(41)
Defined benefit obligation, end of year	**578**	578

The plan is exposed to a number of risks, including:

- Interest rate risk: decreases/increases in the discount rate used (high quality corporate bonds) will increase/decrease the defined benefit obligation.
- Longevity risk: changes in the estimation of mortality rates of current and former employees.
- Health care cost risk: increases in cost of providing health, dental and life insurance benefits.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
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16. POST RETIREMENT BENEFITS (continued)

Assumptions used in the actuarial valuation in order to determine the present value of the unfunded obligation are as follows:

Assumptions used in actuarial valuation	2017	2016
Discount rate	**3.9%**	3.9%
Consumer price index	**2.0%**	2.0%
Compensation increase	**2.5%**	2.5%
Health cost increases	**4.5%**	4.5%
Dental cost increase	**4.5%**	4.5%
Retirement age	**60**	60

17. DEFERRED REVENUE

Deferred revenue consists of capital contributions received from developers during the construction and acquisition of distribution PP&E which has not yet been recognized into other revenue. Such capital contributions are recorded as deferred revenue and recognized to other revenue over the life of the related assets as follows:

Deferred revenue	2017	2016
	$	$
Balance, beginning of year	**1,526**	1,166
Contributions in aid of construction received	**349**	396
Contributions in aid of construction amortized to other revenue	**(45)**	(36)
Balance, end of year	**1,830**	1,526

(in thousands of Canadian dollars unless otherwise noted)

18. LONG TERM DEBT

Long term debt	2017	2016
	$	$
Promissory notes due to the City	**9,762**	9,762
Debenture payable to Ontario Infrastructure Projects Corporation ("OIPC")	**525**	735
	10,287	10,497
Current portion of debenture payable to OIPC	**210**	210
	10,077	10,287
Principal repayments anticipated over the next five years and thereafter:		
2017	**-**	210
2018	**525**	210
2019	**-**	210
2020	**-**	105
2021	**-**	-
2022	**-**	-
Thereafter	**9,762**	**9,762**
	10,287	10,497

Promissory notes payable to the City

The promissory notes payable to the City bear interest for the current year at 6.25% per annum (2016 – 6.25%). Interest payments are required to be made quarterly on the last day of March, June, September and December. The promissory notes are due December 31, 2030 and payments to the City of Orillia are interest only. Under the terms of the notes, the City of Orillia can demand repayment of up to 20% of the original principal in a calendar year with the payment to be made March 31 provided the City gives six months' notice to OPDC. No such demand has been made by the City as of the date of approval of these financial statements. The fair value of the notes at current market borrowing rates approximates $11,193 (2016 - $11,383). The notes are secured by a general security agreement on all the assets of OPDC. Should the OEB approve the sale of OPDC to Hydro One, the promissory note to the City will be repaid prior to the closing date of the sale.

Debenture payable to Infrastructure OIPC

OPDC had entered into debenture financing with OIPC to fund its smart meter infrastructure expenditures. On May 3, 2010 a debenture in the amount of $2,100 was issued based on a 10-year term and an annual interest rate of 4.39%. OPDC incurred $32 (2016 - $39) in interest expense to OIPC in 2017. Under the terms of the debenture, OPDC was required to make principal repayments of $210 annually, until debenture retirement in 2020. The fair value of the debenture at current market borrowing rates approximated $539 (2016 - $763). The financing arrangement granted OIPC a general security agreement against OPDC, in third priority behind the Toronto Dominion Bank and the City of Orillia. The debenture was retired on February 26, 2018 for a total of $539 plus accrued interest.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
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19. SHARE CAPITAL

Nature and purpose of equity

The reserves recorded in equity on OPDC's Statement of Financial Position include "Share capital" and "Retained earnings". Share capital is used to record the issuance of equity. Retained earnings is used to record OPDC's change in retained earnings from year to year.

Share capital

An unlimited number of common shares with no par value are authorized for issue. All shares are ranked equally with regards to OPDC's residual assets and there was no change in share capital during 2016 and 2015. OPDC does not have preference shares.

Share capital	2017	2016
	$	$
Share capital	**8,236**	8,236
	8,236	8,236
Issued and fully paid:		
Number of common shares	**1,001**	1,001

20. OPERATING REVENUE

Operating revenue	2017	2016
	$	$
Distribution revenue	**8,216**	7,951
Other revenue	**532**	682
	8,748	8,633

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
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21. OPERATING EXPENSES

Operating expenses	2017	2016
	$	$
EXPENSES BY NATURE		
Board of Directors and staff costs	**2,790**	2,918
Operations and maintenance	**845**	595
General adminstration and overhead	**1,139**	1,233
Bad debts	**83**	88
Donations	**13**	288
	4,870	5,122
EXPENSES BY FUNCTION		
Operations and maintenance	**2,288**	2,163
Billing and collection	**1,183**	1,136
Administration and general	**1,399**	1,823
	4,870	5,122

22. FINANCE INCOME AND FINANCE COSTS

Finance income and finance costs	2017	2016
	$	$
FINANCE INCOME		
Recognized in profit or loss:		
Interest on related party loans	**-**	5
Interest income on bank deposits	**7**	5
	7	10
FINANCE COSTS		
Recognized in profit or loss:		
Interest on prommisory notes payable to the City	**610**	610
Interest on third party debt	**176**	105
Interest on post retirement benefits	**22**	25
	808	740
INTEREST PAID		
Finance costs	**808**	740
Less interest on post retirement benefits obligation	**22**	25
Interest paid in cash	**786**	715

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
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23. NON-CASH OR NON-OPERATING ADJUSTMENTS INCLUDED IN PROFIT

In order to arrive at cash flows from operating activities on the Statement of Cash Flows the following items need to be added or subtracted from profit for the year:

Other non-cash or non-operating items included in profit	2017	2016
	$	$
NON-CASH OR NON-OPERATING ITEMS INCLUDED IN PROFIT		
Provision for PILs included in profit	**507**	(767)
Loss on disposal of PP&E	**(93)**	77
Amortization of deferred revenue	**(46)**	(36)
Post-retirement benefits	**8**	11
Other non-cash adjustments	**-**	(57)
Finance income	**(7)**	(10)
Finance costs	**808**	740
	1,177	(42)
REGULATORY ITEMS (NON-CASH)		
Net movement in regulatory balances including related deferred taxes	**356**	547
	1,533	505

24. NET CHANGES IN NON-CASH WORKING CAPITAL

In order to arrive at cash flows from operating activities on the Statement of Cash Flows the following items need to be added or subtracted from profit for the year:

Net changes in non-cash working capital	2017	2016
	$	$
Accounts receivable	**683**	(928)
Unbilled energy and distribution revenue	**799**	(243)
Inventories	**(42)**	(26)
Prepaid expenses	**(11)**	63
Due from related parties	**140**	81
Bank indebtedness to finance working capital requirements	**(1,137)**	1,137
Accounts payable and accrued liabilities	**275**	803
Payments in lieu of taxes payable	**59**	355
Customer security deposits	**121**	8
Due to related parties	**(32)**	99
	855	1,349

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2017
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25. RELATED PARTY TRANSACTIONS

IAS 24 disclosure exemptions

OPDC is exempt from some of the general disclosure requirements of IAS 24 with relation to transactions with government-related parties, and has applied the government-related disclosure requirements.

Key management personnel compensation

Key management personnel are defined in IAS 24 as “those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity”. Key management personnel of OPDC have been defined as members of its Board of Directors, officers and senior managers reporting directly to the President and Chief Executive Officer.

Key management personnel compensation	2017	2016
	$	$
Board of Directors	122	140
Officers and senior managers	417	492
	539	632

Transactions with related parties

OPDC provides electricity and other services to the City. OPDC also purchases services and pays property taxes and promissory note interest to the City. OPDC has a shared services agreement with an affiliate, Orillia Power Generation Corporation (“OPGC”). The control centre, building space, purchasing and administrative staff are shared among the two companies as outlined in the agreement. OPDC has Affiliate Relationships Code and Standard Supply Service Code exemptions approved by the OEB to allow the shared services.

NOTES TO THE FINANCIAL STATEMENTS

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25. RELATED PARTY TRANSACTIONS (continued)

Related party transactions	2017	2016
	$	$
Financing activities with the City		
Finance costs paid to the City	**610**	610
Operating activities with the City		
Power sold to the City	**2,735**	2,626
Other services sold to the City	**169**	68
Goods and services purchased from the City	**121**	92
Property taxes paid to the City	**74**	72
Balances outstanding with the City		
Promissory note due to the City	**9,762**	9,762
Due from the City included in receivables	**304**	290
Due to from City included in payables	**24**	6
Investing and financing activities with affiliates		
Dividends paid to Orillia Power Corporation	**600**	250
Finance income received from Orillia Power Corporation	**-**	5
Operating activities with affiliates - sold to		
Goods and services sold to Orillia Power Corporation	**2**	3
Goods and services sold to OPGC	**836**	1,017
Goods and services sold to 2429106 Ontario Inc. (subsidiary of OPGC)	**11**	11
Operating activities with affiliates - purchased from		
Goods and services purchased from Orillia Power Corporation	**125**	143
Goods and services purchased from OPGC	**319**	213
Due from related parties		
Due from Orillia Power Generation Corporation	**635**	779
Due from 2429106 Ontario Inc.	**11**	7
Due to related parties		
Due to Orillia Power Corporation	**122**	154

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26. COMMITMENTS AND CONTINGENCIES

IESO prudential security commitments

Purchasers of electricity in Ontario, through the IESO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IESO could draw on these guarantees if OPDC fails to make a payment required by default notice issued by the IESO. As at December 31, 2017, OPDC has provided prudential support to the IESO in the form of an irrevocable, automatically renewing bank letter of credit in the amount of $2,035 (December 31, 2016 - $2,035).

Liability insurance

OPDC belongs to the Municipal Electric Association Reciprocal Insurance Exchange (“MEARIE”), a self-insurance plan designed to pool all member risks. Any losses experienced by MEARIE are shared amongst all of its members. As of the date of Board of Directors approval of these financial statements, OPDC has not been made aware of any assessments for significant losses. OPDC has contracted for a maximum total of $30 million in event coverage with MEARIE and $10 million in excess liability coverage with a secondary provider.

Legal proceeding contingencies

In 2012, a legal proceeding was commenced against OPDC related to damages to Bell Canada property. OPDC has turned this matter over to its liability insurer and the matter is currently before the Ontario Superior Court of Justice. At this time, it is not possible to quantify the effect, if any, on the financial statements of OPDC. Management does not believe that the outcome of this matter will have a material impact on the financial statements.

In relation to a 2013 motor vehicle accident, a legal proceeding has been commenced against OPDC. This matter has been turned over to OPDC’s liability insurer and is currently before the Ontario Superior Court of Justice. At this time, it is not possible to quantify the effect, if any, on the financial statements of OPDC. Management does not believe that the outcome of this matter will have a material impact on the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

As part of its operations, OPDC carries out transactions that expose it to financial risks such as credit, liquidity and market risks. The following is a discussion of risks and related mitigation strategies that have been identified by OPDC for financial instruments. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks identified.

Cash and cash equivalents are measured at fair value. The carrying values of receivables, and accounts payable and accrued charges approximate fair value because of the short maturity of these instruments.

Credit risk

Financial assets carry credit risk that a counter-party will fail to discharge an obligation which would result in a financial loss.

Financial assets held by OPDC, such as accounts receivable, expose it to credit risk. OPDC earns its revenue from a broad base of approximately 13,900 customers located in the City of Orillia. No single customer accounts for revenue in excess of 10% of total revenue. The carrying amount of accounts receivable is reduced through the use of an allowance for impairment. The amount of the related impairment loss is recognized in the statement of profit or loss as are any subsequent recoveries of receivables previously provisioned. Further details on accounts receivable can be found in other notes to these financial statements.

Credit risk is managed through collection of security deposits from customers in accordance with OEB codes and regulations. Further details on customer security deposits can be found in other notes to these financial statements.

Market risk

OPDC is not exposed to significant market risk given they do not have investments in foreign currency, and have minimal investment in interest bearing instruments.

Liquidity risk

Liquidity risk is the risk that OPDC will not be able to meet its financial obligations as they come due. OPDC monitors its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements. OPDC's objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing interest exposure. OPDC has access to various operating lines of credit and monitors cash balances to ensure that sufficient levels of liquidity are on hand to meet financial commitments as they come due. Further details on accounts payable and accrued liabilities can be found in other notes to these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

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28. CAPITAL MANAGEMENT

OPDC considers its capital to be its share capital, retained earnings and accumulated other comprehensive income. OPDC's objectives when managing capital are:

- to safeguard OPDC's ability to continue as a going concern, so that it can continue to provide adequate returns for the shareholder and benefits for other stakeholders while maintaining its assets,
- to provide an adequate return to the shareholder by controlling costs and establishing rates that maximize rate of return commensurate with the level of risk, and
- to ensure the capital structure does not prevent OPDC from taking advantage of potential growth opportunities provided that they do not expose OPDC to unnecessary risk.

OPDC manages its capital structure and makes adjustments to it in light of changes in economic conditions, annual profitability and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, OPDC will adjust the amount of dividends paid to the shareholder, subject to the constraints imposed by lending agreements. OPDC is subject to quarterly reporting and bank review of its interest coverage and debt capitalization ratios, in relation to its various bank credit lines.

Consistent with others in the industry, OPDC monitors capital on the basis of the debt-to-capital ratio calculated as long term debt divided by the sum of long term debt plus equity, as shown in the following table. For purposes of comparing the measures below to benchmarks, OPDC was initially incorporated at a debt to capital ratio of 0.48.

Debt to capital ratio	2017	2016
	$	$
Sum of long term debt and shareholder's equity		
Long term debt	**10,077**	10,287
Shareholder's equity	**14,571**	13,954
	24,648	24,241
Key Ratio - Debt to Capital		
Ratio of debt to debt plus equity	**0.41**	0.42

Orillia Power Distribution Corporation

FINANCIAL STATEMENTS

December 31, 2016

Energizing Our Community®

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BDO Canada LLP
19 Front Street N
PO Box 670
Orillia ON L3V 6K5 Canada

Independent Auditor's Report

To the Shareholder of Orillia Power Distribution Corporation

We have audited the accompanying financial statements of Orillia Power Distribution Corporation, which comprise the statement of financial position as at December 31, 2016 and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Orillia Power Distribution Corporation as at December 31, 2016, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

BDO Canada LLP

Chartered Professional Accountants, Licensed Public Accountants

Orillia, Ontario
April 19, 2017

STATEMENT OF FINANCIAL POSITION

As at
(in thousands of Canadian dollars)

	Notes	**December 31 2016** $	December 31 2015 $
ASSETS			
Current Assets			
Cash and cash equivalents	5	**-**	602
Accounts receivable	6	**4,347**	3,419
Unbilled energy and distribution revenue	7	**4,396**	4,153
Inventories	8	**527**	501
Prepaid expenses		**107**	170
Due from related parties	25	**786**	867
Current assets		**10,163**	9,712
Non-current Assets			
Property, plant and equipment	9	**27,969**	23,586
Intangible assets	10	**86**	125
Deferred income tax asset	14	**2,754**	1,079
Non-current assets		**30,809**	24,790
Total assets		**40,972**	34,502
Regulatory deferral account debit balances	11	**1,757**	2,126
Total assets and regulatory deferral account debit balances		**42,729**	36,628

The accompanying notes are an integral part of these financial statements

STATEMENT OF FINANCIAL POSITION

As at
(in thousands of Canadian dollars)

	Notes	December 31 2016 $	December 31 2015 $
LIABILITIES AND SHAREHOLDER'S EQUITY			
Current Liabilities			
Bank indebtedness	12	**6,137**	2,000
Accounts payable and accrued liabilities	13	**6,562**	5,759
Payments in lieu of taxes payable	14	**572**	217
Customer security deposits	15	**141**	133
Current portion of long term debt	18	**210**	210
Due to related parties	25	**154**	55
Current liabilities		**13,776**	8,374
Non-current Liabilities			
Customer security deposits	15	**472**	320
Post-retirement benefits	16	**578**	648
Deferred revenue	17	**1,526**	1,166
Long term debt	18	**10,287**	10,497
Non-current liabilities		**12,863**	12,631
Shareholder's Equity			
Share capital	19	**8,236**	8,236
Retained earnings		**5,808**	4,505
Accumulated other comprehensive loss		**(90)**	(105)
Shareholder's equity		**13,954**	12,636
Total liabilities and shareholder's equity		**40,593**	33,641
Regulatory deferral account credit balances	11	**2,136**	2,987
Total equity, liabilities and regulatory deferral account credit balances		**42,729**	36,628

The accompanying notes are an integral part of these financial statements

On Behalf of the Board of Directors:

Director Director

STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31
(in thousands of Canadian dollars)

	Notes	**2016** $	2015 $
Revenue			
Recovered energy purchases		**40,346**	36,546
Operating revenue	20	**8,633**	8,535
		48,979	45,081
Expenses			
Energy purchases		**40,573**	36,292
Operating expenses	21	**5,122**	4,849
Depreciation and amortization		**1,144**	1,150
Loss on disposal of property plant and equipment		**77**	79
		46,916	42,370
Operating profit		**2,063**	2,711
Finance income	22	**10**	8
Finance costs	22	**(740)**	(682)
Profit before provision for payments in lieu of taxes		**1,333**	2,037
Provision for payments in lieu of taxes			
Current provision	14	**913**	322
Deferred provision	14	**(1,680)**	154
		(767)	476
Profit for the year before net movement in regulatory deferral account balances		**2,100**	1,561
Net movement in regulatory balances including related deferred taxes	11	**(547)**	(688)
Profit for the year		**1,553**	873
Other comprehensive income:			
Items that will not be reclassified subsequently to profit and loss:			
Actuarial gain on defined benefit plans net of deferred taxes		**15**	-
Total comprehensive income for the year		**1,568**	873

The accompanying notes are an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY

Year ended December 31 (in thousands of Canadian dollars)	Share Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Equity Totals
	$	$	$	$
SUMMARY OF CHANGES IN EQUITY				
Balance at December 31, 2014 (unaudited)	**8,236**	**4,862**	**(105)**	**12,993**
Changes in equity during 2015				
Total comprehensive income for the year	**-**	**873**	**-**	**873**
Dividends paid	**-**	**(1,230)**	**-**	**(1,230)**
Balance at December 31, 2015	**8,236**	**4,505**	**(105)**	**12,636**
Changes in equity during 2016				
Total comprehensive income for the year	**-**	**1,553**	**15**	**1,568**
Dividends paid	**-**	**(250)**	**-**	**(250)**
Balance at December 31, 2016	**8,236**	**5,808**	**(90)**	**13,954**

The accompanying notes are an integral part of these financial statements

STATEMENT OF CASH FLOWS

Year ended December 31
(in thousands of Canadian dollars)

	Notes	2016 $	2015 $
Operating activities			
Profit for the year after net movement in regulatory deferral account balances		**1,553**	873
Adjustments to reconcile profit to net cash used in operating activities			
Depreciation and amortization (non-cash)		**1,144**	1,150
Other non-cash or non-operating items included in profit	23	**505**	1,899
		3,202	3,922
Net changes in non-cash working capital	24	**1,349**	(444)
Payments in lieu of income taxes - current provision	14	**(913)**	(322)
Net cash from operating activities including tax provision		**3,638**	3,156
Investing activities			
Purchase of property, plant, equipment and intangible assets	9, 10	**(5,565)**	(2,311)
Interest received	22	**10**	8
Changes in regulatory deferral account balances	11	**(1,029)**	(384)
Net cash used in investing activities		**(6,584)**	(2,687)
Financing activities			
Borrowing on term debt facility	12	**3,000**	2,000
Repayment of long term debt	18	**(210)**	(210)
Deferred revenue	17	**396**	135
Customer security deposits	15	**152**	43
Post retirement benefits payments	16	**(29)**	(24)
Interest paid	22	**(715)**	(658)
Dividends paid in cash		**(250)**	(1,230)
Net cash from financing activities		**2,344**	56
Net change in cash and cash equivalents		**(602)**	525
Cash and cash equivalents, beginning of the year		**602**	77
Cash and cash equivalents, end of the year		**-**	602

The accompanying notes are an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS
For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

1. CORPORATE INFORMATION

Orillia Power Distribution Corporation ("OPDC") owns and operates an electricity distribution system, which delivers electricity to approximately 13,600 customers located in Orillia, Ontario. The address of OPDC's corporate office and principal place of business is 360 West Street South, Orillia, Ontario, Canada L3V 6J9.

Orillia Power Corporation is the sole shareholder of OPDC. The common shares of Orillia Power Corporation are 100% owned by the Corporation of the City of Orillia ("City"), the ultimate parent.

OPDC was incorporated under the Business Corporations Act (Ontario) on October 26, 2000. OPDC operates under license issued by the Ontario Energy Board ("OEB"). OPDC is regulated by the OEB and adjustments to OPDC's distribution and power rates require OEB approval.

2. BASIS OF PREPARATION

2.1 Statement of compliance

The Financial Statements of OPDC have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations as issued by the International Financial Reporting Interpretations Committee of the IASB.

The Financial Statements were authorized for issue by the Board of Directors on April 19, 2017.

2.2 Basis of measurement

The Financial Statements have been prepared on a historical cost basis.

2.3 Presentation currency

The Financial Statements are presented in Canadian dollars, which is also OPDC's functional currency, and all values are rounded to the nearest one thousand dollars, unless when otherwise indicated.

2.4 Explanation of activities subject to rate regulation

The Ontario government enacted the Energy Competition Act, 1998, to introduce competition to the Ontario energy market. The OEB was granted a legislative mandate including broad powers relating to licensing, standards of conduct and service quality and the regulation of rates charged by OPDC and other electricity distributors in Ontario.

OPDC as an electricity distributor, is licensed and regulated by the OEB. The OEB exercises statutory authority through setting or approving all rates charged by the distribution company and establishing standards of service quality for its customers. OPDC's distribution rates are set by the OEB on an annual basis for May 1 to April 30.

2.5 Regulatory risk

Regulatory risk is the risk that the Province and its regulator, the OEB, could establish a regulatory regime that imposes conditions that restrict the electricity distribution business from achieving an acceptable rate of return that permits financial sustainability of its operations including the recovery of expenses incurred for the benefit of other market participants in the electricity industry such as transition costs and other regulatory assets. All requests for changes in electricity distribution charges require the approval of the OEB.

2. BASIS OF PREPARATION (continued)

2.6 Recovery risk

Regulatory developments in Ontario's electricity industry, including current and possible future consultations between the OEB and interested stakeholders, may affect distribution rates and other permitted recoveries in the future. OPDC is subject to a cost of service regulatory mechanism under which the OEB establishes the revenues required (i) to recover the forecast operating costs, including depreciation and amortization and income taxes, of providing the regulated service, and (ii) to provide a fair and reasonable return on utility investment, or rate base. As actual operating conditions may vary from forecast, actual returns achieved can differ from approved returns.

2.7 Potential sale of OPDC

The City and Orillia Power Corporation have signed a share purchase agreement ("SPA") with Hydro One Inc. ("Hydro One") to sell OPDC. The agreement was signed on August 15, 2016 subject to review and approval by the OEB. No decision had been made by the OEB as of the issuance date of these financial statements.

2.8 Comparative Figures

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted for the current year.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The preparation and presentation of financial statements can be significantly affected by the accounting policies selected by OPDC. The financial statements reflect the following significant accounting policies, which are an integral part of understanding the financial results and financial position presented within.

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements unless otherwise indicated.

3.1 Regulatory deferral accounts

Regulatory deferral account debit balances represent future revenues associated with certain costs incurred in the current period or in prior period(s), which are expected to be recovered from consumers in future periods through the rate-setting process. Regulatory deferral account credit balances are associated with the collection of certain revenues earned in the current period or in prior period(s), which are expected to be returned to consumers in future periods through the rate-setting process.

Regulatory deferral account balances can arise from differences in amounts collected from customers (based on regulated rates) and the corresponding cost of non-competitive electricity service incurred by OPDC in the wholesale market administered by the Independent Electricity System Operator (the "IESO") after May 1, 2002. These amounts have been accumulated pursuant to regulation underlying the Electricity Act, 1998 (the "EA") and deferred in anticipation of their future recovery (payment) from (to) distribution customers.

Explanation of Recognized Amounts

Regulatory deferral account balances are recognized and measured initially and subsequently at cost. They are assessed for impairment on the same basis as other non-financial assets as described below. Management continually assesses the likelihood of recovery of regulatory assets. If recovery through future rates is no longer considered probable, the amounts would be charged to the results of operations in the period that the assessment is made.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Revenue

Revenue is recognized to the extent that it is probable that economic benefits will flow to OPDC and that the revenue can be reliably measured. Revenue is comprised of recovered energy purchases, distribution of energy, pole use rental, collection charges, investment income and other miscellaneous revenues.

Recovered energy purchases and distribution of energy

OPDC is licensed by the OEB to distribute electricity. As a licensed distributor, OPDC is responsible for billing customers for electricity generated by third parties and the related costs of providing electricity service, such as transmission services and other services provided by third parties. OPDC is required, pursuant to regulation, to remit such amounts to these third parties, irrespective of whether OPDC ultimately collects these amounts from customers. OPDC has determined that they are acting as a principal for the electricity distribution and, therefore, have presented the electricity revenues on a gross basis.

Revenues from recovered energy purchases and distribution of electricity is recognized on an accrual basis, including unbilled revenues accrued in respect of electricity delivered but not yet billed. Recovered energy purchases and distribution of energy revenue is comprised of customer billings based on actual monthly meter readings.

Other

Other revenues, which include revenues from pole use rental, collection charges, contributions in aid of construction and other miscellaneous revenues are recognized at the time services are provided.

Deferred revenue

Where OPDC has an ongoing obligation to provide services, revenues are recognized as the service is performed and amounts billed in advance are recognized as deferred revenue.

Certain assets may be acquired or constructed with financial assistance in the form of contributions from customers when the estimated revenue is less than the cost of providing service or where special equipment is needed to supply the customers' specific requirements. Since the contributions in aid of construction will provide customers with ongoing access to the supply of electricity, these contributions are classified as deferred revenue and are amortized as revenue on a straight-line basis over the useful life of the constructed or contributed asset.

3.3 Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held at call with financial institutions and other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and subject to an insignificant risk of change in value.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.4 Financial instruments

Recognition, initial measurement and derecognition

Financial assets and liabilities are recognized when OPDC becomes a party to the contractual provisions of the financial instrument and are measured initially at fair value adjusted for transaction costs, except for those carried at fair value through comprehensive income which are measured initially at fair value. Subsequent measurement of financial assets and financial liabilities is described below.

Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and substantially all the risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled or expires.

Classification and subsequent measurement of financial assets

For the purpose of subsequent measurement of financial assets, they are classified into the following categories upon initial recognition, loans and receivables and available-for-sale financial assets. OPDC currently does not have assets that would be classified as available for sale. All financial assets classified as loans and receivables are reviewed for impairment at least at each reporting date to identify whether there is any objective evidence of impairment. All income and expenses relating to financial assets that are recognized in profit or loss are presented within finance costs or finance income, except for impairment of trade receivables which is presented within operating expenses.

Financial assets classified as loans and receivables

Financial assets classified as loans and receivables include cash and cash equivalents, accounts receivable, unbilled energy and distribution revenue and due from related parties. Collectability of accounts receivable is reviewed on an ongoing basis. Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default. Receivables that are not considered to be individually impaired are reviewed for impairment in groups, which are determined by reference to the industry and region of the counterparty and other shared credit risk characteristics. The impairment loss estimate is then based on recent historical counterparty default rates for each identified group. Accounts receivable which are known to be uncollectible are written off. A provision for doubtful receivables is established when there is objective evidence that OPDC will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of future cash flows. The amount of the provision is recognized in the Statement of Comprehensive Income.

Classification and subsequent measurement of financial liabilities

All of OPDC's financial liabilities are classified as other financial liabilities, and include bank indebtedness, accounts payable and accrued liabilities, customer deposits, due to related parties and long term debt. Other financial liabilities are measured subsequently at amortized cost using the effective interest method. All interest-related charges are reported in profit or loss and included within finance costs or finance income.

Customer Security Deposits

Customers may be required to post security to obtain electricity or other services, which are refundable. Cash and securities lodged with OPDC by counterparties under electricity supply agreements are also included in this balance. Where the security posted is in the form of cash or cash equivalents, these amounts are recorded in the accounts as customer security deposits. Interest rates paid on customer deposits are based on the Bank of Canada's prime business rate less 2%.

(in thousands of Canadian dollars unless otherwise noted)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.5 Property, plant and equipment

Recognition and measurement

Property, plant and equipment ("PP&E") are recognized at cost, being the purchase price and directly attributable cost of acquisition or construction required to bring the asset to the location and condition necessary to be capable of operating in the manner intended by OPDC, including eligible borrowing costs.

Depreciation of PP&E is recorded in the Statement of Comprehensive Income on a straight-line basis over the estimated useful life of the related asset. The estimated useful lives, residual values and depreciation methods are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

The estimated useful lives for PP&E are as follows:

Buildings and fixtures	10 - 50 years
Substations	15 - 60 years
Sub-transmission lines	45 - 60 years
Distribution system	40 - 60 years
Smart meters	15 years
Other capital assets	15 - 20 years
Land	not depreciated

When parts of an item of PP&E have different useful lives, they are accounted for as separate items (major components) of PP&E

Major spare parts

Major spares such as spare transformers and other items kept as standby/back up equipment are accounted for as PP&E since they support OPDC's distribution system reliability.

Contributions in aid of construction

When an asset is received as a capital contribution, the asset is initially recognized at its fair value, with the corresponding amount net of payments to the developer recognized as deferred revenue (contributions in aid of construction).

Gains and losses on disposal

Gains and losses on disposal of an item of PP&E are determined by comparing the net proceeds from disposal with the carrying amount of the asset, and are included in the Statement of Comprehensive Income when the asset is disposed of. When an item of PP&E with related contributions in aid of construction is disposed, the remaining deferred revenue is recognized in full in the Statement of Comprehensive Income.

3.6 Borrowing costs

OPDC capitalizes interest expenses and other finance charges directly relating to the acquisition, construction or production of assets that take a substantial period of time to get ready for its intended use. Capitalization commences when expenditures are being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalization is suspended during periods in which active development is interrupted and ceases when substantially all of the activities necessary to prepare the asset for its intended use or sale are complete.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.7 Intangible assets

Computer software and land rights

Computer software that is acquired or developed by OPDC, including software that is not integral to the functionality of equipment purchased, which has finite useful lives, is measured at cost less accumulated amortization and accumulated impairment losses.

Payments to obtain rights to access land ("land rights") are classified as intangible assets. These include payments made for easements, right of access and right of use over land for which OPDC does not hold title. Land rights are measured at cost less accumulated amortization and accumulated impairment losses.

Amortization

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. Amortization methods and useful lives of all intangible assets are reviewed at each reporting date.

The estimated useful lives for intangible assets are:

Land rights	40 years
Computer software	5 years

3.8 Impairment of non-financial assets

OPDC conducts annual internal assessments of the values of PP&E, intangible assets and regulatory deferral account debit balances to determine whether there are events or changes in circumstances that indicate that their carrying amount may not be recoverable. Where the carrying value exceeds its recoverable amount, which is the higher of value in use and fair value less costs to sell, the asset is written down accordingly.

Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets to which the asset belongs for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets. The entire Company is considered one cash-generating unit for which impairment testing is performed. An impairment loss is charged to the Statement of Comprehensive Income, except to the extent it reverses gains previously recognized in other comprehensive income.

3.9 Provisions

A provision is recognized if, as a result of a past event, OPDC has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.10 Post retirement benefits

Defined contribution plan

The employees of OPDC participate in the Ontario Municipal Employees Retirement System (“OMERS”). OPDC also makes contributions to the OMERS plan on behalf of its employees. The plan has a defined benefit option at retirement available to some employees, which specifies the amount of the retirement benefit plan to be received by the employees based on length of service and rates of pay. OPDC is only one of a number of employers that participates in the plan and the financial information provided to OPDC on the basis of the contractual agreements is insufficient to measure OPDC’s proportionate share in the plan assets and liabilities on defined benefit accounting requirements. As insufficient information is available to account for the plan as a defined benefit plan, the contribution payable in exchange for services rendered during a period is recognized as an expense during that period.

Defined benefit plans

A defined benefit plan is a post employment benefit plan other than a defined contribution plan. OPDC’s net obligation on behalf of its retired employees unfunded life insurance, extended medical and dental benefits is calculated by estimating the amount of future benefits that are expected to be paid out discounted to determine its present value. Any unrecognized past service costs are deducted.

The calculation is performed by a qualified actuary using the projected unit credit method every third year or when there are significant changes to workforce. When the calculation results in a benefit to OPDC, the recognized asset is limited to the total of any unrecognized past service costs and the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. An economic benefit is available to OPDC if it is realizable during the life of the plan, or on settlement of the plan liabilities.

Defined benefit obligations are measured using the projected unit credit method discounted to its present value using yields available on high quality corporate bonds that have maturity dates approximating to the terms of the liabilities. Remeasurements of the defined benefit obligation include actuarial gains and losses and are recognized directly within equity in other comprehensive income. Service costs are recognized in the Statement of Comprehensive Income in operating expenses, and include current and past service costs as well as gains and losses on curtailments.

Net interest expense is recognized the Statement of Comprehensive Income in finance expense, and is calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the balance of the net defined benefit obligation, considering the effects of benefit payments during the period. Gains or losses arising from changes to defined benefits or plan curtailment are recognized immediately in the Statement of Comprehensive Income. Settlements of defined benefit plans are recognized in the period in which the settlement occurs.

Other long-term service benefits

Other employee benefits that are expected to be settled wholly within 12 months after the end of the reporting period are presented as current liabilities. Other employee benefits that are not expected to be settled wholly within 12 months after the end of the reporting period are presented as non-current liabilities and calculated using the projected unit credit method and then discounted using yields available on high quality corporate bonds that have maturity dates approximating to the expected remaining period to settlement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.11 Payment in lieu of taxes payable

Tax status

Prior to August 15, 2016, OPDC was an Municipal Electricity Utility ("MEU") for purposes of the payments in lieu of taxes ("PILs") regime contained in the EA. As an MEU, OPDC was exempt from tax under the Federal Income Tax Act (Canada) and the Corporations Tax Act (Ontario) ("Tax Act").

Under the EA, OPDC was required to make, for each taxation year, PILs to the Ontario Electricity Financial Corporation, commencing October 1, 2001. These payments were calculated in accordance with the rules for computing taxable income and taxable capital and other relevant amounts contained in the Tax Act as modified by the EA, and related regulations.

On August 15, 2016 OPDC became party to a share purchase agreement with Hydro One, a company taxable under the Tax Act. Consequently, under section 149(1.1) of the Tax Act, OPDC ceased to be exempt under the ITA as of the date of signing the Share Purchase Agreement. Pursuant to section 149(10) of the Tax Act, as of the date it ceased to be exempt, OPDC became liable to pay both federal and provincial income tax, with its first tax year starting at that time.

Current and deferred tax

Income tax expense is comprised of current and deferred tax. Current tax and deferred tax are recognized in comprehensive income except to the extent that it relates to items recognized directly in equity or regulatory deferral account balances. Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base. The amount of the deferred tax asset or liability is measured at the amount expected to be recovered from or paid to the taxation authorities. This amount is determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date and are expected to apply when the liabilities / (assets) are settled / (recovered). OPDC recognized deferred tax arising from temporary difference on regulatory deferral account balances, post retirement benefits and PP&E and intangible assets.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available against which the deferred tax asset can be utilized.

At the end of each reporting period, OPDC reassesses both recognized and unrecognized deferred tax assets. OPDC recognizes a previously unrecognized deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

3.12 Leased assets

Leases in terms of which OPDC assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other leases are operating leases and the leased assets are not recognized on OPDC's balance sheet. Payments made under operating leases are recognized in the Statement of Comprehensive Income on a straight-line basis over the lease term.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.13 Finance income and finance costs

Finance income is comprised of interest income on funds invested such as cash and cash equivalents. Interest income is recognized as it accrues in the Statement of Comprehensive Income, using the effective interest method. Finance costs are comprised of interest payable on debt, post retirement benefits and impairment losses recognized on financial assets.

3.14 Inventories

Cost of inventories comprise of direct materials, which typically consists of distribution assets not deemed as major spares, unless purchased for specific capital projects in process or as spare units. Costs, after deducting rebates and discounts, are assigned to individual items of inventory on the basis of weighted average cost. Decommissioned assets that are transferred to inventory are tested for impairment once they are removed from service and placed in inventory. Inventory is recognized at the lower of cost and net realizable value.

Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

3.15 Standards, amendments and interpretations not yet effective

At the date of authorization of these Financial Statements, certain new standards, amendments and interpretations to existing standards have been published by the IASB but are not yet effective, and have not been adopted early by OPDC.

Management anticipates that all of the relevant pronouncements will be adopted in OPDC’s accounting policies for the first period beginning after the effective date of the pronouncement. Information on new standards, amendments and interpretations that are expected to be relevant to OPDC’s Financial Statements is provided below. Certain other new standards and interpretations have been issued but are not expected to have a material impact on OPDC’s Financial Statements.

IFRS 9 Financial Instruments replaces IAS 39 Financial Instruments: Recognition and Measurement

IFRS 9 amends the requirements for classification and measurement of financial assets, impairment, and hedge accounting. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortized cost, fair value through profit or loss, and fair value through other comprehensive income. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The effective date for IFRS 9 is January 1, 2018. OPDC is in the process of evaluating the impact of the new standard.

IFRS 15, Revenue from Contracts with Customers

IFRS 15 is based on the core principle to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. IFRS 15 focuses on the transfer of control. IFRS 15 replaces all of the revenue guidance that previously existed in IFRS. The effective date for IFRS 15 is January 1, 2018. OPDC is in the process of evaluating the impact of the new standard.

IFRS 16, Leases

IFRS 16 requires a lessee to recognize a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The liability accrues interest. This will typically produce a front-loaded expense profile whereas operating leases under IAS 17 would typically have had straight-line expenses. The new Standard is effective for annual reporting periods beginning on or after January 1, 2019, with early application permitted but only if the entity is also applying IFRS 15, Revenue from contracts with customers. OPDC is in the process of evaluating the impact of the new standard.

4. USE OF ESTIMATES AND JUDGEMENTS

OPDC makes certain estimates and assumptions regarding the future. Estimates and judgements are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Employee future benefits

The cost of post employment life insurance, medical and dental benefits are determined using actuarial valuations. An actuarial valuation involves making various assumptions. Due to the complexity of the valuation, the underlying assumptions and its long term nature, post employment medical and insurance benefits are highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date.

PILs payable

OPDC has been required to make payments in lieu of tax calculated on the same basis as income taxes on taxable income earned until August 15, 2016. Subsequent to that date, OPDC is required to pay income taxes under the Tax Act. Significant judgement is required in determining the provision for income taxes. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain. OPDC recognizes liabilities for anticipated tax audit issues based on OPDC's current understanding of the tax law. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred tax provisions in the period in which such determination is made.

Accounts receivable impairment

In determining the allowance for doubtful accounts, OPDC considers historical loss experience of account balances based on the aging and arrears status of accounts receivable balances.

Regulatory deferral account debit and credit balances

In assessing the proper accounting treatment and determining the future disposition of regulatory deferral account debit and credit balances, OPDC considers historical industry precedent and follows the latest available and reliable guidance as well as direction through written orders issued by the regulator.

5. CASH AND CASH EQUIVALENTS

OPDC's bank accounts are held with a Canadian chartered bank and earn interest based upon its average monthly balance at the bank's prime less 1.9%. Prime rate as of December 31, 2016 was 2.70% (December 31, 2015 – 2.70%).

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6. ACCOUNTS RECEIVABLE

Accounts receivable	2016	2015
	$	$
Due from distribution customers	**3,946**	2,861
Recoverable work	**313**	298
Conservation and feed in tariff initiatives	**25**	193
Other	**141**	155
	4,425	3,507
Allowance for doubtful accounts	**(78)**	(88)
	4,347	3,419
ACCOUNTS RECEIVABLES BY AGE		
0 - 60 days	**4,028**	3,143
61 - 90 days	**59**	19
Over 90 days	**338**	345
	4,425	3,507
CONTINUITY OF ALLOWANCE FOR DOUBTFUL ACCOUNTS		
Balance, beginning of year	**(88)**	(132)
Bad debt expense provision included in comprehensive income	**(88)**	(104)
Written off	**98**	148
Balance, end of year	**(78)**	(88)

Due to its short term nature, the carrying amount of the accounts receivable approximates its fair value.

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7. UNBILLED ENERGY AND DISTRIBUTION REVENUE

Unbilled energy and distribution revenue represents amounts for which OPDC has a contractual right to receive cash through future billings and are unbilled at year end. All accounts are billed on a monthly basis based on power consumed in the previous month. The amount of allowance for doubtful accounts that has been provided as at December 31, 2016 for unbilled revenues is $NIL (December 31, 2015 – $NIL).

Unbilled energy and distribution revenue	**December 31 2016**	December 31 2015
	$	$
Unbilled energy and distribution revenue	**4,396**	4,153
	4,396	4,153

8. INVENTORIES

Inventories	**December 31 2016**	December 31 2015
	$	$
Balance, beginning of year	**501**	526
Inventory purchased	**657**	399
Inventory used in:		
Capital projects (capitalized)	**(467)**	(246)
Operations and maintenance (expensed)	**(96)**	(95)
Recoverable work	**(64)**	(82)
Other adjustments	**(4)**	(1)
Balance, end of year	**527**	501

NOTES TO THE FINANCIAL STATEMENTS

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9. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment	December 31 2016	December 31 2015
	$	$
COST		
Balance, beginning of year	**25,637**	23,491
Purchase of property, plant, equipment	**5,559**	2,269
Disposals	**(119)**	(123)
Balance, end of year	**31,077**	25,637
ACCUMULATED DEPRECIATION		
Balance, beginning of year	**2,051**	1,006
Depreciation	**1,099**	1,089
Disposals	**(42)**	(44)
Balance, end of year	**3,108**	2,051
CARRYING AMOUNTS		
Balance, beginning of year	**23,586**	22,485
Purchase of property, plant, equipment	**5,559**	2,269
Depreciation	**(1,099)**	(1,089)
Disposals	**(77)**	(79)
Balance, end of year	**27,969**	23,586
SUMMARY OF CARRYING AMOUNTS BY CATEGORY		
Land and buildings	**1,127**	1,181
Distribution plant and equipment	**26,184**	21,524
Other	**635**	816
Work in progress	**23**	65
Balance, end of year	**27,969**	23,586

The amount of impairment loss that has been provided as at December 31, 2016 for PP&E is $NIL (December 31, 2015 – $NIL).

NOTES TO THE FINANCIAL STATEMENTS

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10. INTANGIBLE ASSETS

Intangible assets	December 31 2016	December 31 2015
	$	$
COST		
Balance, beginning of year	**208**	200
Purchase of intangibles	**6**	42
Disposals	**(33)**	(34)
Balance, end of year	**181**	208
ACCUMULATED AMORTIZATION		
Balance, beginning of year	**83**	56
Amortization	**45**	61
Disposals	**(33)**	(34)
Balance, end of year	**95**	83
CARRYING AMOUNTS		
Balance, beginning of year	**125**	144
Purchase of intangibles	**6**	42
Amortization	**(45)**	(61)
Balance, end of year	**86**	125
SUMMARY OF CARRYING AMOUNTS BY CATEGORY		
Land rights	**16**	12
Computer software	**70**	113
Balance, end of year	**86**	125

The amount of impairment loss that has been provided as at December 31, 2016 for intangible assets is $NIL (December 31, 2015 – $NIL).

NOTES TO THE FINANCIAL STATEMENTS

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11. REGULATORY DEFERRAL ACCOUNT BALANCES

All amounts deferred as regulatory deferral account balances are subject to approval by the OEB. As such, amounts subject to deferral could be altered by the regulators. Remaining recovery periods are those expected and the actual recovery or settlement periods could differ based on OEB approval. Carrying charges are applied to deferral variance accounts unless indicated otherwise using simple interest at the rate prescribed by the OEB applied to monthly opening balances in the account exclusive of accumulated interest.

11.1 Regulatory deferral account balances net of deferred income tax impacts

Due to previous, existing or expected future regulatory articles or decisions, OPDC has the following amounts expected to be recovered by customers (returned to customers) in future periods and as such regulatory deferral account balances are presented net of deferred tax impacts:

Regulatory deferral account balances	Note	**December 31 2016** $	December 31 2015 $
REGULATORY DEFERRAL ACCOUNT DEBIT BALANCES NET OF DEFERRED TAXES			
Regulatory deferral account debit balances	11.3	**2,391**	2,893
Deferred tax impact		**634**	767
		1,757	2,126
REGULATORY DEFERRAL ACCOUNT CREDIT BALANCES NET OF DEFERRED TAXES			
Regulatory deferral account credit balances	11.3	**2,906**	4,064
Deferred tax impact		**770**	1,077
		2,136	2,987

NOTES TO THE FINANCIAL STATEMENTS
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11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.2 Regulatory deferral account impacts on Statements of Comprehensive Income and Cash Flows

The following schedule summarizes the net movement in regulatory deferral account balances adjusted for related deferred tax impacts included in the Statement of Comprehensive Income and reducing profit for the year:

Net movement in regulatory balances including related deferred taxes	2016	2015
	$	$
Regulatory debit reallocated from other income - change in PP&E useful lives	**(664)**	(648)
Retail settlement variances between energy purchased and recovered from customers	**226**	(254)
Lost revenue adjustment reallocated from other revenue	**90**	170
Amortization of stranded meters reallocated from other revenue	**(34)**	(34)
Regulatory interest and other	**9**	-
Net movement in regulatory balances before related deferred taxes	**(373)**	(766)
Deferred taxes related to changes in regulatory balances	**(174)**	78
	(547)	(688)

All of the above amounts are non-cash accruals added back to profit in order to arrive at cash flows from operating activities on the Statement of Cash Flows (see note 23). The following schedule summarizes the net movement in regulatory deferral account balances impacting cash and included in the investing activities section of the Statement of Cash Flows:

Changes in regulatory deferral account balances on cash flow statement	2016	2015
	$	$
NET REGULATORY DEFERRAL ACCOUNT BALANCES		
Regulatory deferral account debit balances	**2,391**	2,893
Regulatory deferral account credit balances	**2,906**	4,064
Net regulatory deferral account debit (credit) balances	**(515)**	(1,171)
CHANGES IN REGULATORY DEFERRAL ACCOUNT BALANCES (CASH FLOW STATEMENT)		
Net change in deferral account debit (credit) balances	**(656)**	382
Net movement in regulatory balances before related deferred taxes	**(373)**	(766)
Changes in regulatory deferral account balances - cash flow	**(1,029)**	(384)
RECONCILED TO ABOVE AS FOLLOWS:		
Disposition of approved regulatory deferral account balances	**361**	(397)
Interim disposition of account 1576 balance	**(1,390)**	-
Other	-	13
Changes in regulatory deferral account balances - cash flow	**(1,029)**	(384)

NOTES TO THE FINANCIAL STATEMENTS
For the year ended December 31, 2016
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11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.3 Detail for regulatory deferral account balances

Regulatory deferral account debit balances are comprised of the following accounts:

Regulatory deferral account debit balances	Account #'s	December 31 2016 $	December 31 2015 $
Low voltage	1550	**1,153**	887
Stranded meter capital	1555	**240**	274
Payment in lieu of taxes	1563	**-**	20
Lost revenue variance	1568	**392**	299
Network services - transmission	1584	**100**	66
Connection services - transmission	1586	**222**	54
Power	1588	**-**	146
Global adjustment	1589	**108**	1,131
Disposition / recoveries	1595	**134**	-
Other		**42**	16
		2,391	2,893

Regulatory deferral account credit balances are comprised of the following accounts:

Regulatory deferral account credit balances	Account #'s	December 31 2016 $	December 31 2015 $
Retail costs	1518 / 1548	**67**	63
IFRS - CGAAP Transitional PP&E amounts	1575	**14**	14
Change in PP&E useful lives estimates	1576	**1,210**	1,936
Disposition / recoveries	1595	**-**	19
Wholesale market services	1580	**1,364**	2,032
Power	1588	**243**	-
Other		**8**	-
		2,906	4,064

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2016
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11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.4 Continuity schedules for regulatory deferral account balances

A continuity schedule for regulatory deferral account debit balances from 2015 to 2016 follows below:

Regulatory deferral account debit balances	Account #'s	Est. Yrs to Rec / Reverse	December 31 2016	Recovery / Reversal	Balances arising in the period	December 31 2015
			$	$	$	$
Low voltage	1550	1 - 4	**1,153**	(405)	671	887
Stranded meter capital	1555	1 - 4	**240**	(34)	-	274
Payment in lieu of taxes	1563	1 - 4	**-**	-	(20)	20
Lost revenue variance	1568	1 - 4	**392**	-	93	299
Network services - transmission	1584	1 - 4	**100**	58	(24)	66
Connection services - transmission	1586	1 - 4	**222**	(52)	220	54
Power	1588	1 - 4	**-**	-	(146)	146
Global adjustment	1589	1 - 4	**108**	(946)	(77)	1,131
Disposition / recoveries	1595	1	**134**	(358)	492	-
Other		1 - 4	**42**	-	26	16
			2,391	(1,737)	1,235	2,893

A continuity schedule for regulatory deferral account credit balances from 2015 to 2016 follows below:

Regulatory deferral account credit balances	Account #'s	Est. Yrs to Rec / Reverse	December 31 2016	Recovery / Reversal	Balances arising in the period	December 31 2015
			$	$	$	$
Retail costs	1518 / 1548	1 - 4	**67**	-	4	63
IFRS - CGAAP Transitional PP&E amounts	1575	1 - 4	**14**	-	-	14
Change in PP&E useful lives estimates	1576	1 - 4	**1,210**	(1,390)	664	1,936
Disposition / recoveries	1595	1	**-**	(19)	-	19
Wholesale market services	1580	1 - 4	**1,364**	(1,126)	458	2,032
Connection services - transmission	1586	1 - 4	**-**	-	-	-
Power	1588	1 - 4	**243**	276	(33)	-
Other		1 - 4	**8**	4	4	-
			2,906	(2,255)	1,097	4,064

11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.5 Description of regulatory deferral account balances

A description of the nature of the regulatory deferral account debit and credit balances listed in the schedules are described below referenced by account number.

Account 1518 - Retail Cost Variance Account – Services

This account records the net of revenue derived from establishing retail service agreements, distributor-consolidated and retailer-consolidated billing and the costs of entering into retail service agreements and related administration, monitoring and other expenses necessary to maintain the contract, as well as the incremental costs incurred and any avoided costs credits to provide the related billing services.

Account 1548 - Retail Cost Variance Account – STR

This account records the net of revenue derived from service transaction requests (“STR”) in the form of a request fee, processing fee, and information request fee and the incremental cost of labour, internal information system maintenance costs and delivery costs related to the provision of these services.

Account 1550 – Low Voltage Charges Variance Account

This account records the net of revenue derived from amounts billed to customers through an OEB-approved rate for low voltage services and the amounts paid to Hydro One Networks Inc. (“Networks”) for the related low voltage services provided to OPDC.

Account 1555 – Stranded Meters Account

Conventional meters were replaced by smart meters during the smart meter deployment from 2009 to 2011 and OPDC recorded the disposition of these stranded assets in PP&E and a regulatory deferral debit balance in accordance with OEB Guidelines. This account records the net book value of the stranded conventional meters, to be amortized to depreciation expense until the next cost of service rate application. Carrying charges are not applied to this account.

Account 1563 – Residual PILs Contra Account

This account represents the residual amount remaining after the disposition of variances resulting from the true-up between certain proxy amounts used to set PILs rates and the actual amount of PILs paid for the period 2001 through April 30, 2006. The residual balance is included in the regulatory deferral credit balance of $246 approved by the OEB for disposition in its Decision and Order for rates effective May 1, 2017 issued on March 30, 2017.

Account 1568 – LRAM Variance Account

The OEB established a Lost Revenue Adjustment Mechanism variance account (“LRAMVA”) to capture the differences between the results of actual, verified impacts of authorized Conservation and Demand Management (“CDM”) activities undertaken by electricity distributors from 2011 to 2014 and the level of CDM program activities included in the distributor’s load forecast (i.e. the level embedded into rates). Lost revenues are recorded annually and are included in the net movement in regulatory deferral account balances on the statement of comprehensive income. The OEB approved the disposition of an LRAMVA debit balance of $394 related to CDM programs up to December 31, 2015 in its Decision and Order for rates effective May 1, 2017 issued on March 30, 2017.

11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.5 Description of regulatory deferral account balances (continued)

Account 1575 – IFRS-CGAAP Transitional PP&E Amounts

This account records the PP&E difference arising as a result of an accounting policy change recognizing capital contributions as deferred revenue upon transition from previously adopted Canadian Generally Accepted Accounting Principles (“CGAAP”) to IFRS on January 1, 2014. The balance in this account represents the amortization of the transition year capital contributions previously expensed in 2014. The associated net book value is recorded as deferred revenue and will be amortized to income over a period that matches the remaining useful lives of the related PP&E. Carrying charges are not applied to this account.

Account 1576 – Accounting Changes under CGAAP

This account records the financial differences arising as a result of changes OPDC made to accounting depreciation under CGAAP effective January 1, 2013. OPDC adopted new asset useful lives based on the 2010 “Kinectric’s Report”, part of an asset depreciation study initiated by the OEB for use by electricity distributors. Carrying charges are not applied to this account.

OPDC filed an application on October 19, 2015 for 2016 distribution rates (EB-2015-0286) related to the disposition of the regulatory deferral credit balance in account 1576 as of December 31, 2014. On January 14, 2016, the OEB approved on an interim basis the disposition of regulatory deferral credit of $1,481 over a one year period January 1, 2016 to December 31, 2016. The balance approved for disposition included a rate of return component of $96 calculated according to OEB filing requirements, reducing operating revenue on the statement of comprehensive income.

Account 1580 – Retail Settlement Variance Account - Wholesale Market Services

This account records the net of revenue derived from amounts billed to consumers through an OEB-approved rate for the cost of services required to operate the provincial electricity system and run the wholesale market and the amounts paid to the IESO for these system costs.

Account 1584 – Retail Settlement Variance Account – Retail Transmission Network Services

This account records the net of revenue derived from amounts billed to consumers through an OEB-approved rate for retail transmission network services and the amounts paid to Networks for the related network costs.

Account 1586 – Retail Settlement Variance Account – Retail Transmission Connection Services

This account records the net of revenue derived from amounts billed to consumers through an OEB-approved rate for retail transmission connection services and the amounts paid to Networks for the related connection costs.

Account 1588 – Retail Settlement Variance Account – Power

This account records the net of revenue derived from amounts billed to consumers for electricity costs and the amounts paid to the IESO and embedded generators for electricity purchased. OPDC purchases power on behalf of the customer and passes these costs on to the customer with no markup. This account captures variances due to theft of power and unaccounted-for energy as well as the difference between estimated and actual distribution line losses.

Account 1589 – Retail Settlement Variance Account – Global Adjustment

This account records the net of revenue derived from amounts billed to non-Regulated Price Plan (“non-RPP”) consumers for global adjustment costs and an allocation of amounts paid to the IESO for global adjustment charged on electricity purchased for non-RPP consumers. This account captures variances due to the timing of bills and difference between global adjustment rates billed to consumers and final charges billed to OPDC each month.

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11. REGULATORY DEFERRAL ACCOUNT BALANCES (continued)

11.5 Description of regulatory deferral account balances (continued)

Account 1595 – Disposition of Regulatory Account Balances

This account records the net of the disposition of regulatory deferral account balances approved for recovery (or refund) in rates as part of the regulatory process and the amounts recovered (or refunded) through OEB-approved regulatory deferral account rate riders from the following OEB applications:

OPDC filed an Incentive Regulation Mechanism ("IRM") application on October 11, 2013 for 2014 distribution rates (EB-2013-0161). On April 24, 2014, the OEB approved the disposition of regulatory deferral debits of $1,236 and regulatory deferral credits of $2,280 over a one year period May 1, 2014 to April 30, 2015. The net disposition balance of $1,044 consisted of principal balances as of December 31, 2012, with carrying charges projected to April 30, 2014.

OPDC filed an IRM application on October 19, 2015 for 2016 distribution rates (EB-2015-0024). On March 17, 2016, the OEB approved the disposition of regulatory deferral debits of $1,690 and regulatory deferral credits of $1,198 over a one year period May 1, 2016 to April 30, 2017. The net disposition balance of $492 consisted of principal balances as of December 31, 2014, with carrying charges projected to April 30, 2016.

11.6 2017 Rate Applications

OPDC filed an IRM application on November 14, 2016 for 2017 distribution rates (EB-2016-0321) which included a request seeking disposition of regulatory deferral balances. On March 30, 2017, the OEB approved the disposition of regulatory deferral debits of $890 and regulatory deferral credits of $1,136 over a one year period May 1, 2017 to April 30, 2018. The net disposition balance of $246 consisted of principal balances as of December 31, 2015, with carrying charges projected to April 30, 2017.

12. BANK INDEBTEDNESS

OPDC has credit facilities currently negotiated with a Canadian chartered bank. The facilities are subject to the borrower meeting certain covenant thresholds in order to pay dividends without bank permission. The agreement also includes financial covenants related to debt service coverage ratios and debt to capitalization ratios that must be met by the borrower. OPDC is in compliance with all covenant requirements. Facilities are as follows:

OPDC - committed revolving operating loan available at the borrower's option by way of prime based loans, banker's acceptances and standby letters of guarantee ("L/G"), utilized to finance ongoing working capital requirements and letter of guarantee requirements. The operating loan is secured by a General Security Agreement on the assets of OPDC. Advances are at prime less 0.25% with a standby fee for the unused portion at 0.15%. L/G are issued at a cost of 0.50% per annum.

OPDC - committed reducing term (multiple draw) loan available at the borrower's option by way of fixed rate terms up to five years and floating prime based loans. Utilized to finance prior year capital expenditures and replenish working capital. The operating loan is secured with a General Security Agreement on the assets of OPDC. Cash advances are at prime less 0.25% with a standby fee for the unused portion at 0.15%. Currently, draws on this facility are interest only and have not been locked in to a fixed term or rate.

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12. BANK INDEBTEDNESS (continued)

The following table outlines facilities available and utilized:

Bank indebtedness	December 31 2016	December 31 2015
	$	$
BORROWING LIMITS ON CREDIT FACILITIES AVAILABLE		
OPDC - revolving operating loan for working capital purposes	**8,000**	5,000
OPDC - committed reducing term facility for capex	**5,000**	5,000
	13,000	10,000
CASH AMOUNTS BORROWED AND OUTSTANDING		
OPDC - revolving operating loan for working capital purposes	**1,137**	-
OPDC - committed reducing term facility for capex	**5,000**	2,000
	6,137	2,000
IRREVOCABLE LETTERS OF CREDIT OUTSTANDING		
OPDC - revolving operating loan for working capital purposes	**2,035**	2,035
	2,035	2,035

13. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities	December 31 2016	December 31 2015
	$	$
Power purchases	**3,288**	2,774
Accounts payable and accrued liabilities	**2,383**	2,161
Customer credit balances	**891**	824
	6,562	5,759

Due to its short term nature, the carrying amount of the accounts payable and accrued liabilities approximates its fair values.

(in thousands of Canadian dollars unless otherwise noted)

14. CURRENT AND DEFERRED INCOME TAXES (PILS)

14.1 Current income tax expense included in Statement of Comprehensive Income

Combined statutory federal and provincial tax rates for Ontario are 26.5% on active business. Income tax expense varies from amounts which would be computed by applying OPDC's combined statutory income tax rate as follows:

Current provision	**2016**	2015
	$	$
Profit for the year	**1,553**	873
Add back provision for PILs	**(767)**	476
	786	1,349
Statutory federal and provincial combined rate	**26.5%**	26.5%
Provision for PILs at statutory rates	**208**	357
Increase (decrease) in PILs resulting from differences in tax base vs carrying values:		
PP&E and intangibles	**(267)**	(157)
Regulatory and other reserves	**19**	107
Departure tax estimate due to exit from PILs regime - August 14, 2016	**1,065**	-
Other	**(112)**	15
	913	322

On August 15, 2016 OPDC became party to a share purchase agreement with Hydro One, a company taxable under the Tax Act. Consequently, under section 149(1.1) of the Tax Act, OPDC ceased to be exempt under that Act as of the date of signing the Share Purchase Agreement. Pursuant to section 149(10) of the Tax Act, as of the date it ceased to be exempt, OPDC became liable to pay both federal and provincial income tax, with its first tax year starting at that time.

OPDC has been deemed to have disposed of all of its assets, and reacquired them, at fair market value for income tax purposes immediately prior to August 15, 2016 and has been required to file a final tax return as of August 14, 2016 with the Ministry of Finance for Ontario. As a result of the fair market value "bump" OPDC is subject to applicable taxes from income and losses up to this date including the impact of the deemed disposition ("departure taxes") payable to the Ministry of Finance estimated at $1,065.

OPDC is required to establish a new taxation year prior to August 15, 2017 and will carry the newly adjusted cost bases for all of its assets forward into the Tax Act regime.

14.2 PILs payable

	December 31	December 31
PILs payable	**2016**	2015
	$	$
PILs payable	**572**	217
	572	217

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14. CURRENT AND DEFERRED INCOME TAXES (PILS) (continued)

14.3 Deferred income tax expense included in Statement of Comprehensive Income

Deferred income taxes recognized in the Statement of Comprehensive Income are as follows:

Deferred provision	2016	2015
	$	$
Included in profit for the year		
PP&E and intangibles	**539**	157
Goodwill estimated as a result of exiting PILs tax regime on SPA signing	**(2,214)**	-
Post retirement benefits and sick pay accrual	**(5)**	(3)
	(1,680)	154
Included in net movement in regulatory balances		
Deferred taxes related to changes in regulatory balances	**174**	**(78)**
	174	**(78)**
Included in other comprehensive income for the year		
Post retirement benefits and sick pay accrual	**5**	-
	5	-

14.4 Deferred income tax assets

Deferred income tax assets are provided for temporary differences between the financial statement carrying values of existing assets and liabilities and their respective tax bases. The following table outlines OPDC's position with respect to deferred tax assets. The utilization of this tax asset is dependent on future taxable profits in excess of profits arising from the reversal of existing taxable temporary differences. OPDC believes that this asset should be recognized as it will be utilized through future activities.

	December 31	December 31
Deferred income tax asset	2016	2015
	$	$
Asset due to excess of tax basis over carrying values:		
PP&E and intangibles	**355**	894
Goodwill estimated as a result of exiting PILs tax regime on SPA signing	**2,214**	**-**
Post retirement benefits	**153**	172
Sick pay accrual	**32**	13
	2,754	1,079

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

14. CURRENT AND DEFERRED INCOME TAXES (PILS) (continued)

14.5 Deferred tax balances related to regulatory deferral accounts

Deferred tax balances related to regulatory deferral account debit and credit balances are netted against the applicable regulatory deferral account debit or credit balances. They are not included with the other deferred income tax asset balances related to PP&E, intangibles, post retirement benefits and loss carry forward.

Deferred income tax assets (liabilities) included with regulatory balances	**December 31 2016**	December 31 2015
	$	$
Asset (liability) due to excess (shortfall) of tax basis over carrying values:		
Asset included with regulatory deferral account credit balances	**770**	1,077
Liability included with regulatory deferral account debit balances	**(634)**	(767)
	136	310

15. CUSTOMER SECURITY DEPOSITS

Customer deposits represents cash deposits from electricity distribution customers and retailers, as well as construction deposits from customers and developers. Deposits from electricity distribution customers are refundable to customers demonstrating an acceptable level of credit risk as determined by OPDC in accordance with policies set out by the OEB or upon termination of their electricity distribution service. Construction deposits represent cash prepayments for the estimated cost of capital projects recoverable from customers and developers. Upon completion of the capital project, these deposits are transferred to contributions in aid of construction.

Customer security deposits	**December 31 2016**	December 31 2015
	$	$
Customer deposits	**402**	313
Construction deposits	**211**	140
	613	453
Allocated to:		
Current	**141**	133
Long term	**472**	320
	613	453

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

16. POST RETIREMENT BENEFITS

Defined contribution plan

The employees of OPDC participate in the Ontario Municipal Employees Retirement System ("OMERS"). Although the plan has a defined retirement benefit plan for employees, the related obligation of the corporation cannot be identified. The OMERS plan has several unrelated participating municipalities and costs are not specifically attributed to each participant. The employer portions of amounts paid to OMERS made for current service and recognized in comprehensive income are as follows:

Contributions to OMERS on behalf of employees	2016	2015
	$	$
Contributions to OMERS on behalf of employees	**355**	360

Defined benefit plan

OPDC provides certain unfunded health, dental and life insurance benefits on behalf of its retired employees. These benefits are provided through a group defined benefit plan. OPDC has reported its share of the defined benefit costs and related liabilities, as calculated by an actuary, in these Financial Statements.

The accrued benefit liability and the expense for the year ended December 31, 2016 were based on results and assumptions determined by actuarial valuation as at December 31, 2016 and are as follows:

	December 31	December 31
Post retirement benefits	**2016**	2015
	$	$
Defined benefit obligation, beginning of year	**648**	637
Amounts recognized in profit for the year		
Current service costs	**11**	11
Finance costs on obligation	**25**	24
	36	35
Benefit payments	**(29)**	(24)
Costs reallocated across companies due to employee transfers	**(36)**	-
Experience loss included in other comprehensive income	**(41)**	-
Defined benefit obligation, end of year	**578**	648

The plan is exposed to a number of risks, including:

- Interest rate risk: decreases/increases in the discount rate used (high quality corporate bonds) will increase/decrease the defined benefit obligation.
- Longevity risk: changes in the estimation of mortality rates of current and former employees.
- Health care cost risk: increases in cost of providing health, dental and life insurance benefits.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

16. POST RETIREMENT BENEFITS (continued)

Assumptions used in the actuarial valuation in order to determine the present value of the unfunded obligation are as follows:

Assumptions used in actuarial valuation	2016	2015
Discount rate	**3.9%**	3.9%
Consumer price index	**2.0%**	2.0%
Compensation increase	**2.5%**	2.0%
Health cost increases	**4.5%**	4.6%
Dental cost increase	**4.5%**	4.8%
Retirement age	**60**	58

17. DEFERRED REVENUE

Deferred revenue consists of capital contributions received from developers during the construction and acquisition of distribution PP&E which has not yet been recognized into other revenue. Such capital contributions are recorded as deferred revenue and recognized to other revenue over the life of the related assets as follows:

Deferred revenue	2016	2015
	$	$
Balance, beginning of year	**1,166**	1,060
Contributions in aid of construction received	**396**	135
Contributions in aid of construction amortized to other revenue	**(36)**	(29)
Balance, end of year	**1,526**	1,166

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

18. LONG TERM DEBT

Long term debt	December 31 2016	December 31 2015
	$	$
Promissory note due to the City	**9,762**	9,762
Debenture payable to Ontario Infrastructure Projects Corporation ("OIPC")	**735**	945
	10,497	10,707
Current portion of debenture payable to OIPC	**210**	210
	10,287	10,497
Principal repayments anticipated over the next five years and thereafter:		
2016	**-**	210
2017	**210**	210
2018	**210**	210
2019	**210**	210
2020	**105**	105
2021	**-**	-
Thereafter	**9,762**	9,762
	10,497	10,707

Promissory notes payable to the City

The promissory notes payable to the City bear interest for the current year at 6.25% per annum (2015 – 6.25%). The interest rate is reviewed annually and payments of interest are required to be made quarterly on the last day of March, June, September and December. The promissory notes are due December 31, 2030 and payments to the City of Orillia are interest only. Under the terms of the notes, the City of Orillia can demand repayment of up to 20% of the original principal in a calendar year with the payment to be made March 31 provided the City gives six months' notice to OPDC. No such demand has been made by the City as of the date of approval of these financial statements. The fair value of the notes at current market borrowing rates approximates $11,383 (2015 - $11,256). The notes are secured by a general security agreement on all the assets of OPDC.

Debenture payable to Infrastructure OIPC

OPDC has entered into a financing arrangement with OIPC, to provide debenture financing for its smart meter infrastructure expenditures. On May 3, 2010 a debenture in the amount of $2,100 was issued based on a 10-year term and an annual interest rate of 4.39%. OPDC incurred $39 (2015 - $48) in interest expense to OIPC in 2016. Under the terms of the debenture, OPDC must make principal repayments of $210 annually, until the debenture is retired in 2020. The fair value of the debenture at current market borrowing rates approximates $763 (2015 - $981).The financing arrangement grants OIPC a general security agreement against OPDC, in third priority behind the Toronto Dominion Bank and the City of Orillia. The agreement restricts dividends paid by OPDC to amounts that meet the definition of "Permitted Distributions" unless waived by OIPC.

Impact of sale transaction on long term debt

Should the OEB approve the sale of OPDC to Hydro One, amounts outstanding for both the promissory note to the City and the debenture payable to OIPC will be repaid to the debt holders prior to the closing date of the sale. Breakage costs for debenture payable to OIPC are estimated to be approximately $28. It is OPDC's intention to refinance outstanding long term debt with demand loans (no term) from a major Canadian chartered bank.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

19. SHARE CAPITAL

Nature and purpose of equity

The reserves recorded in equity on OPDC’s Statement of Financial Position include “Share capital” and “Retained earnings”. Share capital is used to record the issuance of equity. Retained earnings is used to record OPDC’s change in retained earnings from year to year.

Share capital

An unlimited number of common shares with no par value are authorized for issue. All shares are ranked equally with regards to OPDC's residual assets and there was no change in share capital during 2016 and 2015. OPDC does not have preference shares.

	December 31	December 31
Share capital	**2016**	2015
	$	$
Share capital	**8,236**	8,236
	8,236	8,236
Issued and fully paid:		
Number of common shares	**1,001**	1,001

20. OPERATING REVENUE

Operating revenue	**2016**	2015
	$	$
Distribution revenue	**7,951**	7,857
Other revenue	**682**	678
	8,633	8,535

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

21. OPERATING EXPENSES

Operating expenses	2016	2015
	$	$
EXPENSES BY NATURE		
Board of Directors and staff costs	**2,918**	2,609
Operations and maintenance	**595**	711
General adminstration and overhead	**1,233**	1,157
Bad debts	**88**	104
Donations	**288**	268
	5,122	4,849
EXPENSES BY FUNCTION		
Operations and maintenance	**2,163**	1,980
Billing and collection	**1,136**	1,160
Administration and general	**1,823**	1,709
	5,122	4,849

22. FINANCE INCOME AND FINANCE COSTS

Finance income and finance costs	2016	2015
	$	$
FINANCE INCOME		
Recognized in profit or loss:		
Interest on related party loans	**5**	-
Interest income on bank deposits	**5**	8
	10	8
FINANCE COSTS		
Recognized in profit or loss:		
Interest on prommisory notes payable to the City	**610**	610
Interest on non-related debt	**39**	48
Interest on post retirement benefits	**25**	24
Other	**66**	-
	740	682
INTEREST PAID		
Finance costs	**740**	682
Less interest on post retirement benefits obligation	**25**	24
Interest paid in cash	**715**	658

NOTES TO THE FINANCIAL STATEMENTS
For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

23. NON-CASH OR NON-OPERATING ADJUSTMENTS INCLUDED IN PROFIT

In order to arrive at cash flows from operating activities on the Statement of Cash Flows the following items need to be added or subtracted from profit for the year:

Other non-cash or non-operating items included in profit	2016	2015
	$	$
NON-REGULATORY ITEMS (NON-CASH OR NON-OPERATING) INCLUDED IN PROFIT		
Provision for PILs included in profit	**(767)**	476
Loss on disposal of PP&E	**77**	79
Amortization of deferred revenue	**(36)**	(29)
Post-retirement benefits	**11**	11
Other non-cash adjustments	**(57)**	-
Finance income	**(10)**	(8)
Finance costs	**740**	682
	(42)	1,211
REGULATORY ITEMS (NON-CASH)		
Net movement in regulatory balances including related deferred taxes	**547**	688
	505	1,899

24. NET CHANGES IN NON-CASH WORKING CAPITAL

In order to arrive at cash flows from operating activities on the Statement of Cash Flows the following items need to be added or subtracted from profit for the year:

Net changes in non-cash working capital	2016	2015
	$	$
Accounts receivable	**(928)**	786
Unbilled energy and distribution revenue	**(243)**	(353)
Inventories	**(26)**	25
Prepaid expenses	**63**	25
Due from related parties	**81**	(99)
Bank indebtedness to finance working capital requirements	**1,137**	(200)
Accounts payable and accrued liabilities	**803**	(908)
Payment in lieu of taxes payable	**355**	217
Customer security deposits	**8**	65
Due to related parties	**99**	(2)
	1,349	(444)

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

25. RELATED PARTY TRANSACTIONS

IAS 24 disclosure exemptions

OPDC is exempt from some of the general disclosure requirements of IAS 24 with relation to transactions with government-related parties, and has applied the government-related disclosure requirements.

Key management personnel compensation

Key management personnel are defined in IAS 24 as "those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity". Key management personnel of OPDC have been defined as members of its Board of Directors, officers and senior managers reporting directly to the President and Chief Executive Officer.

Key management personnel compensation	**2016**	2015
	$	$
Board of Directors	**140**	69
Officers and senior managers	**492**	447
	632	516

Transactions with related parties

OPDC provides electricity and other services to the City. OPDC also purchases services and pays property taxes and promissory note interest to the City. OPDC has a shared services agreement with an affiliate, Orillia Power Generation Corporation ("OPGC"). The control centre, building space, purchasing and administrative staff are shared among the two companies as outlined in the agreement. OPDC has Affiliate Relationships Code and Standard Supply Service Code exemptions approved by the OEB to allow the shared services.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

25. RELATED PARTY TRANSACTIONS (continued)

Related party transactions	2016	2015
	$	$
Financing activities with the City		
Finance costs paid to the City	**610**	610
Operating activities with the City		
Power sold to the City	**2,626**	2,339
Other services sold to the City	**68**	128
Goods and services purchased from the City	**92**	69
Property taxes paid to the City	**72**	70
Balances outstanding with the City		
Promissory notes due to the City	**9,762**	9,762
Due from the City included in receivables	**290**	224
Due to from City included in payables	**6**	9
Investing and financing activities with affiliates		
Dividends paid to Orillia Power Corporation	**250**	1,230
Finance income received from Orillia Power Corporation	**5**	-
Operating activities with affiliates - sold to		
Goods and services sold to Orillia Power Corporation	**3**	6
Goods and services sold to OPGC	**1,017**	1,049
Goods and services sold to 2429106 Ontario Inc. (subsidiary of OPGC)	**11**	4
Operating activities with affiliates - purchased from		
Goods and services purchased from Orillia Power Corporation	**143**	69
Goods and services purchased from Orillia Power Generaton Corporation	**213**	122
Due from related parties		
Due from Orillia Power Generation Corporation	**779**	863
Due from 2429106 Ontario Inc.	**7**	4
Due to related parties		
Due to Orillia Power Corporation	**154**	55

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

26. COMMITMENTS AND CONTINGENCIES

IESO prudential security commitments

Purchasers of electricity in Ontario, through the IESO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IESO could draw on these guarantees if OPDC fails to make a payment required by default notice issued by the IESO. As at December 31, 2016, OPDC has provided prudential support to the IESO in the form of an irrevocable, automatically renewing bank letter of credit in the amount of $2,035 (December 31, 2015 - $2,035).

Membership commitment

In 2015, the Company renewed a three year membership commitment in the Cornerstone Hydro Electric Concepts Association Inc. (“CHEC”), an association of approximately fifteen distributors modelled after a co-operative to share resources and proficiencies. OPDC can terminate its membership by giving sixty days notice and paying the unpaid balance of its three year commitment. As of December 31, 2016 the cost to terminate the membership is approximately $40.

Liability insurance

OPDC belongs to the Municipal Electric Association Reciprocal Insurance Exchange (“MEARIE”), a self-insurance plan designed to pool all member risks. Any losses experienced by MEARIE are shared amongst all of its members. As of the date of Board of Directors approval of these financial statements, OPDC has not been made aware of any assessments for significant losses. OPDC has contracted for a maximum total of $24 million in event coverage with MEARIE and $10 million in excess liability coverage with a secondary provider.

Legal proceeding contingencies

In 2012, a legal proceeding was commenced against OPDC related to damages to Bell Canada property. OPDC has turned this matter over to its liability insurer and the matter is currently before the Ontario Superior Court of Justice. At this time, it is not possible to quantify the effect, if any, on the financial statements of OPDC. Management does not believe that the outcome of this matter will have a material impact on the financial statements.

In relation to a 2013 motor vehicle accident, a legal proceeding has been commenced against OPDC. This matter has been turned over to OPDC’s liability insurer and is currently before the Ontario Superior Court of Justice. At this time, it is not possible to quantify the effect, if any, on the financial statements of OPDC. Management does not believe that the outcome of this matter will have a material impact on the financial statements.

27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

As part of its operations, OPDC carries out transactions that expose it to financial risks such as credit, liquidity and market risks. The following is a discussion of risks and related mitigation strategies that have been identified by OPDC for financial instruments. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks identified.

Cash and cash equivalents are measured at fair value. The carrying values of receivables, and accounts payable and accrued charges approximate fair value because of the short maturity of these instruments.

Credit risk

Financial assets carry credit risk that a counter-party will fail to discharge an obligation which would result in a financial loss.

Financial assets held by OPDC, such as accounts receivable, expose it to credit risk. OPDC earns its revenue from a broad base of approximately 13,600 customers located in the City of Orillia. No single customer accounts for revenue in excess of 10% of total revenue. The carrying amount of accounts receivable is reduced through the use of an allowance for impairment. The amount of the related impairment loss is recognized in the statement of profit or loss as are any subsequent recoveries of receivables previously provisioned. Further details on accounts receivable can be found in other notes to these financial statements.

Credit risk is managed through collection of security deposits from customers in accordance with OEB codes and regulations. Further details on customer security deposits can be found in other notes to these financial statements.

Market risk

OPDC is not exposed to significant market risk given they do not have investments in foreign currency, and have minimal investment in interest bearing instruments.

Liquidity risk

Liquidity risk is the risk that OPDC will not be able to meet its financial obligations as they come due. OPDC monitors its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements. OPDC's objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing interest exposure. OPDC has access to various operating lines of credit and monitors cash balances to ensure that sufficient levels of liquidity are on hand to meet financial commitments as they come due. Further details on accounts payable and accrued liabilities can be found in other notes to these financial statements.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended December 31, 2016
(in thousands of Canadian dollars unless otherwise noted)

28. CAPITAL MANAGEMENT

OPDC considers its capital to be its share capital, retained earnings and accumulated other comprehensive income. OPDC's objectives when managing capital are:

- to safeguard OPDC's ability to continue as a going concern, so that it can continue to provide adequate returns for the shareholder and benefits for other stakeholders while maintaining its assets,
- to provide an adequate return to the shareholder by controlling costs and establishing rates that maximize rate of return commensurate with the level of risk, and
- to ensure the capital structure does not prevent OPDC from taking advantage of potential growth opportunities provided that they do not expose OPDC to unnecessary risk.

OPDC manages its capital structure and makes adjustments to it in light of changes in economic conditions, annual profitability and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, OPDC will adjust the amount of dividends paid to the shareholder, subject to the constraints imposed by lending agreements. OPDC is subject to quarterly reporting and bank review of its interest coverage and debt capitalization ratios, in relation to its various bank credit lines.

Consistent with others in the industry, OPDC monitors capital on the basis of the debt-to-capital ratio calculated as long term debt divided by the sum of long term debt plus equity, as shown in the following table. For purposes of comparing the measures below to benchmarks, OPDC was initially incorporated at a debt to capital ratio of 0.48.

	December 31	December 31
Debt to capital ratio	**2016**	2015
	$	$
Sum of long term debt and shareholder's equity		
Long term debt	**10,287**	10,497
Shareholder's equity	**13,954**	12,636
	24,241	23,133
Key Ratio - Debt to Capital		
Ratio of debt to debt plus equity	**0.42**	0.45

The Consolidated Financial Statements, Management's Discussion and Analysis (MD&A) and related financial information have been prepared by the management of Hydro One Inc. (Hydro One or the Company). Management is responsible for the integrity, consistency and reliability of all such information presented. The Consolidated Financial Statements have been prepared in accordance with United States Generally Accepted Accounting Principles and applicable securities legislation. The MD&A has been prepared in accordance with National Instrument 51-102.

The preparation of the Consolidated Financial Statements and information in the MD&A involves the use of estimates and assumptions based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. Estimates and assumptions are based on historical experience, current conditions and various other assumptions believed to be reasonable in the circumstances, with critical analysis of the significant accounting policies followed by the Company as described in Note 2 to the Consolidated Financial Statements. The preparation of the Consolidated Financial Statements and the MD&A includes information regarding the estimated impact of future events and transactions. The MD&A also includes information regarding sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from the present assessment of this information because future events and circumstances may not occur as expected. The Consolidated Financial Statements and MD&A have been properly prepared within reasonable limits of materiality and in light of information up to February 12, 2018.

Management is responsible for establishing and maintaining adequate disclosure controls and procedures and internal control over financial reporting as described in the annual MD&A. Management evaluated the effectiveness of the design and operation of internal control over financial reporting based on the framework and criteria established in the Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that evaluation, management concluded that the Company's internal control over financial reporting was effective at a reasonable level of assurance as of December 31, 2017. As required, the results of that evaluation were reported to the Audit Committee of the Hydro One Board of Directors and the external auditors.

The Consolidated Financial Statements have been audited by KPMG LLP, independent external auditors appointed by the shareholders of the Company. The external auditors' responsibility is to express their opinion on whether the Consolidated Financial Statements are fairly presented in accordance with United States Generally Accepted Accounting Principles. The Independent Auditors' Report outlines the scope of their examination and their opinion.

The Hydro One Board of Directors, through its Audit Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control over reporting and disclosure. The Audit Committee of Hydro One met periodically with management, the internal auditors and the external auditors to satisfy itself that each group had properly discharged its respective responsibility and to review the Consolidated Financial Statements before recommending approval by the Board of Directors. The external auditors had direct and full access to the Audit Committee, with and without the presence of management, to discuss their audit findings.

On behalf of Hydro One's management:

Mayo Schmidt
President and Chief Executive Officer

Christopher Lopez
Senior Vice President, Finance
acting in the capacity of chief financial officer

To the Shareholder of Hydro One Inc.

We have audited the accompanying consolidated financial statements of Hydro One Inc., which comprise the consolidated balance sheets as at December 31, 2017 and December 31, 2016, the consolidated statements of operations and comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with United States Generally Accepted Accounting Principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Hydro One Inc. as at December 31, 2017 and December 31, 2016, and its consolidated results of operations and its consolidated cash flows for the years then ended in accordance with United States Generally Accepted Accounting Principles.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Canada
February 12, 2018

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
For the years ended December 31, 2017 and 2016

Year ended December 31 *(millions of Canadian dollars, except per share amounts)*	**2017**	**2016**
Revenues		
Distribution (includes $279 related party revenues; 2016 – $160) *(Note 26)*	4,366	4,915
Transmission (includes $1,526 related party revenues; 2016 – $1,556) *(Note 26)*	1,581	1,587
	5,947	6,502
Costs		
Purchased power (includes $1,594 related party costs; 2016 – $2,103) *(Note 26)*	2,875	3,427
Operation, maintenance and administration *(Note 26)*	1,014	1,043
Depreciation and amortization *(Note 5)*	810	769
	4,699	5,239
Income before financing charges and income taxes	**1,248**	**1,263**
Financing charges *(Note 6)*	411	392
Income before income taxes	**837**	**871**
Income taxes *(Note 7)*	120	135
Net income	**717**	**736**
Other comprehensive income	—	—
Comprehensive income	**717**	**736**
Net income attributable to:		
Noncontrolling interest *(Note 25)*	6	6
Common shareholder	711	730
	717	**736**
Comprehensive income attributable to:		
Noncontrolling interest *(Note 25)*	6	6
Common shareholder	711	730
	717	**736**
Earnings per common share *(Note 23)*		
Basic	$4,999	$5,132
Diluted	$4,999	$5,132
Dividends per common share declared *(Note 22)*	$105	$14

See accompanying notes to Consolidated Financial Statements.

HYDRO ONE INC.
CONSOLIDATED BALANCE SHEETS
At December 31, 2017 and 2016

December 31 *(millions of Canadian dollars)*	**2017**	**2016**
Assets		
Current assets:		
Cash and cash equivalents	—	48
Accounts receivable *(Note 8)*	635	833
Due from related parties *(Note 26)*	439	224
Other current assets *(Note 9)*	104	97
	1,178	1,202
Property, plant and equipment *(Note 10)*	19,871	19,068
Other long-term assets:		
Regulatory assets *(Note 12)*	3,049	3,145
Deferred income tax assets *(Note 7)*	954	1,213
Intangible assets *(Note 11)*	369	349
Goodwill *(Note 4)*	325	327
Other assets	5	6
	4,702	5,040
Total assets	**25,751**	**25,310**
Liabilities		
Current liabilities:		
Bank indebtedness	3	—
Short-term notes payable *(Note 15)*	926	469
Long-term debt payable within one year *(Notes 15, 16)*	752	602
Accounts payable and other current liabilities *(Note 13)*	892	933
Due to related parties *(Note 26)*	343	253
	2,916	2,257
Long-term liabilities:		
Long-term debt (includes $541 measured at fair value; 2016 – $548) *(Notes 15, 16)*	9,315	10,078
Regulatory liabilities *(Note 12)*	128	209
Deferred income tax liabilities *(Note 7)*	70	60
Other long-term liabilities *(Note 14)*	2,734	2,765
	12,247	13,112
Total liabilities	**15,163**	**15,369**
Contingencies and Commitments (Notes 28, 29)		
Subsequent Events (Note 31)		
Preferred shares *(Note 21)*	486	—
Noncontrolling interest subject to redemption *(Note 25)*	22	22
Equity		
Common shares *(Note 21)*	4,856	5,391
Retained earnings	5,183	4,487
Accumulated other comprehensive loss	(9)	(9)
Hydro One shareholder's equity	10,030	9,869
Noncontrolling interest *(Note 25)*	50	50
Total equity	**10,080**	**9,919**
	25,751	**25,310**

See accompanying notes to Consolidated Financial Statements.

On behalf of the Board of Directors:

David Denison
Chair

Philip Orsino
Chair, Audit Committee

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
For the years ended December 31, 2017 and 2016

Year ended December 31, 2017 *(millions of Canadian dollars)*	Common Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Hydro One Shareholder's Equity	Non-controlling Interest *(Note 25)*	Total Equity
January 1, 2017	5,391	4,487	(9)	9,869	50	9,919
Net income	—	711	—	711	4	715
Other comprehensive income	—	—	—	—	—	—
Distributions to noncontrolling interest	—	—	—	—	(4)	(4)
Dividends on common shares	—	(15)	—	(15)	—	(15)
Return of stated capital *(Note 21)*	(535)	—	—	(535)	—	(535)
December 31, 2017	**4,856**	**5,183**	**(9)**	**10,030**	**50**	**10,080**

Year ended December 31, 2016 *(millions of Canadian dollars)*	Common Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Hydro One Shareholder's Equity	Non-controlling Interest *(Note 25)*	Total Equity
January 1, 2016	6,000	3,759	(9)	9,750	52	9,802
Net income	—	730	—	730	4	734
Other comprehensive income	—	—	—	—	—	—
Distributions to noncontrolling interest	—	—	—	—	(6)	(6)
Dividends on common shares	—	(2)	—	(2)	—	(2)
Return of stated capital *(Note 21)*	(609)	—	—	(609)	—	(609)
December 31, 2016	**5,391**	**4,487**	**(9)**	**9,869**	**50**	**9,919**

See accompanying notes to Consolidated Financial Statements.

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, 2017 and 2016

Year ended December 31 *(millions of Canadian dollars)*	**2017**	**2016**
Operating activities		
Net income	717	736
Environmental expenditures	(24)	(20)
Adjustments for non-cash items:		
Depreciation and amortization (excluding asset removal costs)	720	679
Regulatory assets and liabilities	112	(16)
Deferred income taxes	96	111
Other	10	10
Changes in non-cash balances related to operations *(Note 27)*	63	168
Net cash from operating activities	**1,694**	**1,668**
Financing activities		
Long-term debt issued	—	2,300
Long-term debt repaid	(602)	(502)
Short-term notes issued	3,795	3,031
Short-term notes repaid	(3,338)	(4,053)
Promissory note issued *(Note 26)*	486	—
Promissory note repaid *(Note 26)*	(486)	—
Return of stated capital	(535)	(609)
Preferred shares issued	486	—
Dividends paid	(15)	(2)
Distributions paid to noncontrolling interest	(6)	(9)
Change in bank indebtedness	3	—
Other	—	(10)
Net cash from (used in) financing activities	**(212)**	**146**
Investing activities		
Capital expenditures *(Note 27)*		
Property, plant and equipment	(1,456)	(1,594)
Intangible assets	(80)	(61)
Acquisitions *(Note 4)*	—	(224)
Capital contributions received *(Note 27)*	9	21
Other	(3)	3
Net cash used in investing activities	**(1,530)**	**(1,855)**
Net change in cash and cash equivalents	(48)	(41)
Cash and cash equivalents, beginning of year	48	89
Cash and cash equivalents, end of year	**—**	**48**

See accompanying notes to Consolidated Financial Statements.

1. DESCRIPTION OF THE BUSINESS

Hydro One Inc. (Hydro One or the Company) was incorporated on December 1, 1998, under the Business Corporations Act (Ontario) and is wholly-owned by Hydro One Limited. The principal businesses of Hydro One are the transmission and distribution of electricity to customers within Ontario.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation

These Consolidated Financial Statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances have been eliminated.

Basis of Accounting

These Consolidated Financial Statements are prepared and presented in accordance with United States (US) Generally Accepted Accounting Principles (GAAP) and in Canadian dollars.

Use of Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains and losses during the reporting periods. Management evaluates these estimates on an ongoing basis based upon historical experience, current conditions, and assumptions believed to be reasonable at the time the assumptions are made, with any adjustments being recognized in results of operations in the period they arise. Significant estimates relate to regulatory assets and regulatory liabilities, environmental liabilities, pension benefits, post-retirement and post-employment benefits, asset retirement obligations, goodwill and asset impairments, contingencies, unbilled revenues, and deferred income tax assets and liabilities. Actual results may differ significantly from these estimates.

Rate Setting

The Company’s Transmission Business consists of the transmission business of Hydro One Networks Inc. (Hydro One Networks), Hydro One Sault Ste. Marie LP (HOSSM) (formerly Great Lakes Power Transmission LP), and its 66% interest in B2M Limited Partnership (B2M LP). The Company’s Distribution Business consists of the distribution businesses of Hydro One Networks, as well as Hydro One Remote Communities Inc. (Hydro One Remote Communities).

<u>Transmission</u>

In November 2017, the Ontario Energy Board (OEB) approved Hydro One Networks’ 2017 transmission rates revenue requirement of $1,438 million. See Note 12 - Regulatory Assets and Liabilities for additional information.

In December 2015, the OEB approved B2M LP’s 2015-2019 rates revenue requirements of $39 million, $36 million, $37 million, $38 million and $37 million for the respective years. On January 14, 2016, the OEB approved the B2M LP revenue requirement recovery through the 2016 Uniform Transmission Rates, and the establishment of a deferral account to capture costs of Tax Rate and Rule changes. On June 8, 2017, the OEB approved the 2017 rates revenue requirement of $34 million, updated for the cost of capital parameters.

On September 28, 2017, the OEB issued its Decision and Order on HOSSM's 2017 transmission rates application, denying the requested revenue requirement for 2017. HOSSM's 2016 approved revenue requirement of $41 million will remain in effect for 2017.

<u>Distribution</u>

In March 2015, the OEB approved Hydro One Networks’ distribution revenue requirements of $1,326 million for 2015, $1,430 million for 2016 and $1,486 million for 2017. The OEB has subsequently approved updated revenue requirements of $1,410 million for 2016 and $1,415 million for 2017.

On March 30, 2017, the OEB approved an increase of 1.9% to Hydro One Remote Communities’ basic rates for the distribution and generation of electricity, with an effective date of May 1, 2017.

Regulatory Accounting

The OEB has the general power to include or exclude revenues, costs, gains or losses in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have been applied in an unregulated company. Such change in timing involves the application of rate-regulated accounting, giving rise to the recognition of regulatory assets and liabilities. The Company’s regulatory assets represent amounts receivable from future customers and costs that have been deferred for accounting purposes because it is probable that they will be recovered in future rates. In addition, the Company has recorded regulatory liabilities that generally represent amounts that are refundable to future customers. The Company continually assesses the likelihood of recovery of each of its regulatory assets and continues to believe that it is probable that the OEB will include its regulatory assets and liabilities in setting future rates. If, at some future date, the Company judges that it is no longer probable that the OEB will include a regulatory asset or liability in setting future rates, the appropriate carrying amount would be reflected in results of operations in the period that the assessment is made.

Cash and Cash Equivalents

Cash and cash equivalents include cash and short-term investments with an original maturity of three months or less.

Revenue Recognition

Transmission revenues are collected through OEB-approved rates, which are based on an approved revenue requirement that includes a rate of return. Such revenue is recognized as electricity is transmitted and delivered to customers.

Distribution revenues attributable to the delivery of electricity are based on OEB-approved distribution rates and are recognized on an accrual basis and include billed and unbilled revenues. Billed revenues are based on electricity delivered as measured from customer meters. At the end of each month, electricity delivered to customers since the date of the last billed meter reading is estimated, and the corresponding unbilled revenue is recorded. The unbilled revenue estimate is affected by energy consumption, weather, and changes in the composition of customer classes.

Distribution revenue also includes an amount relating to rate protection for rural, residential, and remote customers, which is received from the Independent Electricity System Operator (IESO) based on a standardized customer rate that is approved by the OEB.

Revenues also include amounts related to sales of other services and equipment. Such revenue is recognized as services are rendered or as equipment is delivered.

Revenues are recorded net of indirect taxes.

Accounts Receivable and Allowance for Doubtful Accounts

Billed accounts receivable are recorded at the invoiced amount, net of allowance for doubtful accounts. Unbilled accounts receivable are recorded at their estimated value. Overdue amounts related to regulated billings bear interest at OEB-approved rates. The allowance for doubtful accounts reflects the Company's best estimate of losses on billed accounts receivable balances. The Company estimates the allowance for doubtful accounts on billed accounts receivable by applying internally developed loss rates to the outstanding receivable balances by aging category. Loss rates applied to the billed accounts receivable balances are based on historical overdue balances, customer payments and write-offs. Accounts receivable are written-off against the allowance when they are deemed uncollectible. The allowance for doubtful accounts is affected by changes in volume, prices and economic conditions.

Noncontrolling interest

Noncontrolling interest represents the portion of equity ownership in subsidiaries that is not attributable to the shareholder of Hydro One. Noncontrolling interest is initially recorded at fair value and subsequently the amount is adjusted for the proportionate share of net income and other comprehensive income (OCI) attributable to the noncontrolling interest and any dividends or distributions paid to the noncontrolling interest.

If a transaction results in the acquisition of all, or part, of a noncontrolling interest in a subsidiary, the acquisition of the noncontrolling interest is accounted for as an equity transaction. No gain or loss is recognized in consolidated net income or comprehensive income as a result of changes in the noncontrolling interest, unless a change results in the loss of control by the Company.

Income Taxes

Current and deferred income taxes are computed based on the tax rates and tax laws enacted as at the balance sheet date. Tax benefits associated with income tax positions taken, or expected to be taken, in a tax return are recorded only when the "more-likely-than-not" recognition threshold is satisfied and are measured at the largest amount of benefit that has a greater than 50% likelihood of being realized upon settlement. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. Significant management judgment is required to determine recognition thresholds and the related amount of tax benefits to be recognized in the Consolidated Financial Statements. Management re-evaluates tax positions each period using new information about recognition or measurement as it becomes available.

Deferred Income Taxes

Deferred income taxes are provided for using the liability method. Under this method, deferred income tax liabilities are recognized on all taxable temporary differences between the tax bases and carrying amounts of assets and liabilities. Deferred income tax assets are recognized for deductible temporary differences between tax bases and carrying amounts of assets and liabilities, the carry forward unused tax credits and tax losses to the extent that it is more-likely-than-not that these deductions, credits, and losses can be utilized. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized, based on the tax rates and tax laws that have been enacted as at the balance sheet date. Deferred income taxes that are not included in the rate-setting process are charged or credited to the Consolidated Statements of Operations and Comprehensive Income.

Management reassesses the deferred income tax assets at each balance sheet date and reduces the amount to the extent that it is more-likely-than-not that the deferred income tax asset will not be realized. Previously unrecognized deferred income tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become more-likely-than-not that the tax benefit will be realized.

The Company records regulatory assets and liabilities associated with deferred income tax assets and liabilities that will be included in the rate-setting process.

The Company uses the flow-through method to account for investment tax credits (ITCs) earned on eligible scientific research and experimental development expenditures, and apprenticeship job creation. Under this method, only non-refundable ITCs are recognized as a reduction to income tax expense.

Materials and Supplies

Materials and supplies represent consumables, small spare parts and construction materials held for internal construction and maintenance of property, plant and equipment. These assets are carried at average cost less any impairments recorded.

Property, Plant and Equipment

Property, plant and equipment is recorded at original cost, net of customer contributions, and any accumulated impairment losses. The cost of additions, including betterments and replacement asset components, is included on the Consolidated Balance Sheets as property, plant and equipment.

The original cost of property, plant and equipment includes direct materials, direct labour (including employee benefits), contracted services, attributable capitalized financing costs, asset retirement costs, and direct and indirect overheads that are related to the capital project or program. Indirect overheads include a portion of corporate costs such as finance, treasury, human resources, information technology and executive costs. Overhead costs, including corporate functions and field services costs, are capitalized on a fully allocated basis, consistent with an OEB-approved methodology.

Property, plant and equipment in service consists of transmission, distribution, communication, administration and service assets and land easements. Property, plant and equipment also includes future use assets, such as land, major components and spare parts, and capitalized project development costs associated with deferred capital projects.

Transmission

Transmission assets include assets used for the transmission of high-voltage electricity, such as transmission lines, support structures, foundations, insulators, connecting hardware and grounding systems, and assets used to step up the voltage of electricity from generating stations for transmission and to step down voltages for distribution, including transformers, circuit breakers and switches.

Distribution

Distribution assets include assets related to the distribution of low-voltage electricity, including lines, poles, switches, transformers, protective devices and metering systems.

Communication

Communication assets include fibre optic and microwave radio systems, optical ground wire, towers, telephone equipment and associated buildings.

Administration and Service

Administration and service assets include administrative buildings, personal computers, transport and work equipment, tools and other minor assets.

Easements

Easements include statutory rights of use for transmission corridors and abutting lands granted under the *Reliable Energy and Consumer Protection Act, 2002*, as well as other land access rights.

Intangible Assets

Intangible assets separately acquired or internally developed are measured on initial recognition at cost, which comprises purchased software, direct labour (including employee benefits), consulting, engineering, overheads and attributable capitalized financing charges. Following initial recognition, intangible assets are carried at cost, net of any accumulated amortization and accumulated impairment losses. The Company's intangible assets primarily represent major computer applications.

Capitalized Financing Costs

Capitalized financing costs represent interest costs attributable to the construction of property, plant and equipment or development of intangible assets. The financing cost of attributable borrowed funds is capitalized as part of the acquisition cost of such assets.

The capitalized financing costs are a reduction of financing charges recognized in the Consolidated Statements of Operations and Comprehensive Income. Capitalized financing costs are calculated using the Company's weighted average effective cost of debt.

Construction and Development in Progress

Construction and development in progress consists of the capitalized cost of constructed assets that are not yet complete and which have not yet been placed in service.

Depreciation and Amortization

The cost of property, plant and equipment and intangible assets is depreciated or amortized on a straight-line basis based on the estimated remaining service life of each asset category, except for transport and work equipment, which is depreciated on a declining balance basis.

The Company periodically initiates an external independent review of its property, plant and equipment and intangible asset depreciation and amortization rates, as required by the OEB. Any changes arising from OEB approval of such a review are implemented on a remaining service life basis, consistent with their inclusion in electricity rates. The most recent reviews resulted in changes to rates effective January 1, 2015 and January 1, 2017 for Hydro One Networks' distribution and transmission businesses, respectively. A summary of average service lives and depreciation and amortization rates for the various classes of assets is included below:

	Average	Rate	
	Service Life	Range	Average
Property, plant and equipment:			
Transmission	55 years	1% – 3%	2%
Distribution	46 years	1% – 7%	2%
Communication	16 years	1% – 15%	6%
Administration and service	20 years	1% – 20%	6%
Intangible assets	10 years	10%	10%

In accordance with group depreciation practices, the original cost of property, plant and equipment, or major components thereof, and intangible assets that are normally retired, is charged to accumulated depreciation, with no gain or loss being reflected in results of operations. Where a disposition of property, plant and equipment occurs through sale, a gain or loss is calculated based on proceeds and such gain or loss is included in depreciation expense.

Acquisitions and Goodwill

The Company accounts for business acquisitions using the acquisition method of accounting and, accordingly, the assets and liabilities of the acquired entities are primarily measured at their estimated fair value at the date of acquisition. Costs associated with pending acquisitions are expensed as incurred. Goodwill represents the cost of acquired companies that is in excess of the fair value of the net identifiable assets acquired at the acquisition date. Goodwill is not included in rate base.

Goodwill is evaluated for impairment on an annual basis, or more frequently if circumstances require. The Company performs a qualitative assessment to determine whether it is more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount. If the Company determines, as a result of its qualitative assessment, that it is not more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount, no further testing is required. If the Company determines, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount, a goodwill impairment assessment is performed using a two-step, fair value-based test. The first step compares the fair value of the applicable reporting unit to its carrying amount, including goodwill. If the carrying amount of the applicable reporting unit exceeds its fair value, a second step is performed. The second step requires an allocation of fair value to the individual assets and liabilities using purchase price allocation in order to determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount, an impairment loss is recorded as a reduction to goodwill and as a charge to results of operations.

Based on assessment performed as at September 30, 2017, the Company has concluded that goodwill was not impaired at December 31, 2017.

Long-Lived Asset Impairment

When circumstances indicate the carrying value of long-lived assets may not be recoverable, the Company evaluates whether the carrying value of such assets, excluding goodwill, has been impaired. For such long-lived assets, the Company evaluates whether impairment may exist by estimating future estimated undiscounted cash flows expected to result from the use and eventual disposition of the asset. When alternative courses of action to recover the carrying amount of a long-lived asset are under consideration, a probability-weighted approach is used to develop estimates of future undiscounted cash flows. If the carrying value of the long-lived asset is not recoverable based on the estimated future undiscounted cash flows, an impairment loss is recorded, measured as the excess of the carrying value of the asset over its fair value. As a result, the asset's carrying value is adjusted to its estimated fair value.

Within its regulated business, the carrying costs of most of Hydro One's long-lived assets are included in rate base where they earn an OEB-approved rate of return. Asset carrying values and the related return are recovered through approved rates. As a result, such assets are only tested for impairment in the event that the OEB disallows recovery, in whole or in part, or if such a disallowance is judged to be probable. As at December 31, 2017 and 2016, no asset impairment had been recorded.

Costs of Arranging Debt Financing

For financial liabilities classified as other than held-for-trading, the Company defers the external transaction costs related to obtaining debt financing and presents such amounts net of related debt on the Consolidated Balance Sheets. Deferred debt issuance costs are amortized over the contractual life of the related debt on an effective-interest basis and the amortization is included within financing charges in the Consolidated Statements of Operations and Comprehensive Income. Transaction costs for items classified as held-for-trading are expensed immediately.

Comprehensive Income

Comprehensive income is comprised of net income and OCI. Hydro One presents net income and OCI in a single continuous Consolidated Statement of Operations and Comprehensive Income.

Financial Assets and Liabilities

All financial assets and liabilities are classified into one of the following five categories: held-to-maturity; loans and receivables; held-for-trading; other liabilities; or available-for-sale. Financial assets and liabilities classified as held-for-trading are measured at fair value. All other financial assets and liabilities are measured at amortized cost, except accounts receivable and amounts due from related parties, which are measured at the lower of cost or fair value. Accounts receivable and amounts due from related parties are classified as loans and receivables. The Company considers the carrying amounts of accounts receivable and amounts due from related parties to be reasonable estimates of fair value because of the short time to maturity of these instruments. Provisions for impaired accounts receivable are recognized as adjustments to the allowance for doubtful accounts and are recognized when there is objective evidence that the Company will not be able to collect amounts according to the original terms. All financial instrument transactions are recorded at trade date.

Derivative instruments are measured at fair value. Gains and losses from fair valuation are included within financing charges in the period in which they arise. The Company determines the classification of its financial assets and liabilities at the date of initial recognition. The Company designates certain of its financial assets and liabilities to be held at fair value, when it is consistent with the Company's risk management policy disclosed in Note 16 – Fair Value of Financial Instruments and Risk Management.

Derivative Instruments and Hedge Accounting

The Company closely monitors the risks associated with changes in interest rates on its operations and, where appropriate, uses various instruments to hedge these risks. Certain of these derivative instruments qualify for hedge accounting and are designated as accounting hedges, while others either do not qualify as hedges or have not been designated as hedges (hereinafter referred to as undesignated contracts) as they are part of economic hedging relationships.

The accounting guidance for derivative instruments requires the recognition of all derivative instruments not identified as meeting the normal purchase and sale exemption as either assets or liabilities recorded at fair value on the Consolidated Balance Sheets. For derivative instruments that qualify for hedge accounting, the Company may elect to designate such derivative instruments as either cash flow hedges or fair value hedges. The Company offsets fair value amounts recognized on its Consolidated Balance Sheets related to derivative instruments executed with the same counterparty under the same master netting agreement.

For derivative instruments that qualify for hedge accounting and which are designated as cash flow hedges, the effective portion of any gain or loss, net of tax, is reported as a component of accumulated OCI (AOCI) and is reclassified to results of operations in the same period or periods during which the hedged transaction affects results of operations. Any gains or losses on the derivative instrument that represent either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in results of operations. For fair value hedges, changes in fair value of both the derivative instrument and the underlying hedged exposure are recognized in the Consolidated Statements of Operations and Comprehensive Income in the current period. The gain or loss on the derivative instrument is included in the same line item as the offsetting gain or loss on the hedged item in the Consolidated Statements of Operations and Comprehensive Income. The changes in fair value of the undesignated derivative instruments are reflected in results of operations.

Embedded derivative instruments are separated from their host contracts and are carried at fair value on the Consolidated Balance Sheets when: (a) the economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract; (b) the hybrid instrument is not measured at fair value, with changes in fair value recognized in results of operations each period; and (c) the embedded derivative itself meets the definition of a derivative. The Company does not engage in derivative trading or speculative activities and had no embedded derivatives at December 31, 2017 or 2016.

Hydro One periodically develops hedging strategies taking into account risk management objectives. At the inception of a hedging relationship where the Company has elected to apply hedge accounting, Hydro One formally documents the relationship between the hedged item and the hedging instrument, the related risk management objective, the nature of the specific risk exposure being hedged, and the method for assessing the effectiveness of the hedging relationship. The Company also assesses, both at the inception of the hedge and on a quarterly basis, whether the hedging instruments are effective in offsetting changes in fair values or cash flows of the hedged items.

Employee Future Benefits

Employee future benefits provided by Hydro One include pension, post-retirement and post-employment benefits. The costs of the Company's pension, post-retirement and post-employment benefit plans are recorded over the periods during which employees render service.

The Company recognizes the funded status of its defined benefit pension, post-retirement and post-employment plans on its Consolidated Balance Sheets and subsequently recognizes the changes in funded status at the end of each reporting year. Defined benefit pension, post-retirement and post-employment plans are considered to be underfunded when the projected benefit obligation exceeds the fair value of the plan assets. Liabilities are recognized on the Consolidated Balance Sheets for any net underfunded projected benefit obligation. The net underfunded projected benefit obligation may be disclosed as a current liability, long-term liability, or both. The current portion is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next 12 months exceeds the fair value of plan assets. If the fair value of plan assets exceeds the projected benefit obligation of the plan, an asset is recognized equal to the net overfunded projected benefit obligation. The post-retirement and post-employment benefit plans are unfunded because there are no related plan assets.

Hydro One recognizes its contributions to the defined contribution pension plan as pension expense, with a portion being capitalized as part of labour costs included in capital expenditures. The expensed amount is included in operation, maintenance and administration costs in the Consolidated Statements of Operations and Comprehensive Income.

Defined Benefit Pension

Defined benefit pension costs are recorded on an accrual basis for financial reporting purposes. Pension costs are actuarially determined using the projected benefit method prorated on service and are based on assumptions that reflect management's best estimate of the effect of future events, including future compensation increases. Past service costs from plan amendments and all actuarial gains and losses are amortized on a straight-line basis over the expected average remaining service period of active employees in the plan, and over the estimated remaining life expectancy of inactive employees in the plan. Pension plan assets, consisting primarily of listed equity securities as well as corporate and government debt securities, are fair valued at the end of each year. Hydro One records a regulatory asset equal to the net underfunded projected benefit obligation for its pension plan.

Post-retirement and Post-employment Benefits

Post-retirement and post-employment benefits are recorded and included in rates on an accrual basis. Costs are determined by independent actuaries using the projected benefit method prorated on service and based on assumptions that reflect management's best estimates. Past service costs from plan amendments are amortized to results of operations based on the expected average remaining service period.

For post-retirement benefits, all actuarial gains or losses are deferred using the "corridor" approach. The amount calculated above the "corridor" is amortized to results of operations on a straight-line basis over the expected average remaining service life of active employees in the plan and over the remaining life expectancy of inactive employees in the plan. The post-retirement benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment.

For post-employment obligations, the associated regulatory liabilities representing actuarial gains on transition to US GAAP are amortized to results of operations based on the "corridor" approach. The actuarial gains and losses on post-employment obligations that are incurred during the year are recognized immediately to results of operations. The post-employment benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment.

All post-retirement and post-employment future benefit costs are attributed to labour and are either charged to results of operations or capitalized as part of the cost of property, plant and equipment and intangible assets.

Stock-Based Compensation

Share Grant Plans

Hydro One measures share grant plans based on fair value of share grants as estimated based on the grant date Hydro One Limited common share price. The costs are recognized in the financial statements using the graded-vesting attribution method for share grant plans that have both a performance condition and a service condition. The Company records a regulatory asset equal to the accrued costs of share grant plans recognized in each period. Costs are transfered from the regulatory asset to labour costs at the time the share grants vest and are issued, and are recovered in rates. Forfeitures are recognized as they occur.

Deferred Share Unit (DSU) Plans

The Company records the liabilities associated with its Directors' and Management DSU Plans at fair value at each reporting date until settlement, recognizing compensation expense over the vesting period on a straight-line basis. The fair value of the DSU liability is based on the Hydro One Limited common share closing price at the end of each reporting period.

Long-term Incentive Plan (LTIP)

The Company measures the restricted share units (RSUs) and performance share units (PSUs), issued under Hydro One Limited's LTIP, at fair value based on the grant date Hydro One Limited common share price. The related compensation expense is recognized over the vesting period on a straight-line basis. Forfeitures are recognized as they occur.

Loss Contingencies

Hydro One is involved in certain legal and environmental matters that arise in the normal course of business. In the preparation of its Consolidated Financial Statements, management makes judgments regarding the future outcome of contingent events and records a loss for a contingency based on its best estimate when it is determined that such loss is probable and the amount of the loss can be reasonably estimated. Where the loss amount is recoverable in future rates, a regulatory asset is also recorded. When a range estimate for the probable loss exists and no amount within the range is a better estimate than any other amount, the Company records a loss at the minimum amount within the range.

Management regularly reviews current information available to determine whether recorded provisions should be adjusted and whether new provisions are required. Estimating probable losses may require analysis of multiple forecasts and scenarios that often depend on judgments about potential actions by third parties, such as federal, provincial and local courts or regulators. Contingent liabilities are often resolved over long periods of time. Amounts recorded in the Consolidated Financial Statements may differ from the actual outcome once the contingency is resolved. Such differences could have a material impact on future results of operations, financial position and cash flows of the Company.

Provisions are based upon current estimates and are subject to greater uncertainty where the projection period is lengthy. A significant upward or downward trend in the number of claims filed, the nature of the alleged injuries, and the average cost of resolving each claim could change the estimated provision, as could any substantial adverse or favourable verdict at trial. A federal or provincial legislative outcome or structured settlement could also change the estimated liability. Legal fees are expensed as incurred.

Environmental Liabilities

Environmental liabilities are recorded in respect of past contamination when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated. Hydro One records a liability for the estimated future expenditures associated with contaminated land assessment and remediation and for the phase-out and destruction of polychlorinated biphenyl (PCB)-contaminated mineral oil removed from electrical equipment, based on the present value of these estimated future expenditures. The Company determines the present value with a discount rate equal to its credit-adjusted risk-free interest rate on financial instruments with comparable maturities to the pattern of future environmental expenditures. As the Company anticipates that the future expenditures will continue to be recoverable in future rates, an offsetting regulatory asset has been recorded to reflect the future recovery of these environmental expenditures from customers. Hydro One reviews its estimates of future environmental expenditures annually, or more frequently if there are indications that circumstances have changed.

Asset Retirement Obligations

Asset retirement obligations are recorded for legal obligations associated with the future removal and disposal of long-lived assets. Such obligations may result from the acquisition, construction, development and/or normal use of the asset. Conditional asset retirement obligations are recorded when there is a legal obligation to perform a future asset retirement activity but where the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Company. In such a case, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement.

When recording an asset retirement obligation, the present value of the estimated future expenditures required to complete the asset retirement activity is recorded in the period in which the obligation is incurred, if a reasonable estimate can be made. In general, the present value of the estimated future expenditures is added to the carrying amount of the associated asset and the resulting asset retirement cost is depreciated over the estimated useful life of the asset. Where an asset is no longer in service when an asset retirement obligation is recorded, the asset retirement cost is recorded in results of operations.

Some of the Company's transmission and distribution assets, particularly those located on unowned easements and rights-of-way, may have asset retirement obligations, conditional or otherwise. The majority of the Company's easements and rights-of-way are either of perpetual duration or are automatically renewed annually. Land rights with finite terms are generally subject to extension or renewal. As the Company expects to use the majority of its facilities in perpetuity, no asset retirement obligations have been recorded for these assets. If, at some future date, a particular facility is shown not to meet the perpetuity assumption, it will be reviewed to determine whether an estimable asset retirement obligation exists. In such a case, an asset retirement obligation would be recorded at that time.

The Company's asset retirement obligations recorded to date relate to estimated future expenditures associated with the removal and disposal of asbestos-containing materials installed in some of its facilities.

3. NEW ACCOUNTING PRONOUNCEMENTS

The following tables present Accounting Standards Updates (ASUs) issued by the Financial Accounting Standards Board that are applicable to Hydro One:

Recently Adopted Accounting Guidance

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2016-06	March 2016	Contingent call (put) options that are assessed to accelerate the payment of principal on debt instruments need to meet the criteria of being "clearly and closely related" to their debt hosts.	January 1, 2017	No impact upon adoption

Recently Issued Accounting Guidance Not Yet Adopted

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2014-09 2015-14 2016-08 2016-10 2016-12 2016-20 2017-05 2017-10 2017-13 2017-14	May 2014 – November 2017	ASU 2014-09 was issued in May 2014 and provides guidance on revenue recognition relating to the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. ASU 2015-14 deferred the effective date of ASU 2014-09 by one year. Additional ASUs were issued in 2016 and 2017 that simplify transition and provide clarity on certain aspects of the new standard.	January 1, 2018	Hydro One has completed the review of all its revenue streams and has concluded that there will be no material impact upon adoption.
2016-02 2018-01	February 2016 – January 2018	Lessees are required to recognize the rights and obligations resulting from operating leases as assets (right to use the underlying asset for the term of the lease) and liabilities (obligation to make future lease payments) on the balance sheet. ASU 2018-01 permits an entity to elect an optional practical expedient to not evaluate under Topic 842 land easements that exist or expired before the entity's adoption of Topic 842 and that were not previously accounted for as leases under Topic 840.	January 1, 2019	An initial assessment is currently underway encompassing a review of existing leases, which will be followed by a review of relevant contracts. No quantitative determination has been made at this time. The Company is on track for implementation of this standard by the effective date.
2016-15	August 2016	The amendments provide guidance for eight specific cash flow issues with the objective of reducing the existing diversity in practice.	January 1, 2018	No material impact
2017-01	January 2017	The amendment clarifies the definition of a business and provides additional guidance on evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses.	January 1, 2018	No material impact
2017-04	January 2017	The amendment removes the second step of the current two-step goodwill impairment test to simplify the process of testing goodwill.	January 1, 2020	Under assessment
2017-07	March 2017	Service cost components of net benefit cost associated with defined benefit plans are required to be reported in the same line as other compensation costs arising from services rendered by the Company's employees. All other components of net benefit cost are to be presented in the income statement separately from the service cost component. Only the service cost component is eligible for capitalization where applicable.	January 1, 2018	Hydro One has applied for a regulatory deferral account to maintain the capitalization of OPEB related costs. As such, there will be no material impact.
2017-09	May 2017	Changes to the terms or conditions of a share-based payment award will require an entity to apply modified accounting unless the modified award meets all conditions stipulated in this ASU.	January 1, 2018	No impact
2017-11	July 2017	When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock.	January 1, 2019	Under assessment
2017-12	August 2017	Amendments will better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results.	January 1, 2019	Under assessment

4. BUSINESS COMBINATIONS

Acquisition of HOSSM

On October 31, 2016, Hydro One acquired HOSSM, an Ontario regulated electricity transmission business operating along the eastern shore of Lake Superior, north and east of Sault Ste. Marie, Ontario from Brookfield Infrastructure Holdings Inc. The total purchase price for HOSSM was approximately $376 million, including the assumption of approximately $150 million in outstanding indebtedness. During 2017, the Company completed the final determination of the fair value of assets acquired and liabilities assumed with no significant changes, which resulted in a total goodwill of approximately $157 million arising from the HOSSM acquisition. The difference between the preliminary and final purchase price allocation to fair value of assets acquired and liabilities related to a $2 million decrease in deferred income tax liabilities which resulted in a corresponding decrease to goodwill. The following table summarizes the final fair value of the assets acquired and liabilities assumed:

(millions of dollars)	
Cash and cash equivalents	5
Property, plant and equipment	221
Intangible assets	1
Regulatory assets	50
Goodwill	157
Working capital	(2)
Long-term debt	(186)
Pension and post-employment benefit liabilities, net	(5)
Deferred income taxes	(15)
	226

Goodwill arising from the HOSSM acquisition consists largely of the synergies and economies of scale expected from combining the operations of Hydro One and HOSSM. HOSSM contributed revenues of $6 million and less than $1 million of net income to the Company's consolidated financial results for the year ended December 31, 2016. All costs related to the acquisition have been expensed through the Consolidated Statements of Operations and Comprehensive Income. HOSSM's financial information was not material to the Company's consolidated financial results for the year ended December 31, 2016 and therefore, has not been disclosed on a pro forma basis.

Agreement to Purchase Orillia Power

On August 15, 2016, the Company reached an agreement to acquire Orillia Power Distribution Corporation (Orillia Power), an electricity distribution company located in Simcoe County, Ontario, from the City of Orillia for approximately $41 million, including the assumption of approximately $15 million in outstanding indebtedness and regulatory liabilities, subject to closing adjustments. The acquisition is subject to regulatory approval by the OEB.

5. DEPRECIATION AND AMORTIZATION

Year ended December 31 *(millions of dollars)*	**2017**	**2016**
Depreciation of property, plant and equipment	634	603
Asset removal costs	90	90
Amortization of intangible assets	62	56
Amortization of regulatory assets	24	20
	810	769

6. FINANCING CHARGES

Year ended December 31 *(millions of dollars)*	**2017**	**2016**
Interest on long-term debt	450	424
Interest on short-term notes	6	9
Other	12	15
Less: Interest capitalized on construction and development in progress	(56)	(54)
Interest earned on cash and cash equivalents	(1)	(2)
	411	392

7. INCOME TAXES

Income tax expense differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rate. The reconciliation between the statutory and the effective tax rates is provided as follows:

Year ended December 31 *(millions of dollars)*	2017	2016
Income before income taxes	837	871
Income taxes at statutory rate of 26.5% (2016 - 26.5%)	222	231
Increase (decrease) resulting from:		
Net temporary differences recoverable in future rates charged to customers:		
Capital cost allowance in excess of depreciation and amortization	(55)	(53)
Pension contributions in excess of pension expense	(13)	(16)
Overheads capitalized for accounting but deducted for tax purposes	(17)	(16)
Interest capitalized for accounting but deducted for tax purposes	(15)	(14)
Environmental expenditures	(6)	(5)
Other	1	5
Net temporary differences	(105)	(99)
Net permanent differences	3	3
Total income taxes	120	135

The major components of income tax expense are as follows:

Year ended December 31 *(millions of dollars)*	2017	2016
Current income taxes	24	24
Deferred income taxes	96	111
Total income taxes	120	135
Effective income tax rate	14.3%	15.5%

Deferred Income Tax Assets and Liabilities

Deferred income tax assets and liabilities expected to be included in the rate-setting process are offset by regulatory assets and liabilities to reflect the anticipated recovery or disposition of these balances within future electricity rates. Deferred income tax assets and liabilities arise from differences between the tax basis and the carrying amounts of the assets and liabilities. At December 31, 2017 and 2016, deferred income tax assets and liabilities consisted of the following:

December 31 *(millions of dollars)*	2017	2016
Deferred income tax assets		
Depreciation and amortization in excess of capital cost allowance	109	477
Non-depreciable capital property	271	271
Post-retirement and post-employment benefits expense in excess of cash payments	558	603
Environmental expenditures	71	74
Non-capital losses	240	213
Tax credit carryforwards	49	27
Investment in subsidiaries	84	75
Other	13	3
	1,395	1,743
Less: valuation allowance	(364)	(352)
Total deferred income tax assets	1,031	1,391
Less: current portion	—	—
	1,031	1,391
Deferred income tax liabilities		
Regulatory amounts that are not recognized for tax purposes	(47)	(153)
Goodwill	(10)	(10)
Capital cost allowance in excess of depreciation and amortization	(74)	(64)
Other	(16)	(11)
Total deferred income tax liabilities	(147)	(238)
Less: current portion	—	—
	(147)	(238)
Net deferred income tax assets	884	1,153

The net deferred income tax assets are presented on the Consolidated Balance Sheets as follows:

December 31 *(millions of dollars)*	2017	2016
Long-term:		
Deferred income tax assets	954	1,213
Deferred income tax liabilities	(70)	(60)
Net deferred income tax assets	884	1,153

The valuation allowance for deferred tax assets as at December 31, 2017 was $364 million (2016 – $352 million). The valuation allowance primarily relates to temporary differences for non-depreciable assets and investments in subsidiaries. As of December 31, 2017 and 2016, the Company had non-capital losses carried forward available to reduce future years' taxable income, which expire as follows:

Year of expiry *(millions of dollars)*	2017	2016
2034	2	2
2035	221	221
2036	558	579
2037	123	—
Total losses	904	802

8. ACCOUNTS RECEIVABLE

December 31 *(millions of dollars)*	2017	2016
Accounts receivable – billed	297	427
Accounts receivable – unbilled	367	441
Accounts receivable, gross	664	868
Allowance for doubtful accounts	(29)	(35)
Accounts receivable, net	635	833

The following table shows the movements in the allowance for doubtful accounts for the years ended December 31, 2017 and 2016:

Year ended December 31 *(millions of dollars)*	2017	2016
Allowance for doubtful accounts – beginning	(35)	(61)
Write-offs	25	37
Additions to allowance for doubtful accounts	(19)	(11)
Allowance for doubtful accounts – ending	(29)	(35)

9. OTHER CURRENT ASSETS

December 31 *(millions of dollars)*	2017	2016
Regulatory assets *(Note 12)*	46	37
Materials and supplies	18	19
Prepaid expenses and other assets	40	41
	104	97

10. PROPERTY, PLANT AND EQUIPMENT

December 31, 2017 *(millions of dollars)*	Property, Plant and Equipment	Accumulated Depreciation	Construction in Progress	Total
Transmission	15,509	5,162	989	11,336
Distribution	10,213	3,513	149	6,849
Communication	1,088	742	22	368
Administration and service	1,561	857	46	750
Easements	638	70	—	568
	29,009	10,344	1,206	19,871

December 31, 2016 *(millions of dollars)*	Property, Plant and Equipment	Accumulated Depreciation	Construction in Progress	Total
Transmission	14,692	4,862	910	10,740
Distribution	9,656	3,305	243	6,594
Communication	1,069	674	9	404
Administration and service	1,632	924	61	769
Easements	628	67	—	561
	27,677	9,832	1,223	19,068

Financing charges capitalized on property, plant and equipment under construction were $54 million in 2017 (2016 – $52 million).

11. INTANGIBLE ASSETS

December 31, 2017 *(millions of dollars)*	Intangible Assets	Accumulated Amortization	Development in Progress	Total
Computer applications software	698	370	41	369
Other	5	5	—	—
	703	375	41	369

December 31, 2016 *(millions of dollars)*	Intangible Assets	Accumulated Amortization	Development in Progress	Total
Computer applications software	621	326	53	348
Other	5	4	—	1
	626	330	53	349

Financing charges capitalized to intangible assets under development were $2 million in 2017 (2016 – $2 million). The estimated annual amortization expense for intangible assets is as follows: 2018 – $67 million; 2019 – $57 million; 2020 – $40 million; 2021 – $39 million; and 2022 – $36 million.

12. REGULATORY ASSETS AND LIABILITIES

Regulatory assets and liabilities arise as a result of the rate-setting process. Hydro One has recorded the following regulatory assets and liabilities:

December 31 *(millions of dollars)*	2017	2016
Regulatory assets:		
Deferred income tax regulatory asset	1,762	1,587
Pension benefit regulatory asset	981	900
Post-retirement and post-employment benefits	36	243
Environmental	196	204
Share-based compensation	40	31
Debt premium	27	32
Foregone revenue deferral	23	—
Distribution system code exemption	10	10
B2M LP start-up costs	4	5
Retail settlement variance account	—	145
2015-2017 rate rider	—	7
Pension cost variance	—	4
Other	16	14
Total regulatory assets	3,095	3,182
Less: current portion	(46)	(37)
	3,049	3,145
Regulatory liabilities:		
Green Energy expenditure variance	60	69
External revenue variance	46	64
CDM deferral variance	28	54
Pension cost variance	23	—
2015-2017 rate rider	6	—
Deferred income tax regulatory liability	5	4
Other	17	18
Total regulatory liabilities	185	209
Less: current portion	(57)	—
	128	209

Deferred Income Tax Regulatory Asset and Liability

Deferred income taxes are recognized on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable income. The Company has recognized regulatory assets and liabilities that correspond to deferred income taxes that flow through the rate-setting process. In the absence of rate-regulated accounting, the Company's income tax expense would have been recognized using the liability method and there would be no regulatory accounts established for taxes to be recovered through future rates. As a result, the 2017 income tax expense would have been higher by approximately $113 million (2016 – $104 million).

On September 28, 2017, the OEB issued its Decision and Order on Hydro One Networks' 2017 and 2018 transmission rates revenue requirements (Decision). In its Decision, the OEB concluded that the net deferred tax asset resulting from transition from the payments in lieu of tax regime under the *Electricity Act* (Ontario) to tax payments under the federal and provincial tax regime should not accrue entirely to Hydro One's shareholders and that a portion should be shared with ratepayers. On November 9, 2017, the OEB issued a Decision and Order that calculated the portion of the tax savings that should be shared with ratepayers. The OEB's calculation would result in an impairment of Hydro One Networks' transmission deferred income tax regulatory asset of up to approximately $515 million. If the OEB were to apply the same calculation for sharing in Hydro One Networks' 2018-2022 distribution rates, for which a decision is currently outstanding, it would result in an additional impairment of up to approximately $370 million related to Hydro One Networks' distribution deferred income tax regulatory asset. In October 2017, the Company filed a Motion to Review and Vary (Motion) the Decision and filed an appeal with the Divisional Court of Ontario (Appeal). On December 19, 2017, the OEB granted a hearing of the merits of the Motion which is scheduled for mid-February 2018. In both cases, the Company's position is that the OEB made errors of fact and law in its determination of allocation of the tax savings between the shareholders and ratepayers. The Appeal is being held in abeyance pending the outcome of the Motion. If the Decision is upheld, based on the facts known at this time, the exposure from the potential impairments would be a one-time decrease in net income of up to approximately $885 million. Based on the assumptions that the OEB applies established rate making principles in a manner consistent with its past practice and does not exercise its discretion to take other policy considerations into account, management is of the view that it is likely that the Company's Motion will be granted and the aforementioned tax savings will be allocated to the benefit of Hydro One shareholders.

Pension Benefit Regulatory Asset

In accordance with OEB rate orders, pension costs are recovered on a cash basis as employer contributions are paid to the pension fund in accordance with the Pension Benefits Act (Ontario). The Company recognizes the net unfunded status of pension obligations on the Consolidated Balance Sheets with an offset to the associated regulatory asset. A regulatory asset is recognized because management considers it to be probable that pension benefit costs will be recovered in the future through the rate-setting process. The pension benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment. In the absence of rate-regulated accounting, OCI would have been lower by $80 million and operation, maintenance and administration expenses would have been higher by $1 million (2016 – OCI higher by $52 million).

Post-Retirement and Post-Employment Benefits

The Company recognizes the net unfunded status of post-retirement and post-employment obligations on the Consolidated Balance Sheets with an incremental offset to the associated regulatory assets. A regulatory asset is recognized because management considers it to be probable that post-retirement and post-employment benefit costs will be recovered in the future through the rate-setting process. The post-retirement and post-employment benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment. In the absence of rate-regulated accounting, 2017 OCI would have been higher by $207 million (2016 – lower by $3 million).

Environmental

Hydro One records a liability for the estimated future expenditures required to remediate environmental contamination. Because such expenditures are expected to be recoverable in future rates, the Company has recorded an equivalent amount as a regulatory asset. In 2017, the environmental regulatory asset increased by $1 million (2016 – decreased by $1 million) to reflect related changes in the Company's PCB liability, and increased by $7 million (2016 – $10 million) due to changes in the land assessment and remediation liability. The environmental regulatory asset is amortized to results of operations based on the pattern of actual expenditures incurred and charged to environmental liabilities. The OEB has the discretion to examine and assess the prudency and the timing of recovery of all of Hydro One's actual environmental expenditures. In the absence of rate-regulated accounting, 2017 operation, maintenance and administration expenses would have been higher by $8 million (2016 – $9 million). In addition, 2017 amortization expense would have been lower by $24 million (2016 – $20 million), and 2017 financing charges would have been higher by $8 million (2016 – $8 million).

Share-based Compensation

The Company recognizes costs associated with share grant plans in a regulatory asset as management considers it probable that share grant plans' costs will be recovered in the future through the rate-setting process. In the absence of rate-regulated accounting, 2017 operation, maintenance and administration expenses would have been higher by $7 million (2016 – $9 million). Share grant costs are transferred to labour costs at the time the share grants vest and are issued, and are recovered in rates in accordance with recovery of said labour costs.

Debt Premium

The value of debt assumed in the acquisition of HOSSM has been recorded at fair value in accordance with US GAAP - Business Combinations. The OEB allows for recovery of interest at the coupon rate of the Senior Secured Bonds and a regulatory asset has been recorded for the difference between the fair value and face value of this debt. The debt premium is recovered over the remaining term of the debt.

Foregone Revenue Deferral

As part of its September 2017 decision on Hydro One Networks' transmission rate application for 2017 and 2018 rates, the OEB approved the foregone revenue account to record the difference between revenue earned under the rates approved as part of the decision, effective January 1, 2017, and revenue earned under the interim rates until the approved 2017 rates were implemented. The OEB approved a similar account for B2M LP in June 2017 to record the difference between revenue earned under the newly approved rates, effective January 1, 2017, and the revenue recorded under the interim 2017 rates. The balances of these accounts will be returned to or recovered from ratepayers, respectively, over a one-year period ending December 31, 2018. The draft rate order submitted by Hydro One Networks was approved by the OEB in November, 2017. This draft rate order reflects the September 2017 decision, including a reduction of the amount of cash taxes approved for recovery in transmission rates due to the OEB's basis to share the savings resulting from a deferred tax asset with ratepayers. The Company's position in the aforementioned Motion is that the OEB made errors of fact and law in its determination of allocation of the tax savings between the shareholders and ratepayers. Therefore, the Company has also reflected the impact of the Company's position with respect to the Motion in the Foregone Revenue Deferral account. The timing for recovery of this impact will be determined as part of the outcome of the Motion.

Distribution System Code (DSC) Exemption

In June 2010, Hydro One Networks filed an application with the OEB regarding the OEB's new cost responsibility rules contained in the OEB's October 2009 Notice of Amendment to the DSC, with respect to the connection of certain renewable generators that were already connected or that had received a connection impact assessment prior to October 21, 2009. The application sought approval to record and defer the unanticipated costs incurred by Hydro One Networks that resulted from the connection of certain renewable generation facilities. The OEB ruled that identified specific expenditures can be recorded in a deferral account subject to the OEB's review in subsequent Hydro One Networks distribution applications. In March 2015, the OEB approved the disposition of the DSC exemption deferral account balance at December 31, 2013, including accrued interest, which was recovered through the 2015-2017 Rate Rider. In addition, the OEB also approved Hydro One's request to discontinue this deferral account. There were no additions to this regulatory account in 2017 or 2016. The remaining balance in this account at December 31, 2016, including accrued interest, was requested for recovery through the 2018-2022 distribution rate application.

B2M LP Start-up Costs

In December 2015, OEB issued its decision on B2M LP's application for 2015-2019 and as part of the decision approved the recovery of $8 million of start-up costs relating to B2M LP. The costs are being recovered over a four-year period which began in 2016, in accordance with the OEB decision.

Retail Settlement Variance Account (RSVA)

Hydro One has deferred certain retail settlement variance amounts under the provisions of Article 490 of the OEB's Accounting Procedures Handbook. In March 2015, the OEB approved the disposition of the total RSVA balance accumulated from January 2012 to December 2013, including accrued interest, to be recovered through the 2015-2017 Rate Rider.

2015-2017 Rate Rider

In March 2015, as part of its decision on Hydro One Networks' distribution rate application for 2015-2019, the OEB approved the disposition of certain deferral and variance accounts, including RSVAs and accrued interest. The 2015-2017 Rate Rider account included the balances approved for disposition by the OEB and was disposed of in accordance with the OEB decision over a 32-month period ended on December 31, 2017. The balance remaining in the account represents an over-collection to be returned to ratepayers in a future rate application. We have not requested recovery of the remaining balance of this account in the current distribution rate application.

Pension Cost Variance

A pension cost variance account was established for Hydro One Networks' transmission and distribution businesses to track the difference between the actual pension expenses incurred and estimated pension costs approved by the OEB. The balance in this regulatory account reflects the deficit of pension costs paid as compared to OEB-approved amounts. In March 2015, the OEB approved the disposition of the distribution business portion of the total pension cost variance account at December 31, 2013, including accrued interest, which was recovered through the 2015-2017 Rate Rider. In September 2017, the OEB approved the disposition of the transmission business portion of the total pension cost variance account as at December 31, 2015, including accrued interest, which is being recovered over a two-year period ending December 31, 2018. In the absence of rate-regulated accounting, 2017 revenue would have been higher by $24 million (2016 – $25 million).

Green Energy Expenditure Variance

In April 2010, the OEB requested the establishment of deferral accounts which capture the difference between the revenue recorded on the basis of Green Energy Plan expenditures incurred and the actual recoveries received.

External Revenue Variance

In May 2009, the OEB approved forecasted amounts related to export service revenue, external revenue from secondary land use, and external revenue from station maintenance and engineering and construction work. In November 2012, the OEB again approved forecasted amounts related to these revenue categories and extended the scope to encompass all other external revenues. The external revenue variance account balance reflects the excess of actual external revenues compared to the OEB-approved forecasted amounts. In September 2017, the OEB approved the disposition of the external revenue variance account as at December 31, 2015, including accrued interest, which is being returned to customers over a two-year period ending December 31, 2018.

CDM Deferral Variance Account

As part of Hydro One Networks' application for 2013 and 2014 transmission rates, Hydro One agreed to establish a new regulatory deferral variance account to track the impact of actual Conservation and Demand Management (CDM) and demand response results on the load forecast compared to the estimated load forecast included in the revenue requirement. The balance in the CDM deferral variance account relates to the actual 2013 and 2014 CDM compared to the amounts included in 2013 and 2014 revenue requirements, respectively. There were no additions to this regulatory account in 2017 or 2016. The balance of the account at December 31, 2015, including interest, was approved for disposition in the 2017-2018 transmission rate decision and is currently being drawn down over a 2-year period ending December 31, 2018.

13. ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

December 31 *(millions of dollars)*	2017	2016
Accounts payable	173	177
Accrued liabilities	563	651
Accrued interest	99	105
Regulatory liabilities *(Note 12)*	57	—
	892	933

14. OTHER LONG-TERM LIABILITIES

December 31 *(millions of dollars)*	2017	2016
Post-retirement and post-employment benefit liability *(Note 18)*	1,507	1,628
Pension benefit liability *(Note 18)*	981	900
Environmental liabilities *(Note 19)*	168	177
Due to related parties *(Note 26)*	39	26
Asset retirement obligations *(Note 20)*	9	9
Long-term accounts payable and other liabilities	30	25
	2,734	2,765

15. DEBT AND CREDIT AGREEMENTS

Short-Term Notes and Credit Facilities

Hydro One meets its short-term liquidity requirements in part through the issuance of commercial paper under its Commercial Paper Program which has a maximum authorized amount of $1.5 billion. These short-term notes are denominated in Canadian dollars with varying maturities up to 365 days. The Commercial Paper Program is supported by the Company's committed revolving credit facilities totalling $2.3 billion. In June 2017, the maturity date of Hydro One's $2.3 billion credit facilities was extended from June 2021 to June 2022.

The Company may use the credit facilities for working capital and general corporate purposes. If used, interest on the credit facilities would apply based on Canadian benchmark rates. The obligation of each lender to make any credit extension under its credit facility is subject to various conditions including that no event of default has occurred or would result from such credit extension.

Long-Term Debt

The following table presents long-term debt outstanding at December 31, 2017 and 2016:

December 31 *(millions of dollars)*	2017	2016
5.18% Series 13 notes due 2017	—	600
2.78% Series 28 notes due 2018	750	750
Floating-rate Series 31 notes due 2019[1]	228	228
1.48% Series 37 notes due 2019[2]	500	500
4.40% Series 20 notes due 2020	300	300
1.62% Series 33 notes due 2020[2]	350	350
1.84% Series 34 notes due 2021	500	500
3.20% Series 25 notes due 2022	600	600
2.77% Series 35 notes due 2026	500	500
7.35% Debentures due 2030	400	400
6.93% Series 2 notes due 2032	500	500
6.35% Series 4 notes due 2034	385	385
5.36% Series 9 notes due 2036	600	600
4.89% Series 12 notes due 2037	400	400
6.03% Series 17 notes due 2039	300	300
5.49% Series 18 notes due 2040	500	500
4.39% Series 23 notes due 2041	300	300
6.59% Series 5 notes due 2043	315	315
4.59% Series 29 notes due 2043	435	435
4.17% Series 32 notes due 2044	350	350
5.00% Series 11 notes due 2046	325	325
3.91% Series 36 notes due 2046	350	350
3.72% Series 38 notes due 2047	450	450
4.00% Series 24 notes due 2051	225	225
3.79% Series 26 notes due 2062	310	310
4.29% Series 30 notes due 2064	50	50
Hydro One long-term debt (a)	9,923	10,523
6.6% Senior Secured Bonds due 2023 (Face value - $110 million)	136	144
4.6% Note Payable due 2023 (Face value - $36 million)	40	40
HOSSM long-term debt (b)	176	184
	10,099	10,707
Add: Net unamortized debt premiums	14	15
Add: Unrealized mark-to-market gain[2]	(9)	(2)
Less: Deferred debt issuance costs	(37)	(40)
Total long-term debt	10,067	10,680

[1] The interest rates of the floating-rate notes are referenced to the three-month Canadian dollar bankers' acceptance rate, plus a margin.

[2] The unrealized mark-to-market net gain relates to $50 million of the Series 33 notes due 2020 and $500 million Series 37 notes due 2019. The unrealized mark-to-market net gain is offset by a $9 million (2016 – $2 million) unrealized mark-to-market net loss on the related fixed-to-floating interest-rate swap agreements, which are accounted for as fair value hedges.

(a) Hydro One long-term debt

At December 31, 2017, long-term debt of $9,923 million (2016 - $10,523 million) was outstanding, the majority of which was issued under Hydro One's Medium Term Note (MTN) Program. The maximum authorized principal amount of notes issuable under the current MTN Program prospectus filed in December 2015 is $3.5 billion. At December 31 2017, $1.2 billion remained available for issuance until January 2018. In 2017, no long-term debt was issued and $600 million of long-term debt was repaid under the MTN Program (2016 - $2,300 million issued and $500 million repaid).

(b) HOSSM long-term debt

At December 31, 2017, long-term debt of $176 million (2016 - $184 million), with a face value of $146 million (2016 - $148 million) was held by HOSSM. In 2017, $2 million of HOSSM long-term debt was repaid (2016 - $2 million).

The total long-term debt is presented on the consolidated balance sheets as follows:

December 31 *(millions of dollars)*	2017	2016
Current liabilities:		
Long-term debt payable within one year	752	602
Long-term liabilities:		
Long-term debt	9,315	10,078
Total long-term debt	10,067	10,680

Principal and Interest Payments

Principal repayments and related weighted average interest rates are summarized by the number of years to maturity in the following table:

Years to Maturity	Long-term Debt Principal Repayments *(millions of dollars)*	Weighted Average Interest Rate *(%)*
1 year	752	2.8
2 years	731	1.6
3 years	653	2.9
4 years	503	1.9
5 years	604	3.2
	3,243	2.5
6 – 10 years	631	3.5
Over 10 years	6,195	5.2
	10,069	4.2

Interest payment obligations related to long-term debt are summarized by year in the following table:

Year	Interest Payments *(millions of dollars)*
2018	426
2019	402
2020	384
2021	370
2022	355
	1,937
2023-2027	1,672
2028+	4,081
	7,690

16. FAIR VALUE OF FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition focuses on an exit price, which is the price that would be received in the sale of an asset or the amount that would be paid to transfer a liability.

Hydro One classifies its fair value measurements based on the following hierarchy, as prescribed by the accounting guidance for fair value, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that Hydro One has the ability to access. An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information.

Level 2 inputs are those other than quoted market prices that are observable, either directly or indirectly, for an asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted market prices that are observable for the asset or liability, such as interest-rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk and default rates. A Level 2 measurement cannot have more than an insignificant portion of the valuation based on unobservable inputs.

Level 3 inputs are any fair value measurements that include unobservable inputs for the asset or liability for more than an insignificant portion of the valuation. A Level 3 measurement may be based primarily on Level 2 inputs.

Non-Derivative Financial Assets and Liabilities

At December 31, 2017 and 2016, the Company's carrying amounts of cash and cash equivalents, accounts receivable, due from related parties, bank indebtedness, short-term notes payable, accounts payable, and due to related parties are representative of fair value due to the short-term nature of these instruments.

Fair Value Measurements of Long-Term Debt

The fair values and carrying values of the Company's long-term debt at December 31, 2017 and 2016 are as follows:

December 31 *(millions of dollars)*	2017 Carrying Value	2017 Fair Value	2016 Carrying Value	2016 Fair Value
$50 million of MTN Series 33 notes	49	49	50	50
$500 million MTN Series 37 notes	492	492	498	498
Other notes and debentures	9,526	11,027	10,132	11,462
Long-term debt, including current portion	10,067	11,568	10,680	12,010

Fair Value Measurements of Derivative Instruments

At December 31, 2017, Hydro One had interest-rate swaps in the amount of $550 million (2016 – $550 million) that were used to convert fixed-rate debt to floating-rate debt. These swaps are classified as fair value hedges. Hydro One's fair value hedge exposure was approximately 6% (2016 – 5%) of its total long-term debt. At December 31, 2017, Hydro One had the following interest-rate swaps designated as fair value hedges:

- a $50 million fixed-to-floating interest-rate swap agreement to convert $50 million of the $350 million MTN Series 33 notes maturing April 30, 2020 into three-month variable rate debt; and
- two $125 million and one $250 million fixed-to-floating interest-rate swap agreements to convert the $500 million MTN Series 37 notes maturing November 18, 2019 into three-month variable rate debt.

At December 31, 2017 and 2016, the Company had no interest-rate swaps classified as undesignated contracts.

Fair Value Hierarchy

The fair value hierarchy of financial assets and liabilities at December 31, 2017 and 2016 is as follows:

December 31, 2017 *(millions of dollars)*	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Liabilities:					
Bank indebtedness	3	3	3	—	—
Short-term notes payable	926	926	926	—	—
Long-term debt, including current portion	10,067	11,568	—	11,568	—
Derivative instruments					
Fair value hedges – interest-rate swaps	9	9	9	—	—
	11,005	12,506	938	11,568	—

December 31, 2016 *(millions of dollars)*	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	48	48	48	—	—
	48	48	48	—	—
Liabilities:					
Short-term notes payable	469	469	469	—	—
Long-term debt, including current portion	10,680	12,010	—	12,010	—
Derivative instruments					
Fair value hedges – interest-rate swaps	2	2	2	—	—
	11,151	12,481	471	12,010	—

Cash and cash equivalents include cash and short-term investments. The carrying values are representative of fair value because of the short-term nature of these instruments.

The fair value of the hedged portion of the long-term debt is primarily based on the present value of future cash flows using a swap yield curve to determine the assumption for interest rates. The fair value of the unhedged portion of the long-term debt is based on unadjusted period-end market prices for the same or similar debt of the same remaining maturities.

There were no transfers between any of the fair value levels during the years ended December 31, 2017 or 2016.

Risk Management

Exposure to market risk, credit risk and liquidity risk arises in the normal course of the Company's business.

Market Risk

Market risk refers primarily to the risk of loss which results from changes in costs, foreign exchange rates and interest rates. The Company is exposed to fluctuations in interest rates as its regulated return on equity is derived using a formulaic approach that takes anticipated interest rates into account. The Company is not currently exposed to material commodity price risk or material foreign exchange risk.

The Company uses a combination of fixed and variable-rate debt to manage the mix of its debt portfolio. The Company also uses derivative financial instruments to manage interest-rate risk. The Company utilizes interest-rate swaps, which are typically designated as fair value hedges, as a means to manage its interest rate exposure to achieve a lower cost of debt. The Company may also utilize interest-rate derivative instruments to lock in interest-rate levels in anticipation of future financing.

A hypothetical 100 basis points increase in interest rates associated with variable-rate debt would not have resulted in a significant decrease in Hydro One's net income for the years ended December 31, 2017 and 2016.

For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the Consolidated Statements of Operations and Comprehensive Income. The net unrealized loss (gain) on the hedged debt and the related interest-rate swaps for the years ended December 31, 2017 and 2016 was not material.

Credit Risk

Financial assets create a risk that a counterparty will fail to discharge an obligation, causing a financial loss. At December 31, 2017 and 2016, there were no significant concentrations of credit risk with respect to any class of financial assets. The Company's revenue is earned from a broad base of customers. As a result, Hydro One did not earn a material amount of revenue from any single customer. At December 31, 2017 and 2016, there was no material accounts receivable balance due from any single customer.

At December 31, 2017, the Company's provision for bad debts was $29 million (2016 – $35 million). Adjustments and write-offs are determined on the basis of a review of overdue accounts, taking into consideration historical experience. At December 31, 2017, approximately 5% (2016 – 6%) of the Company's net accounts receivable were outstanding for more than 60 days.

Hydro One manages its counterparty credit risk through various techniques including: entering into transactions with highly rated counterparties; limiting total exposure levels with individual counterparties; entering into master agreements which enable net settlement and the contractual right of offset; and monitoring the financial condition of counterparties. The Company monitors current credit exposure to counterparties both on an individual and an aggregate basis. The Company's credit risk for accounts receivable is limited to the carrying amounts on the Consolidated Balance Sheets.

Derivative financial instruments result in exposure to credit risk since there is a risk of counterparty default. The credit exposure of derivative contracts, before collateral, is represented by the fair value of contracts at the reporting date. At December 31, 2017 and 2016, the counterparty credit risk exposure on the fair value of these interest-rate swap contracts was not material. At December 31, 2017, Hydro One's credit exposure for all derivative instruments, and applicable payables and receivables, had a credit rating of investment grade, with four financial institutions as the counterparties.

Liquidity Risk

Liquidity risk refers to the Company's ability to meet its financial obligations as they come due. Hydro One meets its short-term liquidity requirements using cash and cash equivalents on hand, funds from operations, the issuance of commercial paper, and the revolving standby credit facilities. The short-term liquidity under the Commercial Paper Program, revolving standby credit facilities, and anticipated levels of funds from operations are expected to be sufficient to fund normal operating requirements.

17. CAPITAL MANAGEMENT

The Company's objectives with respect to its capital structure are to maintain effective access to capital on a long-term basis at reasonable rates, and to deliver appropriate financial returns. In order to ensure ongoing access to capital, the Company targets to maintain strong credit quality. At December 31, 2017 and 2016, the Company's capital structure was as follows:

December 31 *(millions of dollars)*	2017	2016
Long-term debt payable within one year	752	602
Short-term notes payable	926	469
Bank indebtedness	3	—
Less: cash and cash equivalents	—	(48)
	1,681	1,023
Long-term debt	9,315	10,078
Preferred shares	486	—
Common shares	4,856	5,391
Retained earnings	5,183	4,487
Total capital	21,521	20,979

Hydro One and HOSSM have customary covenants typically associated with long-term debt. Hydro One's long-term debt and credit facility covenants limit permissible debt to 75% of its total capitalization, limit the ability to sell assets and impose a negative pledge provision, subject to customary exceptions. At December 31, 2017, the Company was in compliance with all financial covenants and limitations associated with the outstanding borrowings and credit facilities.

18. PENSION AND POST-RETIREMENT AND POST-EMPLOYMENT BENEFITS

Hydro One has a defined benefit pension plan (Pension Plan), a defined contribution pension plan (DC Plan), a supplemental pension plan (Supplemental Plan), and post-retirement and post-employment benefit plans.

DC Plan

Hydro One established a DC Plan effective January 1, 2016. The DC Plan covers eligible management employees hired on or after January 1, 2016, as well as management employees hired before January 1, 2016 who were not eligible or had not irrevocably elected to join the Pension Plan as of September 30, 2015. Members of the DC Plan have an option to contribute 4%, 5% or 6% of their pensionable earnings, with matching contributions by Hydro One.

Hydro One contributions to the DC Plan for the year ended December 31, 2017 were $1 million (2016 – less than $1 million). At December 31, 2017, Company contributions payable included in accrued liabilities on the Consolidated Balance Sheets were less than $1 million (2016 – less than $1 million).

Pension Plan, Supplemental Plan, and Post-Retirement and Post-Employment Plans

The Pension Plan is a defined benefit contributory plan which covers eligible regular employees of Hydro One and its subsidiaries. The Pension Plan provides benefits based on highest three-year average pensionable earnings. For management employees who commenced employment on or after January 1, 2004, and for The Society of Energy Professionals (The Society)-represented staff hired after November 17, 2005, benefits are based on highest five-year average pensionable earnings. After retirement, pensions are indexed to inflation. Membership in the Pension Plan was closed to management employees who were not eligible or had not irrevocably elected to join the Pension Plan as of September 30, 2015. These employees are eligible to join the DC Plan.

Company and employee contributions to the Pension Plan are based on actuarial valuations performed at least every three years. Annual Pension Plan contributions for 2017 of $87 million (2016 – $108 million) were based on an actuarial valuation effective December 31, 2016 (2016 - based on an actuarial valuation effective December 31, 2015) and the level of pensionable earnings. Estimated annual Pension Plan contributions for 2018 and 2019 are approximately $71 million for each year based on the actuarial valuation as at December 31, 2016 and projected levels of pensionable earnings. Future minimum contributions beyond 2019 will be based on an actuarial valuation effective no later than December 31, 2019. Contributions are payable one month in arrears. All of the contributions are expected to be in the form of cash.

The Supplemental Plan provides members of the Pension Plan with benefits that would have been earned and payable under the Pension Plan but for limitations imposed by the *Income Tax Act* (Canada). The Supplemental Plan obligation is included with other post-retirement and post-employment benefit obligations on the Consolidated Balance Sheets.

Hydro One recognizes the overfunded or underfunded status of the Pension Plan, and post-retirement and post-employment benefit plans (Plans) as an asset or liability on its Consolidated Balance Sheets, with offsetting regulatory assets and liabilities as appropriate. The underfunded benefit obligations for the Plans, in the absence of regulatory accounting, would be recognized in AOCI. The impact of changes in assumptions used to measure pension, post-retirement and post-employment benefit obligations is generally recognized over the expected average remaining service period of the employees. The measurement date for the Plans is December 31.

Year ended December 31 (millions of dollars)	Pension Benefits 2017	Pension Benefits 2016	Post-Retirement and Post-Employment Benefits 2017	Post-Retirement and Post-Employment Benefits 2016
Change in projected benefit obligation				
Projected benefit obligation, beginning of year	7,774	7,683	1,676	1,591
Current service cost	147	144	48	41
Employee contributions	49	45	—	—
Interest cost	304	308	67	66
Benefits paid	(368)	(354)	(44)	(43)
Net actuarial loss (gain)	352	(52)	(195)	14
Change due to employees transfer	—	—	—	7
Projected benefit obligation, end of year	8,258	7,774	1,552	1,676
Change in plan assets				
Fair value of plan assets, beginning of year	6,874	6,731	—	—
Actual return on plan assets	662	370	—	—
Benefits paid	(368)	(354)	(34)	(43)
Employer contributions	87	108	34	43
Employee contributions	49	45	—	—
Administrative expenses	(27)	(26)	—	—
Fair value of plan assets, end of year	7,277	6,874	—	—
Unfunded status	981	900	1,552	1,676

Hydro One presents its benefit obligations and plan assets net on its Consolidated Balance Sheets as follows:

December 31 (millions of dollars)	Pension Benefits 2017	Pension Benefits 2016	Post-Retirement and Post-Employment Benefits 2017	Post-Retirement and Post-Employment Benefits 2016
Other assets[1]	1	1	—	—
Accrued liabilities	—	—	52	55
Pension benefit liability	981	900	—	—
Post-retirement and post-employment benefit liability[2]	—	—	1,507	1,628
Net unfunded status	980	899	1,559	1,683

[1] Represents the funded status of HOSSM defined benefit pension plan.

[2] Includes $7 million (2016 – $7 million) relating to HOSSM post-employment benefit plans.

The funded or unfunded status of the pension, post-retirement and post-employment benefit plans refers to the difference between the fair value of plan assets and the projected benefit obligations for the Plans. The funded/unfunded status changes over time due to several factors, including contribution levels, assumed discount rates and actual returns on plan assets.

The following table provides the projected benefit obligation (PBO), accumulated benefit obligation (ABO) and fair value of plan assets for the Pension Plan:

December 31 (millions of dollars)	2017	2016
PBO	8,258	7,774
ABO	7,614	7,094
Fair value of plan assets	7,277	6,874

On an ABO basis, the Pension Plan was funded at 96% at December 31, 2017 (2016 – 97%). On a PBO basis, the Pension Plan was funded at 88% at December 31, 2017 (2016 – 88%). The ABO differs from the PBO in that the ABO includes no assumption about future compensation levels.

Components of Net Periodic Benefit Costs

The following table provides the components of the net periodic benefit costs for the years ended December 31, 2017 and 2016 for the Pension Plan:

Year ended December 31 *(millions of dollars)*	2017	2016
Current service cost	147	144
Interest cost	304	308
Expected return on plan assets, net of expenses	(442)	(432)
Amortization of actuarial losses	79	96
Net periodic benefit costs	88	116
Charged to results of operations[1]	37	45

[1] The Company accounts for pension costs consistent with their inclusion in OEB-approved rates. During the year ended December 31, 2017, pension costs of $85 million (2016 – $105 million) were attributed to labour, of which $37 million (2016 – $45 million) was charged to operations, and $48 million (2016 – $60 million) was capitalized as part of the cost of property, plant and equipment and intangible assets.

The following table provides the components of the net periodic benefit costs for the years ended December 31, 2017 and 2016 for the post-retirement and post-employment benefit plans:

Year ended December 31 *(millions of dollars)*	2017	2016
Current service cost	48	41
Interest cost	67	66
Amortization of actuarial losses	16	15
Net periodic benefit costs	131	122
Charged to results of operations	58	53

Assumptions

The measurement of the obligations of the Plans and the costs of providing benefits under the Plans involves various factors, including the development of valuation assumptions and accounting policy elections. When developing the required assumptions, the Company considers historical information as well as future expectations. The measurement of benefit obligations and costs is impacted by several assumptions including the discount rate applied to benefit obligations, the long-term expected rate of return on plan assets, Hydro One's expected level of contributions to the Plans, the incidence of mortality, the expected remaining service period of plan participants, the level of compensation and rate of compensation increases, employee age, length of service, and the anticipated rate of increase of health care costs, among other factors. The impact of changes in assumptions used to measure the obligations of the Plans is generally recognized over the expected average remaining service period of the plan participants. In selecting the expected rate of return on plan assets, Hydro One considers historical economic indicators that impact asset returns, as well as expectations regarding future long-term capital market performance, weighted by target asset class allocations. In general, equity securities, real estate and private equity investments are forecasted to have higher returns than fixed-income securities.

The following weighted average assumptions were used to determine the benefit obligations at December 31, 2017 and 2016:

	Pension Benefits		Post-Retirement and Post-Employment Benefits	
Year ended December 31	2017	2016	2017	2016
Significant assumptions:				
Weighted average discount rate	3.40%	3.90%	3.40%	3.90%
Rate of compensation scale escalation (long-term)	2.50%	2.50%	2.50%	2.50%
Rate of cost of living increase	2.00%	2.00%	2.00%	2.00%
Rate of increase in health care cost trends[1]	—	—	4.04%	4.36%

[1] 5.26% per annum in 2018, grading down to 4.04% per annum in and after 2031 (2016 – 6.25% in 2017, grading down to 4.36% per annum in and after 2031).

The following weighted average assumptions were used to determine the net periodic benefit costs for the years ended December 31, 2017 and 2016. Assumptions used to determine current year-end benefit obligations are the assumptions used to estimate the subsequent year's net periodic benefit costs.

Year ended December 31	2017	2016
Pension Benefits:		
Weighted average expected rate of return on plan assets	6.50%	6.50%
Weighted average discount rate	3.90%	4.00%
Rate of compensation scale escalation (long-term)	2.50%	2.50%
Rate of cost of living increase	2.00%	2.00%
Average remaining service life of employees *(years)*	15	15
Post-Retirement and Post-Employment Benefits:		
Weighted average discount rate	3.90%	4.10%
Rate of compensation scale escalation (long-term)	2.50%	2.50%
Rate of cost of living increase	2.00%	2.00%
Average remaining service life of employees *(years)*	15.2	15.3
Rate of increase in health care cost trends[1]	4.36%	4.36%

[1] 6.25% per annum in 2017, grading down to 4.36% per annum in and after 2031 (2016 – 6.38% in 2016, grading down to 4.36% per annum in and after 2031).

The discount rate used to determine the current year pension obligation and the subsequent year's net periodic benefit costs is based on a yield curve approach. Under the yield curve approach, expected future benefit payments for each plan are discounted by a rate on a third-party bond yield curve corresponding to each duration. The yield curve is based on "AA" long-term corporate bonds. A single discount rate is calculated that would yield the same present value as the sum of the discounted cash flows.

The effect of a 1% change in health care cost trends on the projected benefit obligation for the post-retirement and post-employment benefits at December 31, 2017 and 2016 is as follows:

December 31 *(millions of dollars)*	2017	2016
Projected benefit obligation:		
Effect of a 1% increase in health care cost trends	247	286
Effect of a 1% decrease in health care cost trends	(188)	(219)

The effect of a 1% change in health care cost trends on the service cost and interest cost for the post-retirement and post-employment benefits for the years ended December 31, 2017 and 2016 is as follows:

Year ended December 31 *(millions of dollars)*	2017	2016
Service cost and interest cost:		
Effect of a 1% increase in health care cost trends	28	22
Effect of a 1% decrease in health care cost trends	(20)	(16)

The following approximate life expectancies were used in the mortality assumptions to determine the projected benefit obligations for the pension and post-retirement and post-employment plans at December 31, 2017 and 2016:

December 31, 2017				December 31, 2016			
Life expectancy at 65 for a member currently at				Life expectancy at 65 for a member currently at			
Age 65		Age 45		Age 65		Age 45	
Male	Female	Male	Female	Male	Female	Male	Female
22	24	23	24	22	24	23	24

Estimated Future Benefit Payments

At December 31, 2017, estimated future benefit payments to the participants of the Plans were:

(millions of dollars)	Pension Benefits	Post-Retirement and Post-Employment Benefits
2018	326	53
2019	335	54
2020	342	56
2021	350	57
2022	358	58
2023 through to 2027	1,886	311
Total estimated future benefit payments through to 2027	3,597	589

Components of Regulatory Assets

A portion of actuarial gains and losses and prior service costs is recorded within regulatory assets on Hydro One's Consolidated Balance Sheets to reflect the expected regulatory inclusion of these amounts in future rates, which would otherwise be recorded in OCI. The following table provides the actuarial gains and losses and prior service costs recorded within regulatory assets:

Year ended December 31 *(millions of dollars)*	2017	2016
Pension Benefits:		
Actuarial loss (gain) for the year	159	35
Amortization of actuarial losses	(79)	(96)
	80	(61)
Post-Retirement and Post-Employment Benefits:		
Actuarial loss (gain) for the year	(195)	14
Amortization of actuarial losses	(16)	(15)
Amounts not subject to regulatory treatment	4	4
	(207)	3

The following table provides the components of regulatory assets that have not been recognized as components of net periodic benefit costs for the years ended December 31, 2017 and 2016:

Year ended December 31 *(millions of dollars)*	2017	2016
Pension Benefits:		
Actuarial loss	981	900
Post-Retirement and Post-Employment Benefits:		
Actuarial loss	36	243

The following table provides the components of regulatory assets at December 31 that are expected to be amortized as components of net periodic benefit costs in the following year:

	Pension Benefits		Post-Retirement and Post-Employment Benefits	
December 31 *(millions of dollars)*	2017	2016	2017	2016
Actuarial loss	84	79	2	6

Pension Plan Assets

Investment Strategy

On a regular basis, Hydro One evaluates its investment strategy to ensure that Pension Plan assets will be sufficient to pay Pension Plan benefits when due. As part of this ongoing evaluation, Hydro One may make changes to its targeted asset allocation and investment strategy. The Pension Plan is managed at a net asset level. The main objective of the Pension Plan is to sustain a certain level of net assets in order to meet the pension obligations of the Company. The Pension Plan fulfills its primary objective by adhering to specific investment policies outlined in its Summary of Investment Policies and Procedures (SIPP), which is reviewed and approved by the Human Resource Committee of Hydro One's Board of Directors. The Company manages net assets by engaging knowledgeable external investment managers who are charged with the responsibility of investing existing funds and new funds (current year's employee and employer contributions) in accordance with the approved SIPP. The performance of the managers is monitored through a governance structure. Increases in net assets are a direct result of investment income generated by investments held by the Pension Plan and contributions to the Pension Plan by eligible employees and by the Company. The main use of net assets is for benefit payments to eligible Pension Plan members.

Pension Plan Asset Mix

At December 31, 2017, the Pension Plan target asset allocations and weighted average asset allocations were as follows:

	Target Allocation (%)	Pension Plan Assets (%)
Equity securities	55	60
Debt securities	35	31
Other[1]	10	9
	100	100

[1] Other investments include real estate and infrastructure investments.

At December 31, 2017, the Pension Plan held $11 million (2016 – $11 million) Hydro One corporate bonds and $415 million (2016 – $450 million) of debt securities of the Province.

Concentrations of Credit Risk

Hydro One evaluated its Pension Plan's asset portfolio for the existence of significant concentrations of credit risk as at December 31, 2017 and 2016. Concentrations that were evaluated include, but are not limited to, investment concentrations in a single entity, concentrations in a type of industry, and concentrations in individual funds. At December 31, 2017 and 2016, there were no significant concentrations (defined as greater than 10% of plan assets) of risk in the Pension Plan's assets.

The Pension Plan's Statement of Investment Beliefs and Guidelines provides guidelines and restrictions for eligible investments taking into account credit ratings, maximum investment exposure and other controls in order to limit the impact of this risk. The Pension Plan manages its counterparty credit risk with respect to bonds by investing in investment-grade and government bonds and with respect to derivative instruments by transacting only with highly rated financial institutions, and also by ensuring that exposure is diversified across counterparties. The risk of default on transactions in listed securities is considered minimal, as the trade will fail if either party to the transaction does not meet its obligation.

Fair Value Measurements

The following tables present the Pension Plan assets measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy at December 31, 2017 and 2016:

December 31, 2017 *(millions of dollars)*	**Level 1**	**Level 2**	**Level 3**	**Total**
Pooled funds	—	16	549	565
Cash and cash equivalents	153	—	—	153
Short-term securities	—	109	—	109
Derivative instruments	—	5	—	5
Corporate shares – Canadian	921	—	—	921
Corporate shares – Foreign	3,307	125	—	3,432
Bonds and debentures – Canadian	—	1,879	—	1,879
Bonds and debentures – Foreign	—	194	—	194
Total fair value of plan assets[1]	4,381	2,328	549	7,258

[1] At December 31, 2017, the total fair value of Pension Plan assets and liabilities excludes $28 million of interest and dividends receivable, $10 million of pension administration expenses payable, $1 million of sold investments receivable and $1 million of purchased investments payable.

December 31, 2016 *(millions of dollars)*	**Level 1**	**Level 2**	**Level 3**	**Total**
Pooled funds	—	20	425	445
Cash and cash equivalents	146	—	—	146
Short-term securities	—	127	—	127
Corporate shares – Canadian	911	—	—	911
Corporate shares – Foreign	2,985	113	—	3,098
Bonds and debentures – Canadian	—	1,943	—	1,943
Bonds and debentures – Foreign	—	193	—	193
Total fair value of plan assets[1]	4,042	2,396	425	6,863

[1] At December 31, 2016, the total fair value of Pension Plan assets excludes $27 million of interest and dividends receivable, $15 million of purchased investments payable, $9 million of pension administration expenses payable, and $7 million of sold investments receivable.

See note 16 - Fair Value of Financial Instruments and Risk Management for a description of levels within the fair value hierarchy.

Changes in the Fair Value of Financial Instruments Classified in Level 3

The following table summarizes the changes in fair value of financial instruments classified in Level 3 for the years ended December 31, 2017 and 2016. The Pension Plan classifies financial instruments as Level 3 when the fair value is measured based on at least one significant input that is not observable in the markets or due to lack of liquidity in certain markets. The gains and losses presented in the table below may include changes in fair value based on both observable and unobservable inputs.

Year ended December 31 *(millions of dollars)*	**2017**	**2016**
Fair value, beginning of year	425	301
Realized and unrealized gains	(31)	23
Purchases	171	151
Sales and disbursements	(16)	(50)
Fair value, end of year	549	425

There were no significant transfers between any of the fair value levels during the years ended December 31, 2017 and 2016.

The Company performs sensitivity analysis for fair value measurements classified in Level 3, substituting the unobservable inputs with one or more reasonably possible alternative assumptions. This sensitivity analysis resulted in negligible changes in the fair value of financial instruments classified in this level.

Valuation Techniques Used to Determine Fair Value

Pooled funds mainly consist of private equity, real estate and infrastructure investments. Private equity investments represent private equity funds that invest in operating companies that are not publicly traded on a stock exchange. Investment strategies in private equity include limited partnerships in businesses that are characterized by high internal growth and operational efficiencies, venture capital, leveraged buyouts and special situations such as distressed investments. Real estate and infrastructure investments represent funds that invest in real assets which are not publicly traded on a stock exchange. Investment strategies in real estate include limited partnerships that seek to generate a total return through income and capital growth by investing primarily in global and Canadian limited partnerships. Investment strategies in infrastructure include limited partnerships in core infrastructure assets focusing on assets that generate stable, long-term cash flows and deliver incremental returns relative to conventional fixed-income investments. Private equity, real estate and infrastructure valuations are reported by the fund manager and are based on the valuation of the underlying investments which includes inputs such as cost, operating results, discounted future cash flows and market-based comparable data. Since these valuation inputs are not highly observable, private equity and infrastructure investments have been categorized as Level 3 within pooled funds.

Cash equivalents consist of demand cash deposits held with banks and cash held by the investment managers. Cash equivalents are categorized as Level 1.

Short-term securities are valued at cost plus accrued interest, which approximates fair value due to their short-term nature. Short-term securities are categorized as Level 2.

Derivative instruments are used to hedge the Pension Plan's foreign currency exposure back to Canadian dollars. The most significant currencies being hedged against the Canadian dollar are the United States dollar, Euro, and Japanese Yen. The terms to maturity of the forward exchange contracts at December 31, 2017 are within three months. The fair value of the derivative instruments is determined using inputs other than quoted prices that are observable for these assets. The fair value is determined using standard interpolation methodology primarily based on the World Markets exchange rates. Derivative instruments are categorized as Level 2.

Corporate shares are valued based on quoted prices in active markets and are categorized as Level 1. Investments denominated in foreign currencies are translated into Canadian currency at year-end rates of exchange.

Bonds and debentures are presented at published closing trade quotations, and are categorized as Level 2.

19. ENVIRONMENTAL LIABILITIES

The following tables show the movements in environmental liabilities for the years ended December 31, 2017 and 2016:

Year ended December 31, 2017 *(millions of dollars)*	**PCB**	**Land Assessment and Remediation**	**Total**
Environmental liabilities - beginning	143	61	204
Interest accretion	6	2	8
Expenditures	(16)	(8)	(24)
Revaluation adjustment	1	7	8
Environmental liabilities - ending	134	62	196
Less: current portion	(20)	(8)	(28)
	114	54	168

Year ended December 31, 2016 *(millions of dollars)*	**PCB**	**Land Assessment and Remediation**	**Total**
Environmental liabilities - beginning	148	59	207
Interest accretion	7	1	8
Expenditures	(11)	(9)	(20)
Revaluation adjustment	(1)	10	9
Environmental liabilities - ending	143	61	204
Less: current portion	(18)	(9)	(27)
	125	52	177

The following tables show the reconciliation between the undiscounted basis of the environmental liabilities and the amount recognized on the Consolidated Balance Sheets after factoring in the discount rate:

December 31, 2017 *(millions of dollars)*	**PCB**	**Land Assessment and Remediation**	**Total**
Undiscounted environmental liabilities	142	64	206
Less: discounting environmental liabilities to present value	(8)	(2)	(10)
Discounted environmental liabilities	134	62	196

December 31, 2016 *(millions of dollars)*	**PCB**	**Land Assessment and Remediation**	**Total**
Undiscounted environmental liabilities	158	66	224
Less: discounting environmental liabilities to present value	(15)	(5)	(20)
Discounted environmental liabilities	143	61	204

At December 31, 2017, the estimated future environmental expenditures were as follows:

(millions of dollars)	
2018	28
2019	27
2020	32
2021	34
2022	31
Thereafter	54
	206

Hydro One records a liability for the estimated future expenditures for land assessment and remediation and for the phase-out and destruction of PCB-contaminated mineral oil removed from electrical equipment when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated.

There are uncertainties in estimating future environmental costs due to potential external events such as changes in legislation or regulations, and advances in remediation technologies. In determining the amounts to be recorded as environmental liabilities, the Company estimates the current cost of completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. A long-term inflation rate assumption of approximately 2% has been used to express these current cost estimates as estimated future expenditures. Future expenditures have been discounted using factors ranging from approximately 2.0% to 6.3%, depending on the appropriate rate for the period when expenditures are expected to be incurred. All factors used in estimating the Company's environmental liabilities represent management's best estimates of the present value of costs required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company's current assumptions. In addition, with respect to the PCB environmental liability, the availability of critical resources such as skilled labour and replacement assets and the ability to take maintenance outages in critical facilities may influence the timing of expenditures.

PCBs

The Environment Canada regulations, enacted under the *Canadian Environmental Protection Act, 1999*, govern the management, storage and disposal of PCBs based on certain criteria, including type of equipment, in-use status, and PCB-contamination thresholds. Under current regulations, Hydro One's PCBs have to be disposed of by the end of 2025, with the exception of specifically exempted equipment. Contaminated equipment will generally be replaced, or will be decontaminated by removing PCB-contaminated insulating oil and retro filling with replacement oil that contains PCBs in concentrations of less than 2 ppm.

The Company's best estimate of the total estimated future expenditures to comply with current PCB regulations is $142 million (2016 – $158 million). These expenditures are expected to be incurred over the period from 2018 to 2025. As a result of its annual review of environmental liabilities, the Company recorded a revaluation adjustment in 2017 to increase the PCB environmental liability by $1 million (2016 – reduce by $1 million).

Land Assessment and Remediation

The Company's best estimate of the total estimated future expenditures to complete its land assessment and remediation program is $64 million (2016 – $66 million). These expenditures are expected to be incurred over the period from 2018 to 2044. As a result of its annual review of environmental liabilities, the Company recorded a revaluation adjustment in 2017 to increase the land assessment and remediation environmental liability by $7 million (2016 – $10 million).

20. ASSET RETIREMENT OBLIGATIONS

Hydro One records a liability for the estimated future expenditures for the removal and disposal of asbestos-containing materials installed in some of its facilities. Asset retirement obligations, which represent legal obligations associated with the retirement of certain tangible long-lived assets, are computed as the present value of the projected expenditures for the future retirement of specific assets and are recognized in the period in which the liability is incurred, if a reasonable estimate can be made. If the asset remains in service at the recognition date, the present value of the liability is added to the carrying amount of the associated asset in the period the liability is incurred and this additional carrying amount is depreciated over the remaining life of the asset. If an asset retirement obligation is recorded in respect of an out-of-service asset, the asset retirement cost is charged to results of operations. Subsequent to the initial recognition, the liability is adjusted for any revisions to the estimated future cash flows associated with the asset retirement obligation, which can occur due to a number of factors including, but not limited to, cost escalation, changes in technology applicable to the assets to be retired, changes in legislation or regulations, as well as for accretion of the liability due to the passage of time until the obligation is settled. Depreciation expense is adjusted prospectively for any increases or decreases to the carrying amount of the associated asset.

In determining the amounts to be recorded as asset retirement obligations, the Company estimates the current fair value for completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. A long-term inflation assumption of approximately 2% has been used to express these current cost estimates as estimated future expenditures. Future expenditures have been discounted using factors ranging from approximately 3.0% to 5.0%, depending on the appropriate rate for the period when expenditures are expected to be incurred. All factors used in estimating the Company's asset retirement obligations represent management's best estimates of the cost required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company's current assumptions. Asset retirement obligations are reviewed annually or more frequently if significant changes in regulations or other relevant factors occur. Estimate changes are accounted for prospectively.

At December 31, 2017, Hydro One had recorded asset retirement obligations of $9 million (2016 – $9 million), primarily consisting of the estimated future expenditures associated with the removal and disposal of asbestos-containing materials installed in some of its facilities. The amount of interest recorded is nominal.

21. SHARE CAPITAL

Common Shares

The Company is authorized to issue an unlimited number of common shares. At December 31, 2017, the Company had 142,239 common shares issued and outstanding (2016 – 142,239).

In 2017, a return of stated capital in the amount of $535 million (2016 – $609 million) was paid.

The amount and timing of any dividends payable by Hydro One is at the discretion of the Hydro One Board of Directors and is established on the basis of Hydro One's results of operations, maintenance of its deemed regulatory capital structure, financial condition, cash requirements, the satisfaction of solvency tests imposed by corporate laws for the declaration and payment of dividends and other factors that the Board of Directors may consider relevant.

Preferred Shares

The Company is authorized to issue an unlimited number of preferred shares, issuable in series. At December 31, 2017, two series of preferred shares are authorized for issuance: the Class A preferred shares and Class B preferred shares. At December 31, 2017, the Company had 485,870 Class B preferred shares and no Class A preferred shares issued and outstanding (2016 - no Class A or Class B preferred shares issued and outstanding).

Class A Preferred Shares

On November 2, 2015, a special resolution of Hydro One Limited (as sole shareholder of Hydro One) was made to amend the articles of Hydro One to delete the share ownership restrictions and to amend the Hydro One preferred share terms to provide for basic redeemable preferred shares. When issued, the Class A preferred shares will be redeemable at the option of the Company. The holders of the Class A preferred shares will be entitled to receive, if and when declared by the Hydro One Board of Directors, non-cumulative preferred share dividends at a rate per year to be determined by the Hydro One Board of Directors. The holders of the Class A preferred shares will not be entitled to receive notice of, or to attend or to vote at, any meeting of the shareholders of Hydro One. The holders of the Class A preferred shares will be entitled to receive, before any distributions to the holders of common shares and any other shares ranking junior to the Class A preferred shares, an amount equal to the amount paid for the Class A preferred shares together with all dividends declared and unpaid up to the date of liquidation, dissolution or winding up of Hydro One, or the date of redemption.

Class B Preferred Shares

On November 10, 2017, a special resolution of Hydro One Limited was made to amend the articles of Hydro One to create an unlimited number of Class B preferred shares. The holders of the Class B preferred shares are entitled to receive quarterly floating-rate cumulative dividends, if and when declared by the Board of Directors, at a rate equal to the sum of the average 3-month Canadian dollar bankers' acceptance rate and 0.25% as reset quarterly. The holders of the Class B preferred shares will not be entitled to receive notice of, or to attend or to vote at, any meeting of the shareholders of Hydro One. The holders of the Class B preferred shares will be entitled to receive, before any distributions to the holders of the Class A preferred shares, the common shares and any other shares ranking junior to the Class B preferred shares, an amount equal to the amount paid for the Class B preferred shares together with all dividends unpaid up to the date of liquidation, dissolution or winding up of Hydro One, or the date of redemption.

The Class B preferred shares have a redemption feature that is outside the control of the Company because the holders can exercise their right to redeem the Class B preferred shares at any time without approval of the Company's Board of Directors. The Class B preferred shares are classified on the Consolidated Balance Sheet as temporary equity because this redemption feature is outside the control of the Company.

On November 20, 2017, Hydro One issued 485,870 Class B preferred shares to 2587264 Ontario Inc., a subsidiary of Hydro One Limited, for proceeds of $486 million.

22. DIVIDENDS

In 2017, common share dividends in the amount of $15 million (2016 – $2 million) were declared and paid.

23. EARNINGS PER COMMON SHARE

Basic and diluted earnings per common share (EPS) is calculated by dividing net income attributable to common shareholder of Hydro One by the weighted average number of common shares outstanding. The weighted average number of shares outstanding at December 31, 2017 was 142,239 (2016 – 142,239). There were no dilutive securities during 2017 or 2016.

24. STOCK-BASED COMPENSATION

The following compensation plans were established by Hydro One Limited, however they represent components of compensation costs of Hydro One in current and future periods.

Share Grant Plans

Hydro One Limited has two share grant plans (Share Grant Plans), one for the benefit of certain members of the Power Workers' Union (the PWU Share Grant Plan) and one for the benefit of certain members of The Society of Energy Professionals (the Society Share Grant Plan). Hydro One and Hydro One Limited entered into an intercompany agreement, such that Hydro One will pay Hydro One Limited for the compensation costs associated with these plans.

The PWU Share Grant Plan provides for the issuance of common shares of Hydro One Limited from treasury to certain eligible members of the PWU annually, commencing on April 1, 2017 and continuing until the earlier of April 1, 2028 or the date an eligible employee no longer meets the eligibility criteria of the PWU Share Grant Plan. To be eligible, an employee must be a member of the Pension Plan on April 1, 2015, be employed on the date annual share issuance occurs and continue to have under 35 years of service. The requisite service period for the PWU Share Grant Plan began on July 3, 2015, which is the date the share grant plan was ratified by the PWU. The number of common shares issued annually to each eligible employee will be equal to 2.7% of such eligible employee's salary as at April 1, 2015, divided by $20.50, being the price of the common shares of Hydro One Limited in the IPO. The aggregate number of Hydro One Limited common shares issuable under the PWU Share Grant Plan shall not exceed 3,981,763 common shares. In 2015, 3,952,212 Hydro One Limited common shares were granted under the PWU Share Grant Plan relevant to the total share based compensation recognized by Hydro One.

The Society Share Grant Plan provides for the issuance of common shares of Hydro One Limited from treasury to certain eligible members of The Society annually, commencing on April 1, 2018 and continuing until the earlier of April 1, 2029 or the date an eligible employee no longer meets the eligibility criteria of the Society Share Grant Plan. To be eligible, an employee must be a member of the Pension Plan on September 1, 2015, be employed on the date annual share issuance occurs and continue to have under 35 years of service. Therefore the requisite service period for the Society Share Grant Plan began on September 1, 2015. The number of common shares issued annually to each eligible employee will be equal to 2.0% of such eligible employee's salary as at September 1, 2015, divided by $20.50, being the price of the common shares of Hydro One Limited in the IPO. The aggregate number of Hydro One Limited common shares issuable under the Society Share Grant Plan shall not exceed 1,434,686 common shares. In 2015, 1,367,158 Hydro One Limited common shares were granted under the Society Share Grant Plan relevant to the total share based compensation recognized by Hydro One.

The fair value of the Hydro One Limited 2015 share grants of $111 million was estimated based on the grant date Hydro One Limited share price of $20.50 and is recognized using the graded-vesting attribution method as the share grant plans have both a performance condition and a service condition. In 2017, 369,266 common shares of Hydro One Limited were granted under the Share Grant Plans (2016 - nil) to eligible employees of Hydro One. Total share based compensation recognized during 2017 was $17 million (2016 – $21 million) and was recorded as a regulatory asset.

A summary of share grant activity under the Share Grant Plans during years ended December 31, 2017 and 2016 is presented below:

Year ended December 31, 2017	Share Grants *(number of common shares)*	Weighted-Average Price
Share grants outstanding - beginning	5,239,678	$20.50
Vested and issued[1]	(369,266)	—
Forfeited	(132,629)	$20.50
Share grants outstanding - ending	4,737,783	$20.50

[1] On April 1, 2017, Hydro One LImited issued from treasury 369,266 common shares to eligible Hydro One employees in accordance with provisions of the PWU Share Grant Plan.

Year ended December 31, 2016	Share Grants *(number of common shares)*	Weighted-Average Price
Share grants outstanding – beginning	5,319,370	$20.50
Forfeited[1]	(79,692)	$20.50
Share grants outstanding – ending	5,239,678	$20.50

[1] Includes shares forfeited as well as shares transferred corresponding to transfer of employees from an affiliate company.

Directors' DSU Plan

Under the Directors' DSU Plan, directors can elect to receive credit for their annual cash retainer in a notional account of DSUs in lieu of cash. Hydro One Limited's Board of Directors may also determine from time to time that special circumstances exist that would reasonably justify the grant of DSUs to a director as compensation in addition to any regular retainer or fee to which the director is entitled. Each DSU represents a unit with an underlying value equivalent to the value of one common share of Hydro One Limited and is entitled to accrue Hydro One Limited common share dividend equivalents in the form of additional DSUs at the time dividends are paid, subsequent to declaration by Hydro One Limited's Board of Directors.

During the years ended December 31, 2017 and 2016, the Company granted awards under the Directors' DSU Plan, as follows:

Year ended December 31 *(number of DSUs)*	2017	2016
DSUs outstanding – beginning	99,083	20,525
DSUs granted	88,007	78,558
DSUs outstanding – ending	187,090	99,083

For the year ended December 31, 2017, an expense of $2 million (2016 – $2 million) was recognized in earnings with respect to the Directors' DSU Plan. At December 31, 2017, a liability of $4 million (2016 – $2 million), related to outstanding DSUs has been recorded at the closing price of Hydro One Limited's common shares of $22.40 and is included in long-term accounts payable and other liabilities on the Consolidated Balance Sheets.

Management DSU Plan

Under the Management DSU Plan, eligible executive employees can elect to receive a specified proportion of their annual short-term incentive in a notional account of DSUs in lieu of cash. Each DSU represents a unit with an underlying value equivalent to the value of one common share of Hydro One Limited and is entitled to accrue common share dividend equivalents in the form of additional DSUs at the time dividends are paid, subsequent to declaration by Hydro One's Board of Directors.

During the years ended December 31, 2017 and 2016, the Company granted awards under the Management DSU Plan, as follows:

Year ended December 31 *(number of DSUs)*	2017	2016
DSUs outstanding - beginning	—	—
Granted	64,828	—
Paid	(1,068)	—
DSUs outstanding - ending	63,760	—

For the year ended December 31, 2017, an expense of $2 million (2016 - $nil) was recognized in earnings with respect to the Management DSU Plan. At December 31, 2017, a liability of $2 million (2016 – $nil) related to outstanding DSUs has been recorded at the closing price of Hydro One Limited common shares of $22.40 and is included in long-term accounts payable and other liabilities on the Consolidated Balance Sheets.

Employee Share Ownership Plan

In 2015, Hydro One Limited established Employee Share Ownership Plans (ESOP) for certain eligible management and non-represented employees (Management ESOP) and for certain eligible Society-represented staff (Society ESOP). Under the Management ESOP, the eligible management and non-represented employees may contribute between 1% and 6% of their base salary towards purchasing common shares of Hydro One Limited. The Company matches 50% of their contributions, up to a maximum Company contribution of $25,000 per calendar year. Under the Society ESOP, the eligible Society-represented staff may contribute between 1% and 4% of their base salary towards purchasing common shares of Hydro One Limited. The Company matches 25% of their contributions, with no maximum Company contribution per calendar year. In 2017, Company contributions made under the ESOP were $2 million (2016 - $2 million).

LTIP

Effective August 31, 2015, the Board of Directors of Hydro One Limited adopted an LTIP. Under the LTIP, long-term incentives are granted to certain executive and management employees of Hydro One Limited and its subsidiaries, and all equity-based awards will be settled in newly issued shares of Hydro One Limited from treasury, consistent with the provisions of the plan. The aggregate number of shares issuable under the LTIP shall not exceed 11,900,000 shares of Hydro One Limited.

The LTIP provides flexibility to award a range of vehicles, including RSUs, PSUs, stock options, share appreciation rights, restricted shares, deferred share units and other share-based awards. The mix of vehicles is intended to vary by role to recognize the level of executive accountability for overall business performance.

During 2017 and 2016, Hydro One Limited granted awards under its LTIP as follows:

	PSUs		RSUs	
Year ended December 31 *(number of units)*	**2017**	**2016**	**2017**	**2016**
Units outstanding – beginning	228,890	—	252,440	—
Units granted	300,090	233,710	239,280	257,260
Units vested	(609)	—	(14,079)	—
Units forfeited	(103,251)	(4,820)	(89,501)	(4,820)
Units outstanding – ending	425,120	228,890	388,140	252,440

The grant date total fair value of the awards granted in 2017 was $13 million (2016 – $12 million). The compensation expense related to these awards recognized by the Company during 2017 was $6 million (2016 – $3 million).

25. NONCONTROLLING INTEREST

On December 16, 2014, transmission assets totalling $526 million were transferred from Hydro One Networks to B2M LP. This was financed by 60% debt ($316 million) and 40% equity ($210 million). On December 17, 2014, the Saugeen Ojibway Nation (SON) acquired a 34.2% equity interest in B2M LP for consideration of $72 million, representing the fair value of the equity interest acquired. The SON's initial investment in B2M LP consists of $50 million of Class A units and $22 million of Class B units.

The Class B units have a mandatory put option which requires that upon the occurrence of an enforcement event (i.e. an event of default such as a debt default by the SON or insolvency event), Hydro One purchase the Class B units of B2M LP for net book value on the redemption date. The noncontrolling interest relating to the Class B units is classified on the Consolidated Balance Sheet as temporary equity because the redemption feature is outside the control of the Company. The balance of the noncontrolling interest is classified within equity.

The following tables show the movements in noncontrolling interest during the years ended December 31, 2017 and 2016:

Year ended December 31, 2017 *(millions of dollars)*	**Temporary Equity**	**Equity**	**Total**
Noncontrolling interest – beginning	22	50	72
Distributions to noncontrolling interest	(2)	(4)	(6)
Net income attributable to noncontrolling interest	2	4	6
Noncontrolling interest – ending	22	50	72

Year ended December 31, 2016 *(millions of dollars)*	**Temporary Equity**	**Equity**	**Total**
Noncontrolling interest – beginning	23	52	75
Distributions to noncontrolling interest	(3)	(6)	(9)
Net income attributable to noncontrolling interest	2	4	6
Noncontrolling interest – ending	22	50	72

26. RELATED PARTY TRANSACTIONS

Hydro One is owned by Hydro One Limited. The Province is a shareholder of Hydro One Limited with approximately 47.4% ownership at December 31, 2017. The IESO, Ontario Power Generation Inc. (OPG), Ontario Electricity Financial Corporation (OEFC), the OEB, and Hydro One Telecom, are related parties to Hydro One because they are controlled or significantly influenced by the Province or by Hydro One Limited. Hydro One Brampton was a related party until February 28, 2017, when it was acquired from the Province by Alectra Inc., and subsequent to the acquisition by Alectra Inc., is no longer a related party to Hydro One.

Year ended December 31 *(millions of dollars)*			
Related Party	**Transaction**	**2017**	**2016**
IESO	Power purchased	1,583	2,096
	Revenues for transmission services	1,521	1,549
	Amounts related to electricity rebates	357	—
	Distribution revenues related to rural rate protection	247	125
	Distribution revenues related to the supply of electricity to remote northern communities	32	32
	Funding received related to CDM programs	59	63
OPG	Power purchased	9	6
	Revenues related to provision of construction and equipment maintenance services	2	4
	Costs related to the purchase of services	1	1
OEFC	Power purchased from power contracts administered by the OEFC	2	1
OEB	OEB fees	8	11
Hydro One Brampton	Cost recovery from management, administrative and smart meter network services	—	3
Hydro One Limited	Return of stated capital	535	609
	Dividends paid	15	2
	Stock-based compensation costs	23	24
	Cost recovery for services provided	6	—
Hydro One Telecom	Services received – costs expensed	24	24
	Services received – costs capitalized	—	12
	Revenues for services provided	3	3
2587264 Ontario Inc.	Promissory note issued and repaid[1]	486	—
	Preferred shares issued[2]	486	—

[1] On October 17, 2017, Hydro One issued a promissory note to 2587264 Ontario Inc., a subsidiary of Hydro One Limited, totalling $486 million. On November 20, 2017, Hydro One repaid the $486 million promissory note to 2587264 Ontario Inc., as well as interest totalling $1 million.

[2] On November 20, 2017, Hydro One issued 485,870 Class B preferred shares to 2587264 Ontario Inc. for proceeds of $486 million. See Note 21 for details of the Class B preferred shares.

Sales to and purchases from related parties are based on the requirements of the OEB's Affiliate Relationships Code. Outstanding balances at period end are interest-free and settled in cash.

27. CONSOLIDATED STATEMENTS OF CASH FLOWS

The changes in non-cash balances related to operations consist of the following:

Year ended December 31 *(millions of dollars)*	2017	2016
Accounts receivable	191	(59)
Due from related parties	(215)	(40)
Materials and supplies	1	2
Prepaid expenses and other assets	2	(17)
Accounts payable	7	18
Accrued liabilities	(89)	52
Due to related parties	88	113
Accrued interest	(6)	9
Long-term accounts payable and other liabilities	(2)	6
Post-retirement and post-employment benefit liability	86	84
	63	168

Capital Expenditures

The following table reconciles investments in property, plant and equipment and the amounts presented in the Consolidated Statements of Cash Flows after accounting for capitalized depreciation and the net change in related accruals:

Year ended December 31 *(millions of dollars)*	2017	2016
Capital investments in property, plant and equipment	(1,482)	(1,624)
Capitalized depreciation and net change in accruals included in capital investments in property, plant and equipment	26	30
Cash outflow for capital expenditures – property, plant and equipment	(1,456)	(1,594)

The following table reconciles investments in intangible assets and the amounts presented in the Consolidated Statements of Cash Flows after accounting for the net change in related accruals:

Year ended December 31 *(millions of dollars)*	2017	2016
Capital investments in intangible assets	(74)	(67)
Net change in accruals included in capital investments in intangible assets	(6)	6
Cash outflow for capital expenditures – intangible assets	(80)	(61)

Capital Contributions

Hydro One enters into contracts governed by the OEB Transmission System Code when a transmission customer requests a new or upgraded transmission connection. The customer is required to make a capital contribution to Hydro One based on the shortfall between the present value of the costs of the connection facility and the present value of revenues. The present value of revenues is based on an estimate of load forecast for the period of the contract with Hydro One. Once the connection facility is commissioned, in accordance with the OEB Transmission System Code, Hydro One will periodically reassess the estimated of load forecast which will lead to a decrease, or an increase in the capital contributions from the customer. The increase or decrease in capital contributions is recorded directly to fixed assets in service. In 2017, capital contributions from these reassessments totalled $9 million (2016 – $21 million), which represents the difference between the revised load forecast of electricity transmitted compared to the load forecast in the original contract, subject to certain adjustments.

Supplementary Information

Year ended December 31 *(millions of dollars)*	2017	2016
Net interest paid	452	418
Income taxes paid	11	30

28. CONTINGENCIES

Legal Proceedings

Hydro One is involved in various lawsuits and claims in the normal course of business. In the opinion of management, the outcome of such matters will not have a material adverse effect on the Company’s consolidated financial position, results of operations or cash flows.

Hydro One, Hydro One Networks, Hydro One Remote Communities, and Norfolk Power Distribution Inc. are defendants in a class action suit in which the representative plaintiff is seeking up to $125 million in damages related to allegations of improper billing practices. The plaintiff’s motion for certification was dismissed by the court on November 28, 2017, but the plaintiff has appealed the court’s decision, and it is likely that no decision will be rendered by the appeal court until the second half of 2018. At this time, an estimate of a possible loss related to this claim cannot be made.

Transfer of Assets

The transfer orders by which the Company acquired certain of Ontario Hydro’s businesses as of April 1, 1999 did not transfer title to some assets located on Reserves (as defined in the *Indian Act* (Canada)). Currently, the OEFC holds these assets. Under the terms of the transfer orders, the Company is required to manage these assets until it has obtained all consents necessary to complete the transfer of title of these assets to itself. The Company cannot predict the aggregate amount that it may have to pay, either on an annual or one-time basis, to obtain the required consents. In 2017, the Company paid approximately $2 million (2016 – $1 million) in respect of consents obtained. If the Company cannot obtain the required consents, the OEFC will continue to hold these assets for an indefinite period of time. If the Company cannot reach a satisfactory settlement, it may have to relocate these assets to other locations at a cost that could be substantial or, in a limited number of cases, to abandon a line and replace it with diesel-generation facilities. The costs relating to these assets could have a material adverse effect on the Company’s results of operations if the Company is not able to recover them in future rate orders.

29. COMMITMENTS

The following table presents a summary of Hydro One's commitments under leases, outsourcing and other agreements due in the next 5 years and thereafter.

December 31, 2017 *(millions of dollars)*	Year 1	Year 2	Year 3	Year 4	Year 5	Thereafter
Outsourcing agreements	139	95	2	2	2	7
Long-term software/meter agreement	17	17	16	2	1	3
Operating lease commitments	10	5	9	4	1	4

Outsourcing Agreements

Hydro One has agreements with Inergi LP (Inergi) for the provision of back office and IT outsourcing services, including settlements, source to pay services, pay operations services, information technology and finance and accounting services, expiring on December 31, 2019, and for the provision of customer service operations outsourcing services expiring on February 28, 2018. Hydro One is currently in the process of insourcing the customer service operations services and will not be renewing the existing agreement for these services with Inergi. Agreements have been reached with The Society and the PWU to facilitate the insourcing of these services effective March 1, 2018.

Brookfield Global Integrated Solutions (formerly Brookfield Johnson Controls Canada LP) (Brookfield) provides services to Hydro One, including facilities management and execution of certain capital projects as deemed required by the Company. The agreement with Brookfield for these services expires in December 2024.

Long-term Software/Meter Agreement

Trilliant Holdings Inc. and Trilliant Networks (Canada) Inc. (collectively Trilliant) provide services to Hydro One for the supply, maintenance and support services for smart meters and related hardware and software, including additional software licences, as well as certain professional services. The agreement with Trilliant for these services expires in December 2025, but Hydro One has the option to renew for an additional term of five years at its sole discretion.

Operating Leases

Hydro One is committed as lessee to irrevocable operating lease contracts for buildings used in administrative and service-related functions and storing telecommunications equipment. These leases have typical terms of between three and five years, but several leases have lesser or greater terms to address special circumstances and/or opportunities. Renewal options, which are generally prevalent in most leases, have similar terms of three to five years. All leases include a clause to enable upward revision of the rental charge on an annual basis or on renewal according to prevailing market conditions or pre-established rents. There are no restrictions placed upon Hydro One by entering into these leases. During the year ended December 31, 2017, the Company made lease payments totalling $10 million (2016 – $10 million).

Other Commitments

The following table presents a summary of Hydro One's other commercial commitments by year of expiry in the next 5 years and thereafter.

December 31, 2017 *(millions of dollars)*	Year 1	Year 2	Year 3	Year 4	Year 5	Thereafter
Credit facilities	—	—	—	—	2,300	—
Letters of credit[1]	177	—	—	—	—	—
Guarantees[2]	325	—	—	—	—	—

[1] Letters of credit consist of a $154 million letter of credit related to retirement compensation arrangements, a $16 million letter of credit provided to the IESO for prudential support, $6 million in letters of credit to satisfy debt service reserve requirements, and $1 million in letters of credit for various operating purposes.

[2] Guarantees consist of prudential support provided to the IESO by Hydro One on behalf of its subsidiaries.

<u>Prudential Support</u>

Purchasers of electricity in Ontario, through the IESO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IESO could draw on these guarantees and/or letters of credit if these purchasers fail to make a payment required by a default notice issued by the IESO. The maximum potential payment is the face value of any letters of credit plus the amount of the parental guarantees.

<u>Retirement Compensation Arrangements</u>

Bank letters of credit have been issued to provide security for Hydro One's liability under the terms of a trust fund established pursuant to the supplementary pension plan for eligible employees of Hydro One. The supplementary pension plan trustee is required to draw upon these letters of credit if Hydro One is in default of its obligations under the terms of this plan. Such obligations include the requirement to provide the trustee with an annual actuarial report as well as letters of credit sufficient to secure Hydro One's liability under the plan, to pay benefits payable under the plan and to pay the letter of credit fee. The maximum potential payment is the face value of the letters of credit.

30. SEGMENTED REPORTING

Hydro One has three reportable segments:

- The Transmission Segment, which comprises the transmission of high voltage electricity across the province, interconnecting more than 70 local distribution companies and certain large directly connected industrial customers throughout the Ontario electricity grid;
- The Distribution Segment, which comprises the delivery of electricity to end customers and certain other municipal electricity distributors; and
- Other Segment, which includes certain corporate activities.

The designation of segments has been based on a combination of regulatory status and the nature of the services provided. Operating segments of the Company are determined based on information used by the chief operating decision maker in deciding how to allocate resources and evaluate the performance of each of the segments. The Company evaluates segment performance based on income before financing charges and income taxes from continuing operations (excluding certain allocated corporate governance costs).

Year ended December 31, 2017 *(millions of dollars)*	Transmission	Distribution	Other	Consolidated
Revenues	1,581	4,366	—	5,947
Purchased power	—	2,875	—	2,875
Operation, maintenance and administration	391	599	24	1,014
Depreciation and amortization	420	390	—	810
Income (loss) before financing charges and income taxes	770	502	(24)	1,248
Capital investments	968	588	—	1,556

Year ended December 31, 2016 *(millions of dollars)*	Transmission	Distribution	Other	Consolidated
Revenues	1,587	4,915	—	6,502
Purchased power	—	3,427	—	3,427
Operation, maintenance and administration	410	613	20	1,043
Depreciation and amortization	390	379	—	769
Income (loss) before financing charges and income taxes	787	496	(20)	1,263
Capital investments	988	703	—	1,691

Total Assets by Segment:

December 31 *(millions of dollars)*	2017	2016
Transmission	13,612	13,083
Distribution	9,279	9,393
Other	2,860	2,834
Total assets	25,751	25,310

Total Goodwill by Segment:

December 31 *(millions of dollars)*	2017	2016
Transmission *(Note 4)*	157	159
Distribution	168	168
Total goodwill	325	327

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

31. SUBSEQUENT EVENTS

Dividends and Return of Stated Capital

On February 12, 2018, preferred share dividends in the amount of $2 million and common share dividends in the amount of $5 million were declared. On the same date, a return of stated capital in the amount of $128 million was approved.

HYDRO ONE INC.
MANAGEMENT'S REPORT

The Consolidated Financial Statements, Management's Discussion and Analysis (MD&A) and related financial information have been prepared by the management of Hydro One Inc. (Hydro One or the Company). Management is responsible for the integrity, consistency and reliability of all such information presented. The Consolidated Financial Statements have been prepared in accordance with United States Generally Accepted Accounting Principles and applicable securities legislation. The MD&A has been prepared in accordance with National Instrument 51-102.

The preparation of the Consolidated Financial Statements and information in the MD&A involves the use of estimates and assumptions based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. Estimates and assumptions are based on historical experience, current conditions and various other assumptions believed to be reasonable in the circumstances, with critical analysis of the significant accounting policies followed by the Company as described in Note 2 to the Consolidated Financial Statements. The preparation of the Consolidated Financial Statements and the MD&A includes information regarding the estimated impact of future events and transactions. The MD&A also includes information regarding sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from the present assessment of this information because future events and circumstances may not occur as expected. The Consolidated Financial Statements and MD&A have been properly prepared within reasonable limits of materiality and in light of information up to February 9, 2017.

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. In meeting its responsibility for the reliability of financial information, management maintains and relies on a comprehensive system of internal control and internal audit. The system of internal control includes a written corporate conduct policy; implementation of a risk management framework; effective segregation of duties and delegation of authorities; and sound accounting policies that are regularly reviewed. This structure is designed to provide reasonable assurance that assets are safeguarded and that reliable information is available on a timely basis. In addition, management has assessed the design and operating effectiveness of the Company's internal control over financial reporting in accordance with the criteria set forth in Internal Control – Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that the Company maintained effective internal control over financial reporting as of December 31, 2016. The effectiveness of these internal controls is reported to the Audit Committee of the Hydro One Board of Directors, as required.

The Consolidated Financial Statements have been audited by KPMG LLP, independent external auditors appointed by the shareholder of the Company. The external auditors' responsibility is to express their opinion on whether the Consolidated Financial Statements are fairly presented in accordance with United States Generally Accepted Accounting Principles. The Independent Auditors' Report outlines the scope of their examination and their opinion.

The Hydro One Board of Directors, through its Audit Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Audit Committee of Hydro One met periodically with management, the internal auditors and the external auditors to satisfy itself that each group had properly discharged its respective responsibility and to review the Consolidated Financial Statements before recommending approval by the Board of Directors. The external auditors had direct and full access to the Audit Committee, with and without the presence of management, to discuss their audit findings.

The President and Chief Executive Officer and the Chief Financial Officer have certified Hydro One's annual Consolidated Financial Statements and annual MD&A, related disclosure controls and procedures and the design and effectiveness of related internal controls over financial reporting.

On behalf of Hydro One's management:

Mayo Schmidt	Michael Vels
President and Chief Executive Officer	Chief Financial Officer

HYDRO ONE INC.
INDEPENDENT AUDITORS' REPORT

To the Shareholder of Hydro One Inc.

We have audited the accompanying Consolidated Financial Statements of Hydro One Inc., which comprise the consolidated balance sheets as at December 31, 2016 and December 31, 2015, the consolidated statements of operations and comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these Consolidated Financial Statements in accordance with United States Generally Accepted Accounting Principles, and for such internal control as management determines is necessary to enable the preparation of Consolidated Financial Statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the Consolidated Financial Statements present fairly, in all material respects, the consolidated financial position of Hydro One Inc. as at December 31, 2016 and December 31, 2015, and its consolidated results of operations and its consolidated cash flows for the years then ended in accordance with United States Generally Accepted Accounting Principles.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Canada
February 9, 2017

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
For the years ended December 31, 2016 and 2015

Year ended December 31 *(millions of Canadian dollars, except per share amounts)*	**2016**	**2015**
Revenues		
Distribution (includes $160 related party revenues; 2015 – $159) *(Note 26)*	4,915	4,949
Transmission (includes $1,556 related party revenues; 2015 – $1,554) *(Note 26)*	1,587	1,536
Other	–	44
	6,502	6,529
Costs		
Purchased power (includes $2,103 related party costs; 2015 – $2,335) *(Note 26)*	3,427	3,450
Operation, maintenance and administration *(Note 26)*	1,043	1,130
Depreciation and amortization *(Note 5)*	769	757
	5,239	5,337
Income before financing charges and income taxes	1,263	1,192
Financing charges *(Note 6)*	392	376
Income before income taxes	871	816
Income taxes *(Notes 7, 26)*	135	114
Net income	**736**	**702**
Other comprehensive income	–	–
Comprehensive income	**736**	**702**
Net income and comprehensive income attributable to:		
Noncontrolling interest *(Note 25)*	6	10
Preferred shareholder	–	13
Common shareholder	730	679
	736	**702**
Earnings per common share *(Note 23)*		
Basic	$5,132	$6,340
Diluted	$5,132	$6,340
Dividends per common share declared *(Note 22)*	$14	$8,750

See accompanying notes to Consolidated Financial Statements.

HYDRO ONE INC.
CONSOLIDATED BALANCE SHEETS
At December 31, 2016 and 2015

December 31 *(millions of Canadian dollars)*	**2016**	**2015**
Assets		
Current assets:		
Cash and cash equivalents	48	89
Accounts receivable *(Note 8)*	833	772
Due from related parties *(Note 26)*	224	184
Other current assets *(Note 9)*	97	100
	1,202	1,145
Property, plant and equipment *(Note 10)*	19,068	17,893
Other long-term assets:		
Regulatory assets *(Note 12)*	3,145	3,015
Deferred income tax assets *(Note 7)*	1,213	1,610
Intangible assets *(Note 11)*	349	336
Goodwill *(Note 4)*	327	163
Other assets	6	7
	5,040	5,131
Total assets	**25,310**	**24,169**
Liabilities		
Current liabilities:		
Short-term notes payable *(Note 15)*	469	1,491
Long-term debt payable within one year *(Note 15)*	602	500
Accounts payable and other current liabilities *(Note 13)*	933	858
Due to related parties *(Note 26)*	253	132
	2,257	2,981
Long-term liabilities:		
Long-term debt (includes $548 measured at fair value; 2015 – $51) *(Notes 15, 16)*	10,078	8,207
Regulatory liabilities *(Note 12)*	209	236
Deferred income tax liabilities *(Note 7)*	60	206
Other long-term liabilities *(Note 14)*	2,765	2,714
	13,112	11,363
Total liabilities	**15,369**	**14,344**
Contingencies and Commitments *(Notes 28, 29)*		
Subsequent Events *(Note 31)*		
Noncontrolling interest subject to redemption *(Note 25)*	22	23
Equity		
Common shares *(Notes 21, 22)*	5,391	6,000
Retained earnings	4,487	3,759
Accumulated other comprehensive loss	(9)	(9)
Hydro One shareholder's equity	9,869	9,750
Noncontrolling interest *(Note 25)*	50	52
Total equity	**9,919**	**9,802**
	25,310	**24,169**

See accompanying notes to Consolidated Financial Statements.

On behalf of the Board of Directors:

David Denison
Chair

Philip Orsino
Chair, Audit Committee

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
For the years ended December 31, 2016 and 2015

Year ended December 31, 2016 *(millions of Canadian dollars)*	Common Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Hydro One Shareholder's Equity	Non-controlling Interest *(Note 25)*	Total Equity
January 1, 2016	6,000	3,759	(9)	9,750	52	9,802
Net income	–	730	–	730	4	734
Other comprehensive income	–	–	–	–	–	–
Distributions to noncontrolling interest	–	–	–	–	(6)	(6)
Dividends on common shares	–	(2)	–	(2)	–	(2)
Return of stated capital *(Note 21)*	(609)	–	–	(609)	–	(609)
December 31, 2016	**5,391**	**4,487**	**(9)**	**9,869**	**50**	**9,919**

Year ended December 31, 2015 *(millions of Canadian dollars)*	Common Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Hydro One Shareholder's Equity	Non-controlling Interest *(Note 25)*	Total Equity
January 1, 2015	3,314	4,249	(9)	7,554	49	7,603
Net income	–	692	–	692	7	699
Other comprehensive income	–	–	–	–	–	–
Distributions to noncontrolling interest	–	–	–	–	(4)	(4)
Dividends on preferred shares	–	(13)	–	(13)	–	(13)
Dividends on common shares	–	(875)	–	(875)	–	(875)
Common shares issued *(Note 21)*	2,923	–	–	2,923	–	2,923
Hydro One Brampton spin-off *(Note 4)*	(196)	(258)	–	(454)	–	(454)
Hydro One Telecom and MBSI spin-offs *(Note 4)*	(41)	(36)	–	(77)	–	(77)
December 31, 2015	**6,000**	**3,759**	**(9)**	**9,750**	**52**	**9,802**

See accompanying notes to Consolidated Financial Statements.

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, 2016 and 2015

Year ended December 31 *(millions of Canadian dollars)*	2016	2015
Operating activities		
Net income	736	702
Environmental expenditures	(20)	(19)
Adjustments for non-cash items:		
Depreciation and amortization (excluding removal costs)	679	667
Regulatory assets and liabilities	(16)	(3)
Deferred income taxes *(Note 7)*	111	(2,817)
Other	10	24
Changes in non-cash balances related to operations *(Note 27)*	168	192
Net cash from (used in) operating activities	1,668	(1,254)
Financing activities		
Long-term debt issued	2,300	350
Long-term debt repaid	(502)	(585)
Short-term notes issued	3,031	2,891
Short-term notes repaid	(4,053)	(1,400)
Common shares issued	–	2,600
Return of stated capital	(609)	–
Dividends paid	(2)	(888)
Distributions paid to noncontrolling interest	(9)	(5)
Change in bank indebtedness	–	(2)
Other	(10)	(7)
Net cash from financing activities	146	2,954
Investing activities		
Capital expenditures *(Note 27)*		
Property, plant and equipment	(1,594)	(1,594)
Intangible assets	(61)	(37)
Capital contributions received *(Note 27)*	21	57
Acquisitions *(Note 4)*	(224)	(90)
Investment in Hydro One Brampton *(Note 4)*	–	(53)
Other	3	6
Net cash used in investing activities	(1,855)	(1,711)
Net change in cash and cash equivalents	(41)	(11)
Cash and cash equivalents, beginning of year	89	100
Cash and cash equivalents, end of year	**48**	**89**

See accompanying notes to Consolidated Financial Statements.

1. DESCRIPTION OF THE BUSINESS

Hydro One Inc. (Hydro One or the Company) was incorporated on December 1, 1998, under the *Business Corporations Act* (Ontario) and is wholly owned by Hydro One Limited.

On October 31, 2015, Hydro One Limited, a subsidiary of the Province of Ontario (Province), acquired Hydro One. The principal businesses of Hydro One are the transmission and distribution of electricity to customers within Ontario.

In November 2015, Hydro One Limited and the Province completed an initial public offering (IPO) on the Toronto Stock Exchange. See note 21 for further details regarding the reorganization of Hydro One.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation

These Consolidated Financial Statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances have been eliminated.

Basis of Accounting

These Consolidated Financial Statements are prepared and presented in accordance with United States (US) Generally Accepted Accounting Principles (GAAP) and in Canadian dollars.

Use of Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains and losses during the reporting periods. Management evaluates these estimates on an ongoing basis based upon historical experience, current conditions, and assumptions believed to be reasonable at the time the assumptions are made, with any adjustments being recognized in results of operations in the period they arise. Significant estimates relate to regulatory assets and regulatory liabilities, environmental liabilities, pension benefits, post-retirement and post-employment benefits, asset retirement obligations, goodwill and asset impairments, contingencies, unbilled revenues, allowance for doubtful accounts, derivative instruments, and deferred income tax assets and liabilities. Actual results may differ significantly from these estimates.

Rate Setting

The Company's Transmission Business includes the transmission business of Hydro One Networks Inc. (Hydro One Networks), Hydro One Sault Ste. Marie LP (previously Great Lakes Power Transmission LP (Great Lakes Power)), and its 66% interest in B2M Limited Partnership (B2M LP). The Company's Distribution Business includes the distribution businesses of Hydro One Networks, as well as Hydro One Remote Communities Inc. (Hydro One Remote Communities).

<u>Transmission</u>

In November 2015, the OEB approved Hydro One Networks' 2016 transmission rates revenue requirement of $1,480 million.

In December 2015, the OEB approved B2M LP's 2015-2019 rates revenue requirements of $39 million, $36 million, $37 million, $38 million and $37 million for the respective years. On January 14, 2016, the OEB approved the B2M LP revenue requirement recovery through the 2016 Uniform Transmission Rates, and the establishment of a deferral account to capture costs of Tax Rate and Rule changes.

<u>Distribution</u>

In March 2015, the OEB approved Hydro One Networks' distribution revenue requirements of $1,326 million for 2015, $1,430 million for 2016 and $1,486 million for 2017. The OEB has subsequently approved updated revenue requirements of $1,410 million for 2016 and $1,415 million for 2017.

On March 17, 2016, the OEB approved an increase of 2.10% to Hydro One Remote Communities' basic rates for the distribution and generation of electricity, with an effective date of May 1, 2016.

Regulatory Accounting

The OEB has the general power to include or exclude revenues, costs, gains or losses in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have been applied in an unregulated company. Such change in timing involves the application of rate-regulated accounting, giving rise to the recognition of regulatory assets and liabilities. The Company's regulatory assets represent certain amounts receivable from future customers and costs that have been deferred for accounting purposes because it is probable that they will be recovered in future rates. In addition, the Company has recorded regulatory liabilities that generally represent amounts that are refundable to future customers. The Company continually assesses the likelihood of recovery of each of its regulatory assets and continues to believe that it is probable that the OEB will include its regulatory assets and liabilities in setting of future rates. If, at some future date, the Company judges that it is no longer probable that the OEB will include a regulatory asset or liability in setting future rates, the appropriate carrying amount would be reflected in results of operations in the period that the assessment is made.

Cash and Cash Equivalents

Cash and cash equivalents include cash and short-term investments with an original maturity of three months or less.

Revenue Recognition

Transmission revenues are collected through OEB-approved rates, which are based on an approved revenue requirement that includes a rate of return. Such revenue is recognized as electricity is transmitted and delivered to customers.

Distribution revenues attributable to the delivery of electricity are based on OEB-approved distribution rates and are recognized on an accrual basis and include billed and unbilled revenues. Billed revenues are based on electricity delivered as measured from customer meters. At the end of each month, electricity delivered to customers since the date of the last billed meter reading is estimated, and the corresponding unbilled revenue is recorded. The unbilled revenue estimate is affected by energy consumption, weather, and changes in the composition of customer classes.

Distribution revenue also includes an amount relating to rate protection for rural, residential, and remote customers, which is received from the Independent Electricity System Operator (IESO) based on a standardized customer rate that is approved by the OEB.

Revenues also include amounts related to sales of other services and equipment. Such revenue is recognized as services are rendered or as equipment is delivered.

Revenues are recorded net of indirect taxes.

Accounts Receivable and Allowance for Doubtful Accounts

Billed accounts receivable are recorded at the invoiced amount, net of allowance for doubtful accounts. Unbilled accounts receivable are recorded at their estimated value. Overdue amounts related to regulated billings bear interest at OEB-approved rates. The allowance for doubtful accounts reflects the Company's best estimate of losses on billed accounts receivable balances. The Company estimates the allowance for doubtful accounts on billed accounts receivable by applying internally developed loss rates to the outstanding receivable balances by aging category. Loss rates applied to the billed accounts receivable balances are based on historical overdue balances, customer payments and write-offs. Accounts receivable are written-off against the allowance when they are deemed uncollectible. The allowance for doubtful accounts is affected by changes in volume, prices and economic conditions.

Noncontrolling interest

Noncontrolling interest represents the portion of equity ownership in subsidiaries that is not attributable to shareholders of Hydro One. Noncontrolling interest is initially recorded at fair value and subsequently the amount is adjusted for the proportionate share of net income and other comprehensive income attributable to the noncontrolling interest and any dividends or distributions paid to the noncontrolling interest.

If a transaction results in the acquisition of all, or part, of a noncontrolling interest in a subsidiary, the acquisition of the noncontrolling interest is accounted for as an equity transaction. No gain or loss is recognized in consolidated net income or comprehensive income as a result of changes in the noncontrolling interest, unless a change results in the loss of control by the Company.

Income Taxes

Prior to the IPO of Hydro One Limited, Hydro One was exempt from tax under the *Income Tax Act* (Canada) and the *Taxation Act, 2007* (Ontario) (Federal Tax Regime). However, under the *Electricity Act*, Hydro One was required to make payments in lieu of tax (PILs) to the Ontario Electricity Financial Corporation (OEFC) (PILs Regime). The PILs were, in general, based on the amount of tax that Hydro One would otherwise be liable to pay under the Federal Tax Regime if it was not exempt from taxes under those statutes. In connection with the IPO of Hydro One Limited, Hydro One's exemption from tax under the

Federal Tax Regime ceased to apply. Upon exiting the PILs Regime, Hydro One is required to make corporate income tax payments to the Canada Revenue Agency (CRA) under the Federal Tax Regime.

Current and deferred income taxes are computed based on the tax rates and tax laws enacted as at the balance sheet date. Tax benefits associated with income tax positions taken, or expected to be taken, in a tax return are recorded only when the "more-likely-than-not" recognition threshold is satisfied and are measured at the largest amount of benefit that has a greater than 50% likelihood of being realized upon settlement. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. Significant management judgment is required to determine recognition thresholds and the related amount of tax benefits to be recognized in the Consolidated Financial Statements. Management re-evaluates tax positions each period using new information about recognition or measurement as it becomes available.

Deferred Income Taxes

Deferred income taxes are provided for using the liability method. Deferred income taxes are recognized based on the estimated future tax consequences attributable to temporary differences between the carrying amount of assets and liabilities in the Consolidated Financial Statements and their corresponding tax bases.

Deferred income tax liabilities are recognized on all taxable temporary differences. Deferred tax assets are recognized to the extent that it is more-likely-than-not that these assets will be realized from taxable income available against which deductible temporary differences can be utilized.

Deferred income taxes are calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized, based on the tax rates and tax laws that have been enacted as at the balance sheet date. Deferred income taxes that are not included in the rate-setting process are charged or credited to the Consolidated Statements of Operations and Comprehensive Income.

If management determines that it is more-likely-than-not that some or all of a deferred income tax asset will not be realized, a valuation allowance is recorded against the deferred income tax asset to report the net balance at the amount expected to be realized. Previously unrecognized deferred income tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become more-likely-than-not that the tax benefit will be realized.

The Company records regulatory assets and liabilities associated with deferred income taxes that will be included in the rate-setting process.

The Company uses the flow-through method to account for investment tax credits (ITCs) earned on eligible scientific research and experimental development expenditures, and apprenticeship job creation. Under this method, only non-refundable ITCs are recognized as a reduction to income tax expense.

Materials and Supplies

Materials and supplies represent consumables, small spare parts and construction materials held for internal construction and maintenance of property, plant and equipment. These assets are carried at average cost less any impairments recorded.

Property, Plant and Equipment

Property, plant and equipment is recorded at original cost, net of customer contributions, and any accumulated impairment losses. The cost of additions, including betterments and replacement asset components, is included on the Consolidated Balance Sheets as property, plant and equipment.

The original cost of property, plant and equipment includes direct materials, direct labour (including employee benefits), contracted services, attributable capitalized financing costs, asset retirement costs, and direct and indirect overheads that are related to the capital project or program. Indirect overheads include a portion of corporate costs such as finance, treasury, human resources, information technology and executive costs. Overhead costs, including corporate functions and field services costs, are capitalized on a fully allocated basis, consistent with an OEB-approved methodology.

Property, plant and equipment in service consists of transmission, distribution, communication, administration and service assets and land easements. Property, plant and equipment also includes future use assets, such as land, major components and spare parts, and capitalized project development costs associated with deferred capital projects.

Transmission

Transmission assets include assets used for the transmission of high-voltage electricity, such as transmission lines, support structures, foundations, insulators, connecting hardware and grounding systems, and assets used to step up the voltage of electricity from generating stations for transmission and to step down voltages for distribution, including transformers, circuit breakers and switches.

Distribution

Distribution assets include assets related to the distribution of low-voltage electricity, including lines, poles, switches, transformers, protective devices and metering systems.

Communication

Communication assets include fibre optic and microwave radio systems, optical ground wire, towers, telephone equipment and associated buildings.

Administration and Service

Administration and service assets include administrative buildings, personal computers, transport and work equipment, tools and other minor assets.

Easements

Easements include statutory rights of use for transmission corridors and abutting lands granted under the *Reliable Energy and Consumer Protection Act, 2002*, as well as other land access rights.

Intangible Assets

Intangible assets separately acquired or internally developed are measured on initial recognition at cost, which comprises purchased software, direct labour (including employee benefits), consulting, engineering, overheads and attributable capitalized financing charges. Following initial recognition, intangible assets are carried at cost, net of any accumulated amortization and accumulated impairment losses. The Company's intangible assets primarily represent major computer applications.

Capitalized Financing Costs

Capitalized financing costs represent interest costs attributable to the construction of property, plant and equipment or development of intangible assets. The financing cost of attributable borrowed funds is capitalized as part of the acquisition cost of such assets. The capitalized financing costs are a reduction of financing charges recognized in the Consolidated Statements of Operations and Comprehensive Income. Capitalized financing costs are calculated using the Company's weighted average effective cost of debt.

Construction and Development in Progress

Construction and development in progress consists of the capitalized cost of constructed assets that are not yet complete and which have not yet been placed in service.

Depreciation and Amortization

The cost of property, plant and equipment and intangible assets is depreciated or amortized on a straight-line basis based on the estimated remaining service life of each asset category, except for transport and work equipment, which is depreciated on a declining balance basis.

The Company periodically initiates an external independent review of its property, plant and equipment and intangible asset depreciation and amortization rates, as required by the OEB. Any changes arising from OEB approval of such a review are implemented on a remaining service life basis, consistent with their inclusion in electricity rates. The last review resulted in changes to rates effective January 1, 2015. A summary of average service lives and depreciation and amortization rates for the various classes of assets is included below:

	Average Service Life	Rate	
		Range	Average
Property, plant and equipment:			
Transmission	56 years	1% – 3%	2%
Distribution	46 years	1% – 7%	2%
Communication	16 years	1% – 15%	6%
Administration and service	18 years	1% – 20%	7%
Intangible assets	10 years	10%	10%

In accordance with group depreciation practices, the original cost of property, plant and equipment, or major components thereof, and intangible assets that are normally retired, is charged to accumulated depreciation, with no gain or loss being reflected in results of operations. Where a disposition of property, plant and equipment occurs through sale, a gain or loss is calculated based on proceeds and such gain or loss is included in depreciation expense.

Acquisitions and Goodwill

The Company accounts for business acquisitions using the acquisition method of accounting and, accordingly, the assets and liabilities of the acquired entities are primarily measured at their estimated fair value at the date of acquisition. Goodwill represents the cost of acquired companies that is in excess of the fair value of the net identifiable assets acquired at the acquisition date. Goodwill is not included in rate base.

Goodwill is evaluated for impairment on an annual basis, or more frequently if circumstances require. The Company performs a qualitative assessment to determine whether it is more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount. If the Company determines, as a result of its qualitative assessment, that it is not more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount, no further testing is required. If the Company determines, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount, a goodwill impairment assessment is performed using a two-step, fair value-based test. The first step compares the fair value of the applicable reporting unit to its carrying amount, including goodwill. If the carrying amount of the applicable reporting unit exceeds its fair value, a second step is performed. The second step requires an allocation of fair value to the individual assets and liabilities using purchase price allocation in order to determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount, an impairment loss is recorded as a reduction to goodwill and as a charge to results of operations.

For the year ended December 31, 2016, based on the qualitative assessment performed as at September 30, 2016, the Company has determined that it is not more-likely-than-not that the fair value of each applicable reporting unit assessed is less than its carrying amount. As a result, no further testing was performed, and the Company has concluded that goodwill was not impaired at December 31, 2016.

Long-Lived Asset Impairment

When circumstances indicate the carrying value of long-lived assets may not be recoverable, the Company evaluates whether the carrying value of such assets, excluding goodwill, has been impaired. For such long-lived assets, the Company evaluates whether impairment may exist by estimating future estimated undiscounted cash flows expected to result from the use and eventual disposition of the asset. When alternative courses of action to recover the carrying amount of a long-lived asset are under consideration, a probability-weighted approach is used to develop estimates of future undiscounted cash flows. If the carrying value of the long-lived asset is not recoverable based on the estimated future undiscounted cash flows, an impairment loss is recorded, measured as the excess of the carrying value of the asset over its fair value. As a result, the asset's carrying value is adjusted to its estimated fair value.

Within its regulated business, the carrying costs of most of Hydro One's long-lived assets are included in rate base where they earn an OEB-approved rate of return. Asset carrying values and the related return are recovered through approved rates. As a result, such assets are only tested for impairment in the event that the OEB disallows recovery, in whole or in part, or if such a disallowance is judged to be probable. As at December 31, 2016 and 2015, no asset impairment had been recorded.

Costs of Arranging Debt Financing

For financial liabilities classified as other than held-for-trading, the Company defers the external transaction costs related to obtaining debt financing and presents such amounts net of related debt on the Consolidated Balance Sheets. Deferred debt issuance costs are amortized over the contractual life of the related debt on an effective-interest basis and the amortization is included within financing charges in the Consolidated Statements of Operations and Comprehensive Income. Transaction costs for items classified as held-for-trading are expensed immediately.

Comprehensive Income

Comprehensive income is comprised of net income and other comprehensive income (OCI). Hydro One presents net income and OCI in a single continuous Consolidated Statement of Operations and Comprehensive Income.

Financial Assets and Liabilities

All financial assets and liabilities are classified into one of the following five categories: held-to-maturity; loans and receivables; held-for-trading; other liabilities; or available-for-sale. Financial assets and liabilities classified as held-for-trading are measured at fair value. All other financial assets and liabilities are measured at amortized cost, except accounts receivable and amounts due from related parties, which are measured at the lower of cost or fair value. Accounts receivable and amounts due from related parties are classified as loans and receivables. The Company considers the carrying amounts of accounts receivable and amounts due from related parties to be reasonable estimates of fair value because of the short time to maturity of these instruments. Provisions for impaired accounts receivable are recognized as adjustments to the allowance for doubtful accounts and are recognized when there is objective evidence that the Company will not be able to collect amounts according to the original terms. All financial instrument transactions are recorded at trade date.

Derivative instruments are measured at fair value. Gains and losses from fair valuation are included within financing charges in the period in which they arise. The Company determines the classification of its financial assets and liabilities at the date of initial recognition. The Company designates certain of its financial assets and liabilities to be held at fair value, when it is consistent with the Company's risk management policy disclosed in Note 16 – Fair Value of Financial Instruments and Risk Management.

Derivative Instruments and Hedge Accounting

The Company closely monitors the risks associated with changes in interest rates on its operations and, where appropriate, uses various instruments to hedge these risks. Certain of these derivative instruments qualify for hedge accounting and are designated as accounting hedges, while others either do not qualify as hedges or have not been designated as hedges (hereinafter referred to as undesignated contracts) as they are part of economic hedging relationships.

The accounting guidance for derivative instruments requires the recognition of all derivative instruments not identified as meeting the normal purchase and sale exemption as either assets or liabilities recorded at fair value on the Consolidated Balance Sheets. For derivative instruments that qualify for hedge accounting, the Company may elect to designate such derivative instruments as either cash flow hedges or fair value hedges. The Company offsets fair value amounts recognized on its Consolidated Balance Sheets related to derivative instruments executed with the same counterparty under the same master netting agreement.

For derivative instruments that qualify for hedge accounting and which are designated as cash flow hedges, the effective portion of any gain or loss, net of tax, is reported as a component of accumulated OCI (AOCI) and is reclassified to results of operations in the same period or periods during which the hedged transaction affects results of operations. Any gains or losses on the derivative instrument that represent either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in results of operations. For fair value hedges, changes in fair value of both the derivative instrument and the underlying hedged exposure are recognized in the Consolidated Statements of Operations and Comprehensive Income in the current period. The gain or loss on the derivative instrument is included in the same line item as the offsetting gain or loss on the hedged item in the Consolidated Statements of Operations and Comprehensive Income. The changes in fair value of the undesignated derivative instruments are reflected in results of operations.

Embedded derivative instruments are separated from their host contracts and are carried at fair value on the Consolidated Balance Sheets when: (a) the economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract; (b) the hybrid instrument is not measured at fair value, with changes in fair value recognized in results of operations each period; and (c) the embedded derivative itself meets the definition of a derivative. The Company does not engage in derivative trading or speculative activities and had no embedded derivatives at December 31, 2016 or 2015.

Hydro One periodically develops hedging strategies taking into account risk management objectives. At the inception of a hedging relationship where the Company has elected to apply hedge accounting, Hydro One formally documents the relationship between the hedged item and the hedging instrument, the related risk management objective, the nature of the specific risk exposure being hedged, and the method for assessing the effectiveness of the hedging relationship. The Company also assesses, both at the inception of the hedge and on a quarterly basis, whether the hedging instruments are effective in offsetting changes in fair values or cash flows of the hedged items.

Employee Future Benefits

Employee future benefits provided by Hydro One include pension, post-retirement and post-employment benefits. The costs of the Company's pension, post-retirement and post-employment benefit plans are recorded over the periods during which employees render service.

The Company recognizes the funded status of its defined benefit pension, post-retirement and post-employment plans on its Consolidated Balance Sheets and subsequently recognizes the changes in funded status at the end of each reporting year. Defined benefit pension, post-retirement and post-employment plans are considered to be underfunded when the projected benefit obligation exceeds the fair value of the plan assets. Liabilities are recognized on the Consolidated Balance Sheets for any net underfunded projected benefit obligation. The net underfunded projected benefit obligation may be disclosed as a current liability, long-term liability, or both. The current portion is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next 12 months exceeds the fair value of plan assets. If the fair value of plan assets exceeds the projected benefit obligation of the plan, an asset is recognized equal to the net overfunded projected benefit obligation. The post-retirement and post-employment benefit plans are unfunded because there are no related plan assets.

Hydro One recognizes its contributions to the defined contribution pension plan as pension expense, with a portion being capitalized as part of labour costs included in capital expenditures. The expensed amount is included in operation, maintenance and administration costs in the Consolidated Statements of Operations and Comprehensive Income.

Defined Benefit Pension

Defined benefit pension costs are recorded on an accrual basis for financial reporting purposes. Pension costs are actuarially determined using the projected benefit method prorated on service and are based on assumptions that reflect management's best estimate of the effect of future events, including future compensation increases. Past service costs from plan amendments and all actuarial gains and losses are amortized on a straight-line basis over the expected average remaining service period of active employees in the plan, and over the estimated remaining life expectancy of inactive employees in the plan. Pension plan assets, consisting primarily of listed equity securities as well as corporate and government debt securities, are fair valued at the end of each year. Hydro One records a regulatory asset equal to the net underfunded projected benefit obligation for its pension plan.

Post-retirement and Post-employment Benefits

Post-retirement and post-employment benefits are recorded and included in rates on an accrual basis. Costs are determined by independent actuaries using the projected benefit method prorated on service and based on assumptions that reflect management's best estimates. Past service costs from plan amendments are amortized to results of operations based on the expected average remaining service period.

For post-retirement benefits, all actuarial gains or losses are deferred using the "corridor" approach. The amount calculated above the "corridor" is amortized to results of operations on a straight-line basis over the expected average remaining service life of active employees in the plan and over the remaining life expectancy of inactive employees in the plan. The post-retirement benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment.

For post-employment obligations, the associated regulatory liabilities representing actuarial gains on transition to US GAAP are amortized to results of operations based on the "corridor" approach. The actuarial gains and losses on post-employment obligations that are incurred during the year are recognized immediately to results of operations. The post-employment benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment.

All post-retirement and post-employment future benefit costs are attributed to labour and are either charged to results of operations or capitalized as part of the cost of property, plant and equipment and intangible assets.

Stock-Based Compensation

Share Grant Plans

Hydro One measures share grant plans based on fair value of share grants as estimated based on the grant date Hydro One Limited's share price. The costs are recognized in the financial statements using the graded-vesting attribution method for share grant plans that have both a performance condition and a service condition. The Company records a regulatory asset equal to the accrued costs of share grant plans recognized in each period. Forfeitures are recognized as they occur (see note 3).

Directors' Deferred Share Unit (DSU) Plan

The Company records the liabilities associated with its Directors' DSU Plan at fair value at each reporting date until settlement, recognizing compensation expense over the vesting period on a straight-line basis. The fair value of the DSU liability is based on Hydro One Limited's common share closing price at the end of each reporting period.

Long-term Incentive Plan (LTIP)

The Company measures its LTIP at fair value based on the grant date share price of Hydro One Limited's common shares. The related compensation expense of Hydro One is recognized over the vesting period on a straight-line basis. Forfeitures are recognized as they occur.

Loss Contingencies

Hydro One is involved in certain legal and environmental matters that arise in the normal course of business. In the preparation of its Consolidated Financial Statements, management makes judgments regarding the future outcome of contingent events and records a loss for a contingency based on its best estimate when it is determined that such loss is probable and the amount of the loss can be reasonably estimated. Where the loss amount is recoverable in future rates, a regulatory asset is also recorded. When a range estimate for the probable loss exists and no amount within the range is a better estimate than any other amount, the Company records a loss at the minimum amount within the range.

Management regularly reviews current information available to determine whether recorded provisions should be adjusted and whether new provisions are required. Estimating probable losses may require analysis of multiple forecasts and scenarios that often depend on judgments about potential actions by third parties, such as federal, provincial and local courts or regulators. Contingent liabilities are often resolved over long periods of time. Amounts recorded in the Consolidated Financial Statements may differ from the actual outcome once the contingency is resolved. Such differences could have a material impact on future results of operations, financial position and cash flows of the Company.

Provisions are based upon current estimates and are subject to greater uncertainty where the projection period is lengthy. A significant upward or downward trend in the number of claims filed, the nature of the alleged injuries, and the average cost of resolving each claim could change the estimated provision, as could any substantial adverse or favourable verdict at trial. A federal or provincial legislative outcome or structured settlement could also change the estimated liability. Legal fees are expensed as incurred.

Environmental Liabilities

Environmental liabilities are recorded in respect of past contamination when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated. Hydro One records a liability for the estimated future expenditures associated with contaminated land assessment and remediation and for the phase-out and destruction of polychlorinated biphenyl (PCB)-contaminated mineral oil removed from electrical equipment, based on the present value of these estimated future expenditures. The Company determines the present value with a discount rate equal to its credit-adjusted risk-free interest rate on financial instruments with comparable maturities to the pattern of future environmental expenditures. As the Company anticipates that the future expenditures will continue to be recoverable in future rates, an offsetting regulatory asset has been recorded to reflect the future recovery of these environmental expenditures from customers. Hydro One reviews its estimates of future environmental expenditures annually, or more frequently if there are indications that circumstances have changed.

Asset Retirement Obligations

Asset retirement obligations are recorded for legal obligations associated with the future removal and disposal of long-lived assets. Such obligations may result from the acquisition, construction, development and/or normal use of the asset. Conditional asset retirement obligations are recorded when there is a legal obligation to perform a future asset retirement activity but where the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Company. In such a case, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement.

When recording an asset retirement obligation, the present value of the estimated future expenditures required to complete the asset retirement activity is recorded in the period in which the obligation is incurred, if a reasonable estimate can be made. In general, the present value of the estimated future expenditures is added to the carrying amount of the associated asset and the resulting asset retirement cost is depreciated over the estimated useful life of the asset. Where an asset is no longer in service when an asset retirement obligation is recorded, the asset retirement cost is recorded in results of operations.

Some of the Company's transmission and distribution assets, particularly those located on unowned easements and rights-of-way, may have asset retirement obligations, conditional or otherwise. The majority of the Company's easements and rights-of-way are either of perpetual duration or are automatically renewed annually. Land rights with finite terms are generally subject to extension or renewal. As the Company expects to use the majority of its facilities in perpetuity, no asset retirement obligations have been recorded for these assets. If, at some future date, a particular facility is shown not to meet the perpetuity assumption, it will be reviewed to determine whether an estimable asset retirement obligation exists. In such a case, an asset retirement obligation would be recorded at that time.

The Company's asset retirement obligations recorded to date relate to estimated future expenditures associated with the removal and disposal of asbestos-containing materials installed in some of its facilities and with the decommissioning of specific switching stations located on unowned sites.

3. NEW ACCOUNTING PRONOUNCEMENTS

The following tables present Accounting Standards Updates (ASUs) issued by the Financial Accounting Standards Board (FASB) that are applicable to Hydro One:

Recently Adopted Accounting Guidance

ASU	Date issued	Description	Effective date	Impact on Hydro One
2014-16	November 2014	This update clarifies that all relevant terms and features should be considered in evaluating the nature of a host contract for hybrid financial instruments issued in the form of a share. The nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument.	January 1, 2016	No material impact upon adoption
2015-01	January 2015	Extraordinary items are no longer required to be presented separately in the income statement.	January 1, 2016	No material impact upon adoption
2015-02	February 2015	Guidance on analysis to be performed to determine whether certain types of legal entities should be consolidated.	January 1, 2016	No material impact upon adoption

2015-03	April 2015	Debt issuance costs are required to be presented on the balance sheet as a direct deduction from the carrying amount of the related debt liability consistent with debt discounts or premiums.	January 1, 2016	Reclassification of deferred debt issuance costs and net unamortized debt premiums as an offset to long-term debt. Applied retrospectively (see note 15).
2015-05	April 2015	Cloud computing arrangements that have been assessed to contain a software licence should be accounted for as internal-use software.	January 1, 2016	No material impact upon adoption
2015-16	September 2015	Adjustments to provisional amounts that are identified during the measurement period of a business combination in the reporting period in which the adjustment amount is determined are required to be recognized. The amount recorded in current period earnings are required to be presented separately on the face of the income statement or disclosed in the notes by line item.	January 1, 2016	No material impact upon adoption
2015-17	November 2015	All deferred tax assets and liabilities are required to be classified as noncurrent on the balance sheet.	January 1, 2017	This ASU was early adopted as of April 1, 2016 and was applied prospectively. As a result, the current portions of the Company's deferred income tax assets are reclassified as noncurrent assets on the consolidated Balance Sheet. Prior periods were not retrospectively adjusted (see note 7).
2016-09	March 2016	Several aspects of the accounting for share-based payment transactions were simplified, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows.	January 1, 2017	This ASU was early adopted as of October 1, 2016 and was applied retrospectively. As a result, the Company accounts for forfeitures as they occur. There were no other material impacts upon adoption.

Recently Issued Accounting Guidance Not Yet Adopted

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2014-09 2015-14 2016-08 2016-10 2016-12 2016-20	May 2014 – December 2016	ASU 2014-09 was issued in May 2014 and provides guidance on revenue recognition relating to the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. ASU 2015-14 deferred the effective date of ASU 2014-09 by one year. Additional ASUs were issued in 2016 that simplify transition and provide clarity on certain aspects of the new standard.	January 1, 2018	Hydro One has completed its initial assessment and has identified relevant revenue streams. No quantitative determination has been made as a detailed assessment is now underway and will continue through to the third quarter of 2017, with the end result being a determination of the financial impact of this standard. The Company is on track for implementation of this standard by the effective date.
2016-01	January 2016	This update requires equity investments to be measured at fair value with changes in fair value recognized in net income, and requires enhanced disclosures and presentation of financial assets and liabilities in the financial statements. This ASU also simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment.	January 1, 2018	Under assessment
2016-02	February 2016	Lessees are required to recognize the rights and obligations resulting from operating leases as assets (right to use the underlying asset for the term of the lease) and liabilities (obligation to make future lease payments) on the balance sheet.	January 1, 2019	An initial assessment is currently underway encompassing a review of all existing leases, which will be followed by a detailed review of relevant contracts. No quantitative determination has been made at this time. The Company is on track for implementation of this standard by the effective date.
2016-05	March 2016	The amendments clarify that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require de-designation of that hedging relationship provided that all other hedge accounting criteria continue to be met.	January 1, 2018	Under assessment

2016-06	March 2016	Contingent call (put) options that are assessed to accelerate the payment of principal on debt instruments need to meet the criteria of being "clearly and closely related" to their debt hosts.	January 1, 2017	No material impact
2016-07	March 2016	The requirement to retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in the level of ownership or degree of influence has been eliminated.	January 1, 2017	No material impact
2016-11	May 2016	This amendment covers the SEC Staff's rescinding of certain SEC Staff observer comments that are codified in Topic 605 and Topic 932, effective upon the adoption of Topic 606 and Topic 815, effective to coincide with the effective date of Update 2014-16.	January 1, 2019	No material impact
2016-13	June 2016	The amendment provides users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date.	January 1, 2019	Under assessment
2016-15	August 2016	The amendments provide guidance for eight specific cash flow issues with the objective of reducing the existing diversity in practice.	January 1, 2018	Under assessment
2016-16	October 2016	The amendment eliminates the prohibition of recognizing current and deferred income taxes for an intra-entity asset transfer, other than inventory, until the asset has been sold to an outside party. The amendment will permit income tax consequences of such transfers to be recognized when the transfer occurs.	January 1, 2018	Under assessment
2016-18	November 2016	The amendment requires that restricted cash or restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning and end-of-period balances in the statement of cash flows.	January 1, 2018	Under assessment
2017-01	January 2017	The amendment clarifies the definition of a business and provides additional guidance on evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses.	January 1, 2018	Under assessment

4. BUSINESS COMBINATIONS

Acquisition of Great Lakes Power

On October 31, 2016, Hydro One acquired Great Lakes Power, an Ontario regulated electricity transmission business operating along the eastern shore of Lake Superior, north and east of Sault Ste. Marie, Ontario from Brookfield Infrastructure Holdings Inc. The total purchase price for Great Lakes Power was approximately $376 million, including the assumption of approximately $150 million in outstanding indebtedness. The following table summarizes the determination of the final fair value of the assets acquired and liabilities assumed:

(millions of dollars)	
Cash and cash equivalents	5
Property, plant and equipment	221
Intangible assets	1
Regulatory assets	50
Goodwill	159
Working capital	(2)
Long-term debt	(186)
Pension and post-employment benefit liabilities, net	(5)
Deferred income taxes	(17)
	226

Goodwill of approximately $159 million arising from the Great Lakes Power acquisition consists largely of the synergies and economies of scale expected from combining the operations of Hydro One and Great Lakes Power. Great Lakes Power contributed revenues of $6 million and less than $1 million of net income to the Company's consolidated financial results for the year ended December 31, 2016. All costs related to the acquisition have been expensed through the Consolidated Statements of Operations and Comprehensive Income. Great Lakes Power's financial information is not material to the Company's consolidated financial results for the year ended December 31, 2016 and therefore, has not been disclosed on a pro forma basis. On January 16, 2017, the name of Great Lakes Power was changed to Hydro One Sault Ste. Marie LP.

Agreement to Purchase Orillia Power

On August 15, 2016, the Company reached an agreement to acquire Orillia Power Distribution Corporation (Orillia Power), an electricity distribution company located in Simcoe County, Ontario, from the City of Orillia for approximately $41 million, including the assumption of approximately $15 million in outstanding indebtedness and regulatory liabilities, subject to closing adjustments. The acquisition is subject to regulatory approval by the OEB.

Acquisition of Woodstock Hydro

On October 31, 2015, Hydro One acquired Woodstock Hydro Holdings Inc. (Woodstock Hydro), an electricity distribution company located in southwestern Ontario. The total purchase price for Woodstock Hydro was approximately $32 million. The purchase price was finalized and the Company made the final purchase price payment of $3 million in 2016. The following table summarizes the determination of the fair value of the assets acquired and liabilities assumed:

(millions of dollars)	
Working capital	4
Property, plant and equipment	27
Intangible assets	1
Deferred income tax assets	2
Goodwill	22
Long-term debt	(17)
Derivative instruments	(3)
Post-retirement and post-employment benefit liability	(1)
Regulatory liabilities	(1)
Other long-term liabilities	(2)
	32

Goodwill of approximately $22 million arising from the Woodstock Hydro acquisition consists largely of the synergies and economies of scale expected from combining the operations of Hydro One and Woodstock Hydro. All of the goodwill was assigned to Hydro One's Distribution Business segment. Woodstock Hydro contributed revenues of $12 million and net income of $2 million to the Company's consolidated financial results for the year ended December 31, 2015. All costs related to the acquisition have been expensed through the Consolidated Statements of Operations and Comprehensive Income. Woodstock Hydro's financial information is not material to the Company's consolidated financial results for the year ended December 31, 2015 and therefore, has not been disclosed on a pro forma basis.

Acquisition of Haldimand Hydro

On June 30, 2015, Hydro One acquired Haldimand County Utilities Inc. (Haldimand Hydro), an electricity distribution company located in southwestern Ontario. The total purchase price for Haldimand Hydro was approximately $73 million. The purchase price was finalized in 2016. The following table summarizes the determination of the fair value of the assets acquired and liabilities assumed:

(millions of dollars)	
Cash and cash equivalents	3
Working capital	5
Property, plant and equipment	52
Deferred income tax assets	1
Goodwill	33
Long-term debt	(18)
Regulatory liabilities	(3)
	73

Goodwill of approximately $33 million arising from the Haldimand Hydro acquisition consists largely of the synergies and economies of scale expected from combining the operations of Hydro One and Haldimand Hydro. All of the goodwill was assigned to Hydro One's Distribution Business segment. Haldimand Hydro contributed revenues of $32 million and net income of $6 million to the Company's consolidated financial results for the year ended December 31, 2015. All costs related to the acquisition have been expensed through the Consolidated Statements of Operations and Comprehensive Income. Haldimand Hydro's financial information is not material to the Company's consolidated financial results for the year ended December 31, 2015 and therefore, has not been disclosed on a pro forma basis.

Hydro One Brampton Spin-off

On August 31, 2015, Hydro One completed the spin-off of its subsidiary, Hydro One Brampton. The spin-off was accounted as a non-monetary, nonreciprocal transfer with the Province, based on its carrying values at August 31, 2015. Transactions that immediately preceded the spin-off as well as the spin-off were as follows:

- Hydro One subscribed for 357 common shares of Hydro One Brampton for an aggregate subscription price of $53 million; and
- Hydro One transferred to a company wholly owned by the Province all the issued and outstanding shares of Hydro One Brampton as a dividend-in-kind; and all of the long-term intercompany debt in aggregate principal amount of $193 million plus accrued interest of $3 million owed by Hydro One Brampton to Hydro One as a return of stated capital of $196 million on its common shares.

As a result of the spin-off, goodwill related to Hydro One Brampton of $60 million was eliminated from the Consolidated Balance Sheet.

Other

On November 6, 2015, Hydro One completed the spin-off of its subsidiary, Hydro One Telecom. The spin-off was accounted as a non-monetary, nonreciprocal transfer with Hydro One Limited, based on its carrying values at November 6, 2015. Hydro One transferred to Hydro One Limited all the issued and outstanding shares of Hydro One Telecom totalling $17 million, and all of the intercompany debt receivable held by Hydro One due from Hydro One Telecom and Hydro One Telecom Link Limited totalling $21 million, as a return of stated capital of $38 million on its common shares.

On November 6, 2015, Hydro One completed the spin-off of its subsidiary, Municipal Billing Services Inc. (MBSI). The spin-off was accounted as a non-monetary, nonreciprocal transfer with Hydro One Limited, based on its carrying values at November 6, 2015. Hydro One transferred to Hydro One Limited all the issued and outstanding shares of MBSI and all of the intercompany debt receivable held by Hydro One due from MBSI, as a return of stated capital of $3 million on its common shares.

5. DEPRECIATION AND AMORTIZATION

Year ended December 31 *(millions of dollars)*	2016	2015
Depreciation of property, plant and equipment	603	594
Asset removal costs	90	90
Amortization of intangible assets	56	54
Amortization of regulatory assets	20	19
	769	757

6. FINANCING CHARGES

Year ended December 31 *(millions of dollars)*	2016	2015
Interest on long-term debt	424	417
Interest on short-term notes	9	2
Other	15	14
Less: Interest capitalized on construction and development in progress	(54)	(52)
Interest earned on investments	(2)	(3)
Gain on interest-rate swap agreements	–	(2)
	392	376

7. INCOME TAXES

Income taxes / provision for PILs differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rate. The reconciliation between the statutory and the effective tax rates is provided as follows:

Year ended December 31 *(millions of dollars)*	2016	2015
Income taxes / provision for PILs at statutory rate	231	216
Increase (decrease) resulting from:		
Net temporary differences recoverable in future rates charged to customers:		
Capital cost allowance in excess of depreciation and amortization	(53)	(37)
Pension contributions in excess of pension expense	(16)	(25)
Overheads capitalized for accounting but deducted for tax purposes	(16)	(15)
Interest capitalized for accounting but deducted for tax purposes	(14)	(13)
Environmental expenditures	(5)	(5)
Other	5	(6)
Net temporary differences	(99)	(101)
Net tax benefit resulting from transition from PILs Regime to Federal Tax Regime	–	(9)
Hydro One Brampton spin-off	–	7
Net permanent differences	3	1
Total income taxes / provision for PILs	135	114

The major components of income tax expense are as follows:

Year ended December 31 *(millions of dollars)*	2016	2015
Current income taxes / provision for PILs	24	2,931
Deferred income taxes / provision for (recovery of) PILs	111	(2,817)
Total income taxes / provision for PILs	135	114
Effective income tax rate	15.5%	14.0%

The provision for current income taxes / PILs is remitted to the CRA (Federal Tax Regime) and the OEFC (PILs Regime). At December 31, 2016, $13 million (2015 – $1 million) receivable from the CRA was included in other current assets and $6 million (2015 – $12 million) receivable from the OEFC was included in due from related parties on the Consolidated Balance Sheet.

In connection with Hydro One Limited's IPO in 2015, Hydro One's exemption from tax under the Federal Tax Regime ceased to apply. Under the PILs Regime, Hydro One was deemed to have disposed of its assets immediately before it lost its tax exempt status under the Federal Tax Regime, resulting in Hydro One making payments in lieu of tax (Departure Tax) totalling $2.6 billion. To enable Hydro One to make the Departure Tax payment, Hydro One Limited subscribed for common shares of Hydro One for $2.6 billion in 2015 (see note 21). Hydro One used the proceeds of this share subscription to pay the Departure Tax.

The 2015 total income taxes / provision for PILs included a current provision of $2,600 million and a deferred recovery of $2,798 million resulting from the transition from the PILs Regime to the Federal Tax Regime. The deferred recovery was not included in the rate-setting process. Deferred income tax balances expected to be included in the rate-setting process are offset by regulatory assets and liabilities to reflect the anticipated recovery or disposition of these balances within future electricity rates.

Deferred Income Tax Assets and Liabilities

Deferred income tax assets and liabilities arise from differences between the carrying amounts and tax basis of the Company's assets and liabilities. At December 31, 2016 and 2015, deferred income tax assets and liabilities consisted of the following:

December 31 *(millions of dollars)*	2016	2015
Deferred income tax assets		
Depreciation and amortization in excess of capital cost allowance	477	918
Non-depreciable capital property	271	271
Post-retirement and post-employment benefits expense in excess of cash payments	603	572
Environmental expenditures	74	75
Non-capital losses	213	62
Investment in subsidiaries	75	55
Other	30	2
	1,743	1,955
Less: valuation allowance	(352)	(326)
Total deferred income tax assets	1,391	1,629
Less: current portion	–	19
	1,391	1,610

December 31 *(millions of dollars)*	2016	2015
Deferred income tax liabilities		
Regulatory amounts that are not recognized for tax purposes	(153)	(153)
Goodwill	(10)	(10)
Capital cost allowance in excess of depreciation and amortization	(64)	(42)
Other	(11)	(1)
Total deferred income tax liabilities	(238)	(206)
Less: current portion	–	–
	(238)	(206)
Net deferred income tax assets	1,153	1,423

The net deferred income tax assets are presented on the Consolidated Balance Sheets as follows:

December 31 *(millions of dollars)*	2016	2015
Current:		
Other current assets	–	19
Long-term:		
Deferred income tax assets	1,213	1,610
Deferred income tax liabilities	(60)	(206)
Net deferred income tax assets	1,153	1,423

The valuation allowance for deferred tax assets as at December 31, 2016 was $352 million (2015 - $326 million). The valuation allowance primarily relates to temporary differences for non-depreciable assets and investments in subsidiaries. As of December 31, 2016, the Company had non-capital losses carried forward available to reduce future years' taxable income, which expire as follows:

Year of expiry *(millions of dollars)*	2016	2015
2034	2	2
2035	221	232
2036	579	–
Total losses	802	234

8. ACCOUNTS RECEIVABLE

December 31 *(millions of dollars)*	2016	2015
Accounts receivable – billed	427	374
Accounts receivable – unbilled	441	459
Accounts receivable, gross	868	833
Allowance for doubtful accounts	(35)	(61)
Accounts receivable, net	833	772

The following table shows the movements in the allowance for doubtful accounts for the years ended December 31, 2016 and 2015:

Year ended December 31 *(millions of dollars)*	2016	2015
Allowance for doubtful accounts – January 1	(61)	(66)
Write-offs	37	37
Additions to allowance for doubtful accounts	(11)	(32)
Allowance for doubtful accounts – December 31	(35)	(61)

9. OTHER CURRENT ASSETS

December 31 *(millions of dollars)*	2016	2015
Regulatory assets *(Note 12)*	37	36
Materials and supplies	19	21
Deferred income tax assets *(Notes 3, 7)*	–	19
Prepaid expenses and other assets	41	24
	97	100

10. PROPERTY, PLANT AND EQUIPMENT

December 31, 2016 *(millions of dollars)*	Property, Plant and Equipment	Accumulated Depreciation	Construction in Progress	Total
Transmission	14,692	4,862	910	10,740
Distribution	9,656	3,305	243	6,594
Communication	1,069	674	9	404
Administration and service	1,632	924	61	769
Easements	628	67	–	561
	27,677	9,832	1,223	19,068

December 31, 2015 *(millions of dollars)*	Property, Plant and Equipment	Accumulated Depreciation	Construction in Progress	Total
Transmission	13,704	4,621	853	9,936
Distribution	9,205	3,177	238	6,266
Communication	1,006	609	18	415
Administration and service	1,531	848	35	718
Easements	622	64	–	558
	26,068	9,319	1,144	17,893

Financing charges capitalized on property, plant and equipment under construction were $52 million in 2016 (2015 – $50 million).

11. INTANGIBLE ASSETS

December 31, 2016 *(millions of dollars)*	Intangible Assets	Accumulated Amortization	Development in Progress	Total
Computer applications software	621	326	53	348
Other	5	4	–	1
	626	330	53	349

December 31, 2015 *(millions of dollars)*	Intangible Assets	Accumulated Amortization	Development in Progress	Total
Computer applications software	579	270	24	333
Other	7	4	–	3
	586	274	24	336

Financing charges capitalized to intangible assets under development were $2 million in 2016 (2015 – $1 million). The estimated annual amortization expense for intangible assets is as follows: 2017 – $54 million; 2018 – $54 million; 2019 – $45 million; 2020 – $27 million; and 2021 – $26 million.

12. REGULATORY ASSETS AND LIABILITIES

Regulatory assets and liabilities arise as a result of the rate-setting process. Hydro One has recorded the following regulatory assets and liabilities:

December 31 *(millions of dollars)*	2016	2015
Regulatory assets:		
Deferred income tax regulatory asset	1,587	1,445
Pension benefit regulatory asset	900	952
Post-retirement and post-employment benefits	243	240
Environmental	204	207
Retail settlement variance account	145	110
Debt premium	32	–
Share-based compensation	31	10
Distribution system code exemption	10	10
2015-2017 rate rider	7	20
B2M LP start-up costs	5	8
Pension cost variance	4	37
Other	14	12
Total regulatory assets	3,182	3,051
Less: current portion	37	36
	3,145	3,015
Regulatory liabilities:		
Green Energy expenditure variance	69	76
External revenue variance	64	87
CDM deferral variance	54	53
Deferred income tax regulatory liability	4	23
Other	18	16
Total regulatory liabilities	209	255
Less: current portion	–	19
	209	236

Deferred Income Tax Regulatory Asset and Liability

Deferred income taxes are recognized on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable income. The Company has recognized regulatory assets and liabilities that correspond to deferred income taxes that flow through the rate-setting process. In the absence of rate-regulated accounting, the Company's income tax expense would have been recognized using the liability method and there would be no regulatory accounts established for taxes to be recovered through future rates. As a result, the 2016 income tax expense would have been higher by approximately $104 million (2015 – $101 million).

Pension Benefit Regulatory Asset

In accordance with OEB rate orders, pension costs are recovered on a cash basis as employer contributions are paid to the pension fund in accordance with the *Pension Benefits Act* (Ontario). The Company recognizes the net unfunded status of pension obligations on the Consolidated Balance Sheets with an offset to the associated regulatory asset. A regulatory asset is recognized because management considers it to be probable that pension benefit costs will be recovered in the future through the rate-setting process. The pension benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment. In the absence of rate-regulated accounting, 2016 OCI would have been higher by $52 million (2015 – $284 million).

Post-Retirement and Post-Employment Benefits

The Company recognizes the net unfunded status of post-retirement and post-employment obligations on the Consolidated Balance Sheets with an incremental offset to the associated regulatory assets. A regulatory asset is recognized because management considers it to be probable that post-retirement and post-employment benefit costs will be recovered in the future through the rate-setting process. The post-retirement and post-employment benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the re-measurement adjustment. In the absence of rate-regulated accounting, 2016 OCI would have been lower by $3 million (2015 – higher by $33 million).

Environmental

Hydro One records a liability for the estimated future expenditures required to remediate environmental contamination. Because such expenditures are expected to be recoverable in future rates, the Company has recorded an equivalent amount as a regulatory asset. In 2016, the environmental regulatory asset decreased by $1 million (2015 – $24 million) to reflect related changes in the Company's PCB liability, and increased by $10 million (2015 – $1 million) due to changes in the land assessment and remediation liability. The environmental regulatory asset is amortized to results of operations based on the pattern of actual expenditures incurred and charged to environmental liabilities. The OEB has the discretion to examine and assess the prudency and the timing of recovery of all of Hydro One's actual environmental expenditures. In the absence of rate-regulated accounting, 2016 operation, maintenance and administration expenses would have been higher by $9 million (2015 – lower by $23 million). In addition, 2016 amortization expense would have been lower by $20 million (2015 – $19 million), and 2016 financing charges would have been higher by $8 million (2015 – $10 million).

Retail Settlement Variance Account (RSVA)

Hydro One has deferred certain retail settlement variance amounts under the provisions of Article 490 of the OEB's Accounting Procedures Handbook. In March 2015, the OEB approved the disposition of the total RSVA balance accumulated from January 2012 to December 2013, including accrued interest, to be recovered through the 2015-2017 Rate Rider.

Debt Premium

The value of debt assumed in the acquisition of Great Lakes Power has been recorded at fair value in accordance with US GAAP – Business Combinations. The OEB allows for recovery of interest at the coupon rate of the Senior Secured Bonds and a regulatory asset has been recorded for the difference between the fair value and face value of this debt. The debt premium is recovered over the remaining term of the debt (see note 15).

Share-based Compensation

The Company recognizes costs associated with share grant plans in a regulatory asset as management considers it probable that share grant plans costs will be recovered in the future through the rate-setting process. In the absence of rate-regulated accounting, 2016 operation, maintenance and administration expenses would have been higher by $9 million (2015 – $5 million).

Distribution System Code (DSC) Exemption

In June 2010, Hydro One Networks filed an application with the OEB regarding the OEB's new cost responsibility rules contained in the OEB's October 2009 Notice of Amendment to the DSC, with respect to the connection of certain renewable generators that were already connected or that had received a connection impact assessment prior to October 21, 2009. The application sought approval to record and defer the unanticipated costs incurred by Hydro One Networks that resulted from the connection of certain renewable generation facilities. The OEB ruled that identified specific expenditures can be recorded in a deferral account subject to the OEB's review in subsequent Hydro One Network distribution applications. In March 2015, the OEB approved the disposition of the DSC exemption deferral account at December 31, 2013, including accrued interest, which is being recovered through the 2015-2017 Rate Rider. In addition, the OEB also approved Hydro One's request to discontinue this deferral account. There were no additions to this regulatory account in 2015 or 2016.

2015-2017 Rate Rider

In March 2015, as part of its decision on Hydro One Networks' distribution rate application for 2015-2019, the OEB approved the disposition of certain deferral and variance accounts, including RSVAs and accrued interest. The 2015-2017 Rate Rider account includes the balances approved for disposition by the OEB and is being disposed in accordance with the OEB decision over a 32-month period ending on December 31, 2017.

B2M LP Start-up Costs

In December 2015, OEB issued its decision on B2M LP's application for 2015-2019 and as part of the decision approved the recovery of $8 million of start-up costs relating to B2M LP. The costs are being recovered over a four-year period which began in 2016, in accordance with the OEB decision.

Pension Cost Variance

A pension cost variance account was established for Hydro One Networks' transmission and distribution businesses to track the difference between the actual pension expenses incurred and estimated pension costs approved by the OEB. The balance in this regulatory account reflects the excess of pension costs paid as compared to OEB-approved amounts. In March 2015, the OEB approved the disposition of the distribution business portion of the total pension cost variance account at December 31, 2013, including accrued interest, which is being recovered through the 2015-2017 Rate Rider. In the absence of rate-regulated accounting, 2016 revenue would have been higher by $25 million (2015 – lower by $6 million).

Green Energy Expenditure Variance

In April 2010, the OEB requested the establishment of deferral accounts which capture the difference between the revenue recorded on the basis of Green Energy Plan expenditures incurred and the actual recoveries received.

External Revenue Variance

In May 2009, the OEB approved forecasted amounts related to export service revenue, external revenue from secondary land use, and external revenue from station maintenance and engineering and construction work. In November 2012, the OEB again approved forecasted amounts related to these revenue categories and extended the scope to encompass all other external revenues. The external revenue variance account balance reflects the excess of actual external revenues compared to the OEB-approved forecasted amounts.

CDM Deferral Variance Account

As part of Hydro One Networks' application for 2013 and 2014 transmission rates, Hydro One agreed to establish a new regulatory deferral variance account to track the impact of actual Conservation and Demand Management (CDM) and demand response results on the load forecast compared to the estimated load forecast included in the revenue requirement. The balance in the CDM deferral variance account relates to the actual 2013 and 2014 CDM compared to the amounts included in 2013 and 2014 revenue requirements, respectively. There were no additions to this regulatory account in 2016.

13. ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

December 31 *(millions of dollars)*	2016	2015
Accounts payable	177	152
Accrued liabilities	651	591
Accrued interest	105	96
Regulatory liabilities *(Note 12)*	–	19
	933	858

14. OTHER LONG-TERM LIABILITIES

December 31 *(millions of dollars)*	2016	2015
Post-retirement and post-employment benefit liability *(Note 18)*	1,628	1,541
Pension benefit liability *(Note 18)*	900	952
Environmental liabilities *(Note 19)*	177	185
Due to related parties *(Note 26)*	26	10
Asset retirement obligations *(Note 20)*	9	9
Long-term accounts payable and other liabilities	25	17
	2,765	2,714

15. DEBT AND CREDIT AGREEMENTS

Short-Term Notes and Credit Facilities

Hydro One meets its short-term liquidity requirements in part through the issuance of commercial paper under its Commercial Paper Program which has a maximum authorized amount of $1.5 billion. These short-term notes are denominated in Canadian dollars with varying maturities up to 365 days. The Commercial Paper Program is supported by the Company's committed revolving credit facilities totalling $2.3 billion.

On August 15, 2016, Hydro One terminated its $1.5 billion revolving standby credit facility maturing in June 2020 and its $800 million three-year senior, revolving term credit facility maturing in October 2018 (collectively, Prior Credit Facilities). On the same date, Hydro One entered into a new credit agreement for a $2.3 billion revolving credit facility maturing in June 2021 (New Credit Facility). The New Credit Facility ranks equally with any existing and future senior debt of Hydro One, and has customary covenants substantially similar to the covenants under the Prior Credit Facilities.

The Company may use the credit facilities for working capital and general corporate purposes. If used, interest on the credit facilities would apply based on Canadian benchmark rates. The obligation of each lender to make any credit extension under its credit facility is subject to various conditions including that no event of default has occurred or would result from such credit extension.

Long-Term Debt

At December 31, 2016, $10,523 million long-term debt was issued by the Company under its Medium-Term Note (MTN) Program. The maximum authorized principal amount of notes issuable under the current MTN Program prospectus filed in December 2015 is $3.5 billion. At December 31, 2016, $1.2 billion remained available for issuance until January 2018. In addition, at December 31, 2016, the Company had long-term debt of $184 million assumed as part of the Great Lakes Power acquisition.

The following table presents outstanding long-term debt at December 31, 2016 and 2015:

December 31 *(millions of dollars)*	2016	2015
4.64% Series 10 notes due 2016	–	450
Floating-rate Series 27 notes due 2016[1]	–	50
5.18% Series 13 notes due 2017	600	600
2.78% Series 28 notes due 2018	750	750
Floating-rate Series 31 notes due 2019[1]	228	228
1.48% Series 37 notes due 2019[2]	500	–
4.40% Series 20 notes due 2020	300	300
1.62% Series 33 notes due 2020[2]	350	350
1.84% Series 34 notes due 2021	500	–
3.20% Series 25 notes due 2022	600	600
2.77% Series 35 notes due 2026	500	–
7.35% Debentures due 2030	400	400
6.93% Series 2 notes due 2032	500	500
6.35% Series 4 notes due 2034	385	385
5.36% Series 9 notes due 2036	600	600
4.89% Series 12 notes due 2037	400	400
6.03% Series 17 notes due 2039	300	300
5.49% Series 18 notes due 2040	500	500
4.39% Series 23 notes due 2041	300	300
6.59% Series 5 notes due 2043	315	315
4.59% Series 29 notes due 2043	435	435
4.17% Series 32 notes due 2044	350	350
5.00% Series 11 notes due 2046	325	325
3.91% Series 36 notes due 2046	350	–
3.72% Series 38 notes due 2047	450	–
4.00% Series 24 notes due 2051	225	225
3.79% Series 26 notes due 2062	310	310
4.29% Series 30 notes due 2064	50	50
Hydro One Inc. long-term debt	10,523	8,723
6.6% Senior Secured Bonds due 2023 (Face value – $112 million)	144	–
4.6% Note Payable due 2023 (Face value – $36 million)	40	–
Great Lakes Power long-term debt	184	–
	10,707	8,723
Add: Net unamortized debt premiums[3]	15	17
Add: Unrealized mark-to-market loss (gain)[2]	(2)	1
Less: Deferred debt issuance costs[3]	(40)	(34)
Total long-term debt	10,680	8,707

[1] The interest rates of the floating-rate notes are referenced to the 3-month Canadian dollar bankers' acceptance rate, plus a margin.

[2] The unrealized mark-to-market net gain relates to $50 million of the Series 33 notes due 2020 and $500 million Series 37 notes due 2019 (2015 – loss relates to $50 million of the Series 33 notes due 2020). The unrealized mark-to-market net gain is offset by a $2 million (2015 – $1 million) unrealized mark-to-market net loss (2015 – gain) on the related fixed-to-floating interest-rate swap agreements, which are accounted for as fair value hedges. See note 16 – Fair Value of Financial Instruments and Risk Management for details of fair value hedges.

[3] Effective January 1, 2016, deferred debt issuance costs and net unamortized debt premiums were reclassified from other long-term assets and other long-term liabilities, respectively, as an offset to long-term debt upon adoption of ASU 2015-03 (see note 3). Balances as at December 31, 2015 were updated to reflect the retrospective adoption of ASU 2015-03.

The total long-term debt is presented on the consolidated balance sheets as follows:

December 31 *(millions of dollars)*	2016	2015
Current liabilities:		
Long-term debt payable within one year	602	500
Long-term liabilities:		
Long-term debt	10,078	8,207
Total long-term debt	10,680	8,707

In 2016, Hydro One issued $2,300 million (2015 – $350 million) of long-term debt under the MTN Program, and repaid $502 million (2015 – $550 million) of total long-term debt.

Principal repayments and related weighted average interest rates are summarized by the number of years to maturity in the following table:

Years to Maturity	Long-term Debt Principal Repayments *(millions of dollars)*	Weighted Average Interest Rate *(%)*
1 year	602	5.2
2 years	753	2.8
3 years	731	1.4
4 years	653	2.9
5 years	503	1.9
	3,242	2.8
6 – 10 years	1,234	3.3
Over 10 years	6,195	5.2
	10,671	4.3

Interest payment obligations related to long-term debt are summarized by year in the following table:

Year	Interest Payments *(millions of dollars)*
2017	456
2018	425
2019	402
2020	384
2021	370
	2,037
2022-2026	1,703
2027+	4,405
	8,145

16. FAIR VALUE OF FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition focuses on an exit price, which is the price that would be received in the sale of an asset or the amount that would be paid to transfer a liability.

Hydro One classifies its fair value measurements based on the following hierarchy, as prescribed by the accounting guidance for fair value, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that Hydro One has the ability to access. An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information.

Level 2 inputs are those other than quoted market prices that are observable, either directly or indirectly, for an asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted market prices that are observable for the asset or liability, such as interest-rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk and default rates. A Level 2 measurement cannot have more than an insignificant portion of the valuation based on unobservable inputs.

Level 3 inputs are any fair value measurements that include unobservable inputs for the asset or liability for more than an insignificant portion of the valuation. A Level 3 measurement may be based primarily on Level 2 inputs.

Non-Derivative Financial Assets and Liabilities

At December 31, 2016 and 2015, the Company's carrying amounts of cash and cash equivalents, accounts receivable, due from related parties, short-term notes payable, accounts payable, and due to related parties are representative of fair value because of the short-term nature of these instruments.

Fair Value Measurements of Long-Term Debt

The fair values and carrying values of the Company's long-term debt at December 31, 2016 and 2015 are as follows:

December 31 *(millions of dollars)*	2016 Carrying Value	2016 Fair Value	2015 Carrying Value	2015 Fair Value
Long-term debt				
$50 million of MTN Series 33 notes	50	50	51	51
$500 million of MTN Series 37 notes	498	498	–	–
Other notes and debentures	10,132	11,462	8,656	9,942
	10,680	12,010	8,707	9,993

Fair Value Measurements of Derivative Instruments

At December 31, 2016, Hydro One had interest-rate swaps in the amount of $550 million (2015 – $50 million) that was used to convert fixed-rate debt to floating-rate debt. These swaps are classified as a fair value hedges. Hydro One's fair value hedge exposure was equal to about 5% (2015 – 1%) of its total long-term debt. At December 31, 2016, Hydro One had the following interest-rate swaps designated as fair value hedges:

- a $50 million fixed-to-floating interest-rate swap agreement to convert $50 million of the $350 million MTN Series 33 notes maturing April 30, 2020 into three-month variable rate debt; and
- two $125 million and one $250 million fixed-to-floating interest-rate swap agreements to convert the $500 million MTN Series 37 notes maturing November 18, 2019 into three-month variable rate debt.

At December 31, 2016 and 2015, the Company had no interest-rate swaps classified as undesignated contracts.

Fair Value Hierarchy

The fair value hierarchy of financial assets and liabilities at December 31, 2016 and 2015 is as follows:

December 31, 2016 *(millions of dollars)*	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	48	48	48	–	–
	48	48	48	–	–
Liabilities:					
Short-term notes payable	469	469	469	–	–
Long-term debt, including current portion	10,680	12,010	–	12,010	–
Derivative instruments					
Fair value hedges – interest-rate swaps	2	2	2	–	–
	11,151	12,481	471	12,010	–

December 31, 2015 *(millions of dollars)*	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	89	89	89	–	–
Derivative instruments					
Fair value hedge – interest-rate swap	1	1	1	–	–
	90	90	90	–	–
Liabilities:					
Short-term notes payable	1,491	1,491	1,491	–	–
Long-term debt, including current portion	8,707	9,993	–	9,993	–
	10,198	11,484	1,491	9,993	–

Cash and cash equivalents include cash and short-term investments. The carrying values are representative of fair value because of the short-term nature of these instruments.

The fair value of the hedged portion of the long-term debt is primarily based on the present value of future cash flows using a swap yield curve to determine the assumption for interest rates. The fair value of the unhedged portion of the long-term debt is based on unadjusted period-end market prices for the same or similar debt of the same remaining maturities.

There were no significant transfers between any of the fair value levels during the years ended December 31, 2016 and 2015.

Risk Management

Exposure to market risk, credit risk and liquidity risk arises in the normal course of the Company's business.

Market Risk

Market risk refers primarily to the risk of loss that results from changes in costs, foreign exchange rates and interest rates. The Company is exposed to fluctuations in interest rates as its regulated return on equity is derived using a formulaic approach that takes into account anticipated interest rates. The Company is not currently exposed to material commodity price risk or material foreign exchange risk.

The Company uses a combination of fixed and variable-rate debt to manage the mix of its debt portfolio. The Company also uses derivative financial instruments to manage interest-rate risk. The Company utilizes interest-rate swaps, which are typically designated as fair value hedges, as a means to manage its interest rate exposure to achieve a lower cost of debt. The Company may also utilize interest-rate derivative instruments to lock in interest-rate levels in anticipation of future financing.

A hypothetical 100 basis points increase in interest rates associated with variable-rate debt would not have resulted in a significant decrease in Hydro One's net income for the years ended December 31, 2016 or 2015.

For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the Consolidated Statements of Operations and Comprehensive Income. The net unrealized loss (gain) on the hedged debt and the related interest-rate swaps for the years ended December 31, 2016 and 2015 was not significant.

Credit Risk

Financial assets create a risk that a counterparty will fail to discharge an obligation, causing a financial loss. At December 31, 2016 and 2015, there were no significant concentrations of credit risk with respect to any class of financial assets. The Company's revenue is earned from a broad base of customers. As a result, Hydro One did not earn a significant amount of revenue from any single customer. At December 31, 2016 and 2015, there was no significant accounts receivable balance due from any single customer.

At December 31, 2016, the Company's provision for bad debts was $35 million (2015 – $61 million). Adjustments and write-offs were determined on the basis of a review of overdue accounts, taking into consideration historical experience. At December 31, 2016, approximately 6% (2015 – 6%) of the Company's net accounts receivable were aged more than 60 days.

Hydro One manages its counterparty credit risk through various techniques including: entering into transactions with highly rated counterparties; limiting total exposure levels with individual counterparties; entering into master agreements which enable net settlement and the contractual right of offset; and monitoring the financial condition of counterparties. The Company monitors current credit exposure to counterparties both on an individual and an aggregate basis. The Company's credit risk for accounts receivable is limited to the carrying amounts on the Consolidated Balance Sheets.

Derivative financial instruments result in exposure to credit risk since there is a risk of counterparty default. The credit exposure of derivative contracts, before collateral, is represented by the fair value of contracts at the reporting date. At December 31, 2016 and 2015, the counterparty credit risk exposure on the fair value of these interest-rate swap contracts was not significant. At December 31, 2016, Hydro One's credit exposure for all derivative instruments, and applicable payables and receivables, had a credit rating of investment grade, with four financial institutions as the counterparty.

Liquidity Risk

Liquidity risk refers to the Company's ability to meet its financial obligations as they come due. Hydro One meets its short-term liquidity requirements using cash and cash equivalents on hand, funds from operations, the issuance of commercial paper, and the revolving standby credit facilities. The short-term liquidity under the Commercial Paper Program, revolving standby credit facilities, and anticipated levels of funds from operations are expected to be sufficient to fund normal operating requirements.

At December 31, 2016, accounts payable and accrued liabilities in the amount of $828 million (2015 – $743 million) were expected to be settled in cash at their carrying amounts within the next 12 months.

17. CAPITAL MANAGEMENT

The Company's objectives with respect to its capital structure are to maintain effective access to capital on a long-term basis at reasonable rates, and to deliver appropriate financial returns. In order to ensure ongoing access to capital, the Company targets to maintain strong credit quality. At December 31, 2016 and 2015, the Company's capital structure was as follows:

December 31 *(millions of dollars)*	2016	2015
Long-term debt payable within one year	602	500
Short-term notes payable	469	1,491
Less: cash and cash equivalents	48	89
	1,023	1,902
Long-term debt	10,078	8,207
Common shares	5,391	6,000
Retained earnings	4,487	3,759
Total capital	20,979	19,868

Hydro One and Great Lakes Power have customary covenants typically associated with long-term debt. Hydro One's long-term debt and credit facility covenants limit permissible debt to 75% of its total capitalization, limit the ability to sell assets and impose a negative pledge provision, subject to customary exceptions. At December 31, 2016, Hydro One and Great Lakes Power were in compliance with all covenants and limitations.

18. PENSION AND POST-RETIREMENT AND POST-EMPLOYMENT BENEFITS

Hydro One has a defined benefit pension plan (Pension Plan), a defined contribution pension plan (DC Plan), a supplementary pension plan, and post-retirement and post-employment benefit plans.

Defined Contribution Pension Plan

Hydro One established a DC Plan effective January 1, 2016. The DC Plan is mandatory and covers eligible management employees hired on or after January 1, 2016, as well as management employees hired before January 1, 2016 who were not eligible or had not irrevocably elected to join the Pension Plan as of September 30, 2015. Members of the DC Plan have an option to contribute 4%, 5% or 6% of their pensionable earnings, with matching contributions by Hydro One.

Hydro One contributions to the DC Plan for the year ended December 31, 2016 were less than $1 million (2015 – $nil). At December 31, 2016, Company contributions payable included in accrued liabilities on the Consolidated Balance Sheets were less than $1 million (2015 – $nil).

Defined Benefit Pension Plan, Supplementary Pension Plan, and Post-Retirement and Post-Employment Plans

The Pension Plan is a defined benefit contributory plan which covers all regular employees of Hydro One and its subsidiaries. The Pension Plan provides benefits based on highest three-year average pensionable earnings. For Management employees who commenced employment on or after January 1, 2004, and for Society of Energy Professionals-represented staff hired after November 17, 2005, benefits are based on highest five-year average pensionable earnings. After retirement, pensions are indexed to inflation. Membership in the Pension Plan was closed to Management employees who were not eligible or had not irrevocably elected to join the Pension Plan as of September 30, 2015. These employees are eligible to join the DC Plan.

Company and employee contributions to the Pension Plan are based on actuarial valuations performed at least every three years. Annual Pension Plan contributions for 2016 of $108 million (2015 – $177 million) were based on an actuarial valuation effective December 31, 2015 (2015 – based on an actuarial valuation effective December 31, 2013) and the level of pensionable earnings. Estimated annual Pension Plan contributions for 2017 and 2018 are approximately $105 million and $102 million, respectively, based on the actuarial valuation as at December 31, 2015 and projected levels of pensionable earnings. Future minimum contributions beyond 2018 will be based on an actuarial valuation effective no later than December 31, 2018. Contributions are payable one month in arrears. All of the contributions are expected to be in the form of cash.

The Hydro One Supplemental Pension Plan (Supplemental Plan) provides members of the Pension Plan with benefits that would have been earned and payable under the Pension Plan but for limitations imposed by the *Income Tax Act* (Canada). The Supplemental Plan obligation is included with other post-retirement and post-employment benefit obligations on the Consolidated Balance Sheets.

Hydro One recognizes the overfunded or underfunded status of the Pension Plan, and post-retirement and post-employment benefit plans (Plans) as an asset or liability on its Consolidated Balance Sheets, with offsetting regulatory assets and liabilities as appropriate. The underfunded benefit obligations for the Plans, in the absence of regulatory accounting, would be recognized in AOCI. The impact of changes in assumptions used to measure pension, post-retirement and post-employment benefit obligations is generally recognized over the expected average remaining service period of the employees. The measurement date for the Plans is December 31.

Year ended December 31 *(millions of dollars)*	Pension Benefits 2016	Pension Benefits 2015	Post-Retirement and Post-Employment Benefits 2016	Post-Retirement and Post-Employment Benefits 2015
Change in projected benefit obligation				
Projected benefit obligation, beginning of year	7,683	7,535	1,591	1,582
Current service cost	144	146	41	43
Employee contributions	45	40	–	–
Interest cost	308	302	66	64
Benefits paid	(354)	(334)	(43)	(47)
Net actuarial loss (gain)	(52)	(6)	14	(27)
Change due to Hydro One Brampton spin-off	–	–	–	(5)
Change due to Hydro One Telecom spin-off	–	–	–	(19)
Change due to employees transfer	–	–	7	–
Projected benefit obligation, end of year	7,774	7,683	1,676	1,591
Change in plan assets				
Fair value of plan assets, beginning of year	6,731	6,299	–	–
Actual return on plan assets	370	582	–	–
Benefits paid	(354)	(334)	(43)	(47)
Employer contributions	108	177	43	47
Employee contributions	45	40	–	–
Administrative expenses	(26)	(33)	–	–
Fair value of plan assets, end of year	6,874	6,731	–	–
Unfunded status	900	952	1,676	1,591

Hydro One presents its benefit obligations and plan assets net on its Consolidated Balance Sheets as follows:

December 31 *(millions of dollars)*	Pension Benefits 2016	Pension Benefits 2015	Post-Retirement and Post-Employment Benefits 2016	Post-Retirement and Post-Employment Benefits 2015
Other assets	1[1]	–	–	–
Accrued liabilities	–	–	55	50
Pension benefit liability	900	952	–	–
Post-retirement and post-employment benefit liability	–	–	1,628[2]	1,541
Net unfunded status	899	952	1,683	1,591

[1] Represents the funded status of Great Lakes Power's defined benefit pension plan.

[2] Includes $7 million (2015 – $nil) relating to Great Lakes Power's post-employment benefit plans.

The funded or unfunded status of the pension, post-retirement and post-employment benefit plans refers to the difference between the fair value of plan assets and the projected benefit obligations for the Plans. The funded/unfunded status changes over time due to several factors, including contribution levels, assumed discount rates and actual returns on plan assets.

The following table provides the projected benefit obligation (PBO), accumulated benefit obligation (ABO) and fair value of plan assets for the Pension Plan:

December 31 *(millions of dollars)*	2016	2015
PBO	7,774	7,683
ABO	7,094	7,020
Fair value of plan assets	6,874	6,731

On an ABO basis, the Pension Plan was funded at 97% at December 31, 2016 (2015 – 96%). On a PBO basis, the Pension Plan was funded at 88% at December 31, 2016 (2015 – 88%). The ABO differs from the PBO in that the ABO includes no assumption about future compensation levels.

Components of Net Periodic Benefit Costs

The following table provides the components of the net periodic benefit costs for the years ended December 31, 2016 and 2015 for the Pension Plan:

Year ended December 31 *(millions of dollars)*	2016	2015
Current service cost, net of employee contributions	144	146
Interest cost	308	302
Expected return on plan assets, net of expenses	(432)	(406)
Amortization of actuarial losses	96	119
Prior service cost amortization	–	2
Net periodic benefit costs	116	163
Charged to results of operations[1]	45	81

[1] The Company follows the cash basis of accounting consistent with the inclusion of pension costs in OEB-approved rates. During the year ended December 31, 2016, pension costs of $105 million (2015 – $177 million) were attributed to labour, of which $45 million (2015 – $81 million) was charged to operations, and $60 million (2015 – $96 million) was capitalized as part of the cost of property, plant and equipment and intangible assets.

The following table provides the components of the net periodic benefit costs for the years ended December 31, 2016 and 2015 for the post-retirement and post-employment benefit plans:

Year ended December 31 *(millions of dollars)*	2016	2015
Current service cost, net of employee contributions	41	43
Interest cost	66	64
Amortization of actuarial losses	15	14
Prior service cost amortization	–	–
Net periodic benefit costs	122	121
Charged to results of operations	53	55

Assumptions

The measurement of the obligations of the Plans and the costs of providing benefits under the Plans involves various factors, including the development of valuation assumptions and accounting policy elections. When developing the required assumptions, the Company considers historical information as well as future expectations. The measurement of benefit obligations and costs is impacted by several assumptions including the discount rate applied to benefit obligations, the long-term expected rate of return on plan assets, Hydro One's expected level of contributions to the Plans, the incidence of mortality, the expected remaining service period of plan participants, the level of compensation and rate of compensation increases, employee age, length of service, and the anticipated rate of increase of health care costs, among other factors. The impact of changes in assumptions used to measure the obligations of the Plans is generally recognized over the expected average remaining service period of the plan participants. In selecting the expected rate of return on plan assets, Hydro One considers historical economic indicators that impact asset returns, as well as expectations regarding future long-term capital market performance, weighted by target asset class allocations. In general, equity securities, real estate and private equity investments are forecasted to have higher returns than fixed-income securities.

The following weighted average assumptions were used to determine the benefit obligations at December 31, 2016 and 2015:

	Pension Benefits		Post-Retirement and Post-Employment Benefits	
Year ended December 31	2016	2015	2016	2015
Significant assumptions:				
Weighted average discount rate	3.90%	4.00%	3.90%	4.10%
Rate of compensation scale escalation (long-term)	2.50%	2.50%	2.50%	2.50%
Rate of cost of living increase	2.00%	2.00%	2.00%	2.00%
Rate of increase in health care cost trends[1]	–	–	4.36%	4.36%

[1] 6.25% per annum in 2017, grading down to 4.36% per annum in and after 2031 (2015 – 6.38% in 2016, grading down to 4.36% per annum in and after 2031).

The following weighted average assumptions were used to determine the net periodic benefit costs for the years ended December 31, 2016 and 2015. Assumptions used to determine current year-end benefit obligations are the assumptions used to estimate the subsequent year's net periodic benefit costs.

Year ended December 31	2016	2015
Pension Benefits:		
Weighted average expected rate of return on plan assets	6.50%	6.50%
Weighted average discount rate	4.00%	4.00%
Rate of compensation scale escalation (long-term)	2.50%	2.50%
Rate of cost of living increase	2.00%	2.00%
Average remaining service life of employees *(years)*	15	13
Post-Retirement and Post-Employment Benefits:		
Weighted average discount rate	4.10%	4.00%
Rate of compensation scale escalation (long-term)	2.50%	2.50%
Rate of cost of living increase	2.00%	2.00%
Average remaining service life of employees *(years)*	15.3	13.8
Rate of increase in health care cost trends[1]	4.36%	4.36%

[1] 6.38% per annum in 2016, grading down to 4.36% per annum in and after 2031 (2015 – 6.52% in 2015, grading down to 4.36% per annum in and after 2031).

The discount rate used to determine the current year pension obligation and the subsequent year's net periodic benefit costs is based on a yield curve approach. Under the yield curve approach, expected future benefit payments for each plan are discounted by a rate on a third-party bond yield curve corresponding to each duration. The yield curve is based on "AA" long-term corporate bonds. A single discount rate is calculated that would yield the same present value as the sum of the discounted cash flows.

The effect of a 1% change in health care cost trends on the projected benefit obligation for the post-retirement and post-employment benefits at December 31, 2016 and 2015 is as follows:

December 31 *(millions of dollars)*	2016	2015
Projected benefit obligation:		
Effect of a 1% increase in health care cost trends	286	252
Effect of a 1% decrease in health care cost trends	(219)	(196)

The effect of a 1% change in health care cost trends on the service cost and interest cost for the post-retirement and post-employment benefits for the years ended December 31, 2016 and 2015 is as follows:

Year ended December 31 *(millions of dollars)*	2016	2015
Service cost and interest cost:		
Effect of a 1% increase in health care cost trends	22	22
Effect of a 1% decrease in health care cost trends	(16)	(16)

The following approximate life expectancies were used in the mortality assumptions to determine the projected benefit obligations for the pension and post-retirement and post-employment plans at December 31, 2016 and 2015:

December 31, 2016 Life expectancy at 65 for a member currently at				December 31, 2015 Life expectancy at 65 for a member currently at			
Age 65		Age 45		Age 65		Age 45	
Male	Female	Male	Female	Male	Female	Male	Female
22	24	23	24	23	25	24	26

Estimated Future Benefit Payments

At December 31, 2016, estimated future benefit payments to the participants of the Plans were:

(millions of dollars)	Pension Benefits	Post-Retirement and Post-Employment Benefits
2017	321	55
2018	331	57
2019	340	60
2020	349	61
2021	358	65
2022 through to 2026	1,910	353
Total estimated future benefit payments through to 2026	3,609	651

Components of Regulatory Assets

A portion of actuarial gains and losses and prior service costs is recorded within regulatory assets on Hydro One's Consolidated Balance Sheets to reflect the expected regulatory inclusion of these amounts in future rates, which would otherwise be recorded in OCI. The following table provides the actuarial gains and losses and prior service costs recorded within regulatory assets:

Year ended December 31 *(millions of dollars)*	2016	2015
Pension Benefits:		
Actuarial loss (gain) for the year	35	(181)
Amortization of actuarial losses	(96)	(119)
Prior service cost amortization	–	(2)
	(61)	(302)
Post-Retirement and Post-Employment Benefits:		
Actuarial loss (gain) for the year	14	(27)
Amortization of actuarial losses	(15)	(14)
Prior service cost amortization	–	–
	(1)	(41)

The following table provides the components of regulatory assets that have not been recognized as components of net periodic benefit costs for the years ended December 31, 2016 and 2015:

Year ended December 31 *(millions of dollars)*	2016	2015
Pension Benefits:		
Prior service cost	–	–
Actuarial loss	900	952
	900	952
Post-Retirement and Post-Employment Benefits:		
Actuarial loss	243	240
	243	240

The following table provides the components of regulatory assets at December 31 that are expected to be amortized as components of net periodic benefit costs in the following year:

	Pension Benefits		Post-Retirement and Post-Employment Benefits	
December 31 *(millions of dollars)*	2016	2015	2016	2015
Prior service cost	–	–	–	–
Actuarial loss	79	96	6	8
	79	96	6	8

Pension Plan Assets

Investment Strategy

On a regular basis, Hydro One evaluates its investment strategy to ensure that Pension Plan assets will be sufficient to pay Pension Plan benefits when due. As part of this ongoing evaluation, Hydro One may make changes to its targeted asset allocation and investment strategy. The Pension Plan is managed at a net asset level. The main objective of the Pension Plan is to sustain a certain level of net assets in order to meet the pension obligations of the Company. The Pension Plan fulfills its primary objective by adhering to specific investment policies outlined in its Summary of Investment Policies and Procedures (SIPP), which is reviewed and approved by the Human Resource Committee of Hydro One's Board of Directors. The Company manages net assets by engaging knowledgeable external investment managers who are charged with the responsibility of investing existing funds and new funds (current year's employee and employer contributions) in accordance with the approved SIPP. The performance of the managers is monitored through a governance structure. Increases in net assets are a direct result of investment income generated by investments held by the Pension Plan and contributions to the Pension Plan by eligible employees and by the Company. The main use of net assets is for benefit payments to eligible Pension Plan members.

Pension Plan Asset Mix

At December 31, 2016, the Pension Plan target asset allocations and weighted average asset allocations were as follows:

	Target Allocation (%)	Pension Plan Assets (%)
Equity securities	55.0	58.7
Debt securities	35.0	33.6
Other[1]	10.0	7.7
	100.0	100.0

[1] Other investments include real estate and infrastructure investments.

At December 31, 2016, the Pension Plan held $11 million (2015 – $9 million) Hydro One corporate bonds and $450 million (2015 – $420 million) of debt securities of the Province.

Concentrations of Credit Risk

Hydro One evaluated its Pension Plan's asset portfolio for the existence of significant concentrations of credit risk as at December 31, 2016 and 2015. Concentrations that were evaluated include, but are not limited to, investment concentrations in a single entity, concentrations in a type of industry, and concentrations in individual funds. At December 31, 2016 and 2015, there were no significant concentrations (defined as greater than 10% of plan assets) of risk in the Pension Plan's assets.

The Pension Plan manages its counterparty credit risk with respect to bonds by investing in investment-grade and government bonds and with respect to derivative instruments by transacting only with financial institutions rated at least "A+" by Standard & Poor's Rating Services, DBRS Limited, and Fitch Ratings Inc., and "A1" by Moody's Investors Service, and also by utilizing exposure limits to each counterparty and ensuring that exposure is diversified across counterparties. The risk of default on transactions in listed securities is considered minimal, as the trade will fail if either party to the transaction does not meet its obligation.

Fair Value Measurements

The following tables present the Pension Plan assets measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy at December 31, 2016 and 2015:

December 31, 2016 *(millions of dollars)*	Level 1	Level 2	Level 3	Total
Pooled funds	–	20	425	445
Cash and cash equivalents	146	–	–	146
Short-term securities	–	127	–	127
Corporate shares – Canadian	911	–	–	911
Corporate shares – Foreign	2,985	113	–	3,098
Bonds and debentures – Canadian	–	1,943	–	1,943
Bonds and debentures – Foreign	–	193	–	193
Total fair value of plan assets[1]	4,042	2,396	425	6,863

[1] At December 31, 2016, the total fair value of Pension Plan assets excludes $27 million of interest and dividends receivable, $15 million of purchased investments payable, $9 million of pension administration expenses payable, and $7 million of sold investments receivable.

December 31, 2015 *(millions of dollars)*	Level 1	Level 2	Level 3	Total
Pooled funds	–	23	301	324
Cash and cash equivalents	191	–	–	191
Short-term securities	–	80	–	80
Corporate shares – Canadian	807	–	–	807
Corporate shares – Foreign	2,931	116	–	3,047
Bonds and debentures – Canadian	–	2,072	–	2,072
Bonds and debentures – Foreign	–	201	–	201
Total fair value of plan assets[1]	3,929	2,492	301	6,722

[1] At December 31, 2015, the total fair value of Pension Plan assets excludes $27 million of interest and dividends receivable, and $18 million relating to accruals for pension administration expense and foreign exchange contracts payable.

See note 16 – Fair Value of Financial Instruments and Risk Management for a description of levels within the fair value hierarchy.

Changes in the Fair Value of Financial Instruments Classified in Level 3

The following table summarizes the changes in fair value of financial instruments classified in Level 3 for the years ended December 31, 2016 and 2015. The Pension Plan classifies financial instruments as Level 3 when the fair value is measured based on at least one significant input that is not observable in the markets or due to lack of liquidity in certain markets. The gains and losses presented in the table below may include changes in fair value based on both observable and unobservable inputs.

Year ended December 31 *(millions of dollars)*	2016	2015
Fair value, beginning of year	301	144
Realized and unrealized gains	23	51
Purchases	151	106
Sales and disbursements	(50)	–
Fair value, end of year	425	301

There were no significant transfers between any of the fair value levels during the years ended December 31, 2016 and 2015.

The Company performs sensitivity analysis for fair value measurements classified in Level 3, substituting the unobservable inputs with one or more reasonably possible alternative assumptions. These sensitivity analyses resulted in negligible changes in the fair value of financial instruments classified in this level.

Valuation Techniques Used to Determine Fair Value

Pooled funds mainly consist of private equity, real estate and infrastructure investments. Private equity investments represent private equity funds that invest in operating companies that are not publicly traded on a stock exchange. Investment strategies in private equity include limited partnerships in businesses that are characterized by high internal growth and operational efficiencies, venture capital, leveraged buyouts and special situations such as distressed investments. Real estate and infrastructure investments represent funds that invest in real assets which are not publicly traded on a stock exchange. Investment strategies in real estate include limited partnerships that seek to generate a total return through income and capital growth by investing primarily in global and Canadian limited partnerships. Investment strategies in infrastructure include limited partnerships in core infrastructure assets focusing on assets that generate stable, long-term cash flows and deliver incremental returns relative to conventional fixed-income investments. Private equity, real estate and infrastructure valuations are reported by the fund manager and are based on the valuation of the underlying investments which includes inputs such as cost, operating results, discounted future cash flows and market-based comparable data. Since these valuation inputs are not highly observable, private equity and infrastructure investments have been categorized as Level 3 within pooled funds.

Cash equivalents consist of demand cash deposits held with banks and cash held by the investment managers. Cash equivalents are categorized as Level 1.

Short-term securities are valued at cost plus accrued interest, which approximates fair value due to their short-term nature. Short-term securities are categorized as Level 2.

Corporate shares are valued based on quoted prices in active markets and are categorized as Level 1. Investments denominated in foreign currencies are translated into Canadian currency at year-end rates of exchange.

Bonds and debentures are presented at published closing trade quotations, and are categorized as Level 2.

19. ENVIRONMENTAL LIABILITIES

The following tables show the movements in environmental liabilities for the years ended December 31, 2016 and 2015:

Year ended December 31, 2016 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Environmental liabilities, January 1	148	59	207
Interest accretion	7	1	8
Expenditures	(11)	(9)	(20)
Revaluation adjustment	(1)	10	9
Environmental liabilities, December 31	143	61	204
Less: current portion	18	9	27
	125	52	177

Year ended December 31, 2015 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Environmental liabilities, January 1	172	67	239
Interest accretion	8	2	10
Expenditures	(8)	(11)	(19)
Revaluation adjustment	(24)	1	(23)
Environmental liabilities, December 31	148	59	207
Less: current portion	12	10	22
	136	49	185

The following tables show the reconciliation between the undiscounted basis of the environmental liabilities and the amount recognized on the Consolidated Balance Sheets after factoring in the discount rate:

December 31, 2016 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Undiscounted environmental liabilities	158	66	224
Less: discounting accumulated liabilities to present value	15	5	20
Discounted environmental liabilities	143	61	204

December 31, 2015 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Undiscounted environmental liabilities	168	61	229
Less: discounting accumulated liabilities to present value	20	2	22
Discounted environmental liabilities	148	59	207

At December 31, 2016, the estimated future environmental expenditures were as follows:

(millions of dollars)	
2017	27
2018	26
2019	25
2020	29
2021	36
Thereafter	81
	224

Hydro One records a liability for the estimated future expenditures for land assessment and remediation and for the phase-out and destruction of PCB-contaminated mineral oil removed from electrical equipment when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated.

There are uncertainties in estimating future environmental costs due to potential external events such as changes in legislation or regulations, and advances in remediation technologies. In determining the amounts to be recorded as environmental liabilities, the Company estimates the current cost of completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. A long-term inflation rate assumption of approximately 2% has been used to express these current cost estimates as estimated future expenditures. Future expenditures have been discounted using factors ranging from approximately 2.0% to 6.3%, depending on the appropriate rate for the period when expenditures are expected to be incurred. All factors used in estimating the Company's environmental liabilities represent management's best estimates of the present value of costs required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company's current assumptions. In addition, with respect to the PCB environmental liability, the availability of critical resources such as skilled labour and replacement assets and the ability to take maintenance outages in critical facilities may influence the timing of expenditures.

PCBs

The Environment Canada regulations, enacted under the *Canadian Environmental Protection Act, 1999*, govern the management, storage and disposal of PCBs based on certain criteria, including type of equipment, in-use status, and PCB-contamination thresholds. Under current regulations, Hydro One's PCBs have to be disposed of by the end of 2025, with the exception of specifically exempted equipment. Contaminated equipment will generally be replaced, or will be decontaminated by removing PCB-contaminated insulating oil and retro filling with replacement oil that contains PCBs in concentrations of less than 2 ppm.

The Company's best estimate of the total estimated future expenditures to comply with current PCB regulations is $158 million (2015 – $168 million). These expenditures are expected to be incurred over the period from 2017 to 2025. As a result of its annual review of environmental liabilities, the Company recorded a revaluation adjustment in 2016 to reduce the PCB environmental liability by $1 million (2015 – $24 million).

Land Assessment and Remediation

The Company's best estimate of the total estimated future expenditures to complete its land assessment and remediation program is $66 million (2015 – $61 million). These expenditures are expected to be incurred over the period from 2017 to 2032. As a result of its annual review of environmental liabilities, the Company recorded a revaluation adjustment in 2016 to increase the land assessment and remediation environmental liability by $10 million (2015 – $1 million).

20. ASSET RETIREMENT OBLIGATIONS

Hydro One records a liability for the estimated future expenditures for the removal and disposal of asbestos-containing materials installed in some of its facilities and for the decommissioning of specific switching stations located on unowned sites. Asset retirement obligations, which represent legal obligations associated with the retirement of certain tangible long-lived assets, are computed as the present value of the projected expenditures for the future retirement of specific assets and are recognized in the period in which the liability is incurred, if a reasonable estimate of fair value can be made. If the asset remains in service at the recognition date, the present value of the liability is added to the carrying amount of the associated asset in the period the liability is incurred and this additional carrying amount is depreciated over the remaining life of the asset. If an asset retirement obligation is recorded in respect of an out-of-service asset, the asset retirement cost is charged to results of operations. Subsequent to the initial recognition, the liability is adjusted for any revisions to the estimated future cash flows associated with the asset retirement obligation, which can occur due to a number of factors including, but not limited to, cost escalation, changes in technology applicable to the assets to be retired, changes in legislation or regulations, as well as for accretion of the liability due to the passage of time until the obligation is settled. Depreciation expense is adjusted prospectively for any increases or decreases to the carrying amount of the associated asset.

In determining the amounts to be recorded as asset retirement obligations, the Company estimates the current fair value for completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. A long-term inflation assumption of approximately 2% has been used to express these current cost estimates as estimated future expenditures. Future expenditures have been discounted using factors ranging from approximately 3.0% to 5.0%, depending on the appropriate rate for the period when expenditures are expected to be incurred. All factors used in estimating the Company’s asset retirement obligations represent management’s best estimates of the cost required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company’s current assumptions. Asset retirement obligations are reviewed annually or more frequently if significant changes in regulations or other relevant factors occur. Estimate changes are accounted for prospectively.

At December 31, 2016, Hydro One had recorded asset retirement obligations of $9 million (2015 – $9 million), primarily consisting of the estimated future expenditures associated with the removal and disposal of asbestos-containing materials installed in some of its facilities. The amount of interest recorded is nominal.

21. SHARE CAPITAL

Common Shares

The Company is authorized to issue an unlimited number of common shares. At December 31, 2016, the Company had 142,239 common shares issued and outstanding (2015 – 142,239).

In 2016, a return of stated capital in the amount of $609 million (2015 – $nil) was paid.

The amount and timing of any dividends payable by Hydro One is at the discretion of the Hydro One Board of Directors and is established on the basis of Hydro One’s results of operations, maintenance of its deemed regulatory capital structure, financial condition, cash requirements, the satisfaction of solvency tests imposed by corporate laws for the declaration and payment of dividends and other factors that the Board of Directors may consider relevant.

Preferred Shares

The Company is authorized to issue an unlimited number of preferred shares, issuable in series. At December 31, 2016, Hydro One had no issued and outstanding preferred shares.

On November 2, 2015, a special resolution of Hydro One Limited (as sole shareholder of Hydro One) was made to amend the articles of Hydro One to delete the share ownership restrictions and to amend the Hydro One preferred share terms to provide for basic redeemable preferred shares. When issued, the Class A preferred shares will be redeemable at the option of the Company. The holders of the Class A preferred shares will be entitled to receive, if and when declared by the Hydro One Board of Directors, non-cumulative preferred share dividends at a rate per year to be determined by the Hydro One Board of Directors. The holders of the Class A preferred shares will not be entitled to receive notice of, or to attend or to vote at, any meeting of the shareholders of Hydro One. The holders of the Class A preferred shares will be entitled to receive, before any distributions to the holders of common shares and any other shares ranking junior to the Class A preferred shares, an amount equal to the amount paid for the Class A preferred shares together with all dividends declared and unpaid up to the date of liquidation, dissolution or winding up of Hydro One, or the date of redemption.

Prior to October 31, 2015, the Company had 12,920,000 issued and outstanding 5.5% cumulative preferred shares held by the Province, with a redemption value of $25 per share or $323 million total value. These preferred shares were entitled to an annual cumulative dividend of $18 million, or $1.375 per share, which was payable on a quarterly basis. These preferred shares had conditions for their redemption that were outside the control of the Company because the Province could exercise its right to redeem in the event of change in ownership without approval of the Company's Board of Directors. At December 31, 2014, these preferred shares were classified on the Consolidated Balance Sheet as temporary equity because the redemption feature was outside the control of the Company. On October 31, 2015, these preferred shares were purchased and cancelled by Hydro One. See "Reorganization" below for further details.

Reorganization

Prior to the completion of the IPO, Hydro One and Hydro One Limited completed a series of transactions (Pre-IPO Transactions) that resulted in, among other things, on October 31, 2015, Hydro One Limited acquiring all of the issued and outstanding shares of Hydro One from the Province.

The following table presents the common shares issued during the year ended December 31, 2015.

Year ended December 31, 2015	*(millions of dollars)*	*(number of shares)*
Pre-Closing Transactions:		
Common shares issued – purchase and cancellation of preferred shares *(a)*	323	2,640
Common shares issued *(b)*	2,600	39,598
Common shares issued *(c)*	–	1
Total common shares issued	2,923	42,239

(a) On October 31, 2015, Hydro One purchased and cancelled its 12,920,000 preferred shares previously held by the Province for cancellation at a price equal to the redemption price of the preferred shares totalling $323 million, which was satisfied by the issuance to the Province of 2,640 common shares of Hydro One.

(b) On November 4, 2015, Hydro One issued 39,598 common shares to Hydro One Limited for proceeds of $2.6 billion.

(c) On November 3, 2015, Hydro One declared a stock dividend on its common shares, which due to the number of shares issued and the resulting effect on the price per share was treated as a stock split. On November 5, 2015, Hydro One effected a reverse split and issued as consideration one common share to Hydro One Limited. There was no impact to the capital structure of Hydro One as a net result of the stock dividend and the reverse split.

22. DIVIDENDS

In 2016, preferred share dividends in the amount of $nil (2015 – $13 million) and common share dividends in the amount of $2 million (2015 – $875 million) were declared.

In August 2015, Hydro One declared a dividend in-kind on its common shares payable in all of the issued and outstanding shares of Hydro One Brampton (see note 4).

23. EARNINGS PER SHARE

Basic and diluted earnings per common share (EPS) is calculated by dividing net income attributable to common shareholder of Hydro One by the weighted average number of common shares outstanding. The weighted average number of shares outstanding at December 31, 2016 was 142,239 (2015 – 107,116). There were no dilutive securities during 2016 or 2015.

24. STOCK-BASED COMPENSATION

The following compensation plans were established by Hydro One Limited, however they represent components of compensation costs of Hydro One in current and future periods.

Share Grant Plans

At December 31, 2016, Hydro One Limited had two share grant plans (Share Grant Plans), one for the benefit of certain members of the Power Workers' Union (the PWU Share Grant Plan) and one for the benefit of certain members of The Society of Energy Professionals (the Society Share Grant Plan). Hydro One and Hydro One Limited entered into an intercompany agreement, such that Hydro One will pay Hydro One Limited for the compensation costs associated with these plans.

The PWU Share Grant Plan provides for the issuance of common shares of Hydro One Limited from treasury to certain eligible members of the Power Workers' Union annually, commencing on April 1, 2017 and continuing until the earlier of April 1, 2028 or the date an eligible employee no longer meets the eligibility criteria of the PWU Share Grant Plan. To be eligible, an employee must be a member of the Pension Plan on April 1, 2015, be employed on the date annual share issuance occurs and continue to have under 35 years of service. The requisite service period for the PWU Share Grant Plan begins on July 3, 2015, which is the date the share grant plan was ratified by the PWU. The number of common shares issued annually to each eligible employee will be equal to 2.7% of such eligible employee's salary as at April 1, 2015, divided by $20.50, being the price of the common shares of Hydro One Limited in the IPO. The aggregate number of Hydro One Limited common shares issuable under the PWU Share Grant Plan shall not exceed 3,981,763 common shares. In 2015, 3,952,212 Hydro One Limited common shares were granted under the PWU Share Grant Plan relevant to the total share based compensation recognized by Hydro One.

The Society Share Grant Plan provides for the issuance of common shares of Hydro One Limited from treasury to certain eligible members of The Society of Energy Professionals annually, commencing on April 1, 2018 and continuing until the earlier of April 1, 2029 or the date an eligible employee no longer meets the eligibility criteria of the Society Share Grant Plan. To be eligible, an employee must be a member of the Pension Plan on September 1, 2015, be employed on the date annual share issuance occurs and continue to have under 35 years of service. Therefore the requisite service period for the Society Share Grant Plan begins on September 1, 2015. The number of common shares issued annually to each eligible employee will be equal to 2.0% of such eligible employee's salary as at September 1, 2015, divided by $20.50, being the price of the common shares of Hydro One Limited in the IPO. The aggregate number of Hydro One Limited common shares issuable under the Society Share Grant Plan shall not exceed 1,434,686 common shares. In 2015, 1,367,158 Hydro One Limited common shares were granted under the Society Share Grant Plan relevant to the total share based compensation recognized by Hydro One.

The fair value of the Hydro One Limited 2015 share grants of $111 million was estimated based on the grant date Hydro One Limited share price of $20.50 and is recognized using the graded-vesting attribution method as the share grant plans have both a performance condition and a service condition. No shares were granted under the Share Grant Plans in 2016. Total share based compensation recognized during 2016 was $21 million (2015 – $10 million) and was recorded as a regulatory asset.

A summary of share grant activity under the Share Grant Plans during years ended December 31, 2016 and 2015 is presented below:

Year ended December 31, 2016	Share Grants *(number of common shares)*	Weighted-Average Price
Share grants outstanding – January 1, 2016	5,319,370	$20.50
Granted (non-vested)	–	–
Forfeited[1]	(79,692)	$20.50
Share grants outstanding – December 31, 2016	5,239,678	$20.50

[1] Includes shares forfeited as well as shares transferred corresponding to transfer of employees from an affiliate company.

Year ended December 31, 2015	Share Grants *(number of common shares)*	Weighted-Average Price
Share grants outstanding – January 1, 2015	–	–
Granted (non-vested)	5,319,370	$20.50
Share grants outstanding – December 31, 2015	5,319,370	$20.50

Directors' DSU Plan

Under the Directors' DSU Plan, directors can elect to receive credit for their annual cash retainer in a notional account of DSUs in lieu of cash. Hydro One Limited's Board of Directors may also determine from time to time that special circumstances exist that would reasonably justify the grant of DSUs to a director as compensation in addition to any regular retainer or fee to which the director is entitled.

Each DSU represents a unit with an underlying value equivalent to the value of one common share of Hydro One Limited and is entitled to accrue Hydro One Limited common share dividend equivalents in the form of additional DSUs at the time dividends are paid, subsequent to declaration by Hydro One Limited's Board of Directors.

Year ended December 31 *(number of DSUs)*	2016	2015
DSUs outstanding – January 1	20,525	–
DSUs granted	78,558	20,525
DSUs outstanding – December 31	99,083	20,525

For the year ended December 31, 2016, an expense of $2 million (2015 – less than $1 million) was recognized in earnings with respect to the DSU Plan. At December 31, 2016, a liability of $2 million (December 31, 2015 – less than $1 million), related to outstanding DSUs has been recorded at the closing price of Hydro One Limited's common shares of $23.58 and is included in accrued liabilities on the Consolidated Balance Sheets.

Employee Share Ownership Plan

Effective December 15, 2015, Hydro One Limited established an Employee Share Ownership Plan (ESOP). Under the ESOP, certain eligible management and non-represented employees may contribute between 1% and 6% of their base salary towards purchasing common shares of Hydro One Limited. The Company matches 50% of the employee's contributions, up to a maximum Company contribution of $25,000 per calendar year. In 2016, Company contributions made under the ESOP were $2 million (2015 - $nil).

Long-term Incentive Plan

Effective August 31, 2015, the Board of Directors of Hydro One Limited adopted an LTIP. Under the LTIP, long-term incentives are granted to certain executive and management employees of Hydro One Limited and its subsidiaries, and all equity-based awards will be settled in newly issued shares of Hydro One Limited from treasury, consistent with the provisions of the plan. The aggregate number of shares issuable under the LTIP shall not exceed 11,900,000 shares of Hydro One Limited.

The LTIP provides flexibility to award a range of vehicles, including restricted share units (RSUs), performance share units (PSUs), stock options, share appreciation rights, restricted shares, deferred share units and other share-based awards. The mix of vehicles is intended to vary by role to recognize the level of executive accountability for overall business performance.

During 2016, Hydro One Limited granted awards under its LTIP, consisting of PSUs and RSUs, all of which are equity settled in Hydro One Limited shares, as follows:

Year ended December 31, 2016	Number of PSUs	Number of RSUs
Units outstanding – January 1, 2016	–	–
Units granted	233,710	257,260
Units forfeited	(4,820)	(4,820)
Units outstanding – December 31, 2016	228,890	252,440

The grant date total fair value of the awards was $12 million (2015 – $nil). The compensation expense recognized by the Company relating to these awards during 2016 was $3 million (2015 – $nil).

25. NONCONTROLLING INTEREST

On December 16, 2014, transmission assets totalling $526 million were transferred from Hydro One Networks to B2M LP. This was financed by 60% debt ($316 million) and 40% equity ($210 million). On December 17, 2014, the Saugeen Ojibway Nation (SON) acquired a 34.2% equity interest in B2M LP for consideration of $72 million, representing the fair value of the equity interest acquired. The SON's initial investment in B2M LP consists of $50 million of Class A units and $22 million of Class B units.

The Class B units have a mandatory put option which requires that upon the occurrence of an enforcement event (i.e. an event of default such as a debt default by the SON or insolvency event), Hydro One purchase the Class B units of B2M LP for net book value on the redemption date. The noncontrolling interest relating to the Class B units is classified on the Consolidated Balance Sheet as temporary equity because the redemption feature is outside the control of the Company. The balance of the noncontrolling interest is classified within equity.

The following tables show the movements in noncontrolling interest for the years ended December 31, 2016 and 2015:

Year ended December 31, 2016 *(millions of dollars)*	Temporary Equity	Equity	Total
Noncontrolling interest – January 1, 2016	23	52	75
Distributions to noncontrolling interest	(3)	(6)	(9)
Net income attributable to noncontrolling interest	2	4	6
Noncontrolling interest – December 31, 2016	22	50	72

Year ended December 31, 2015 *(millions of dollars)*	Temporary Equity	Equity	Total
Noncontrolling interest – January 1, 2015	21	49	70
Distributions to noncontrolling interest	(1)	(4)	(5)
Net income attributable to noncontrolling interest	3	7	10
Noncontrolling interest – December 31, 2015	23	52	75

26. RELATED PARTY TRANSACTIONS

Hydro One is owned by Hydro One Limited. The Province is the majority shareholder of Hydro One Limited. The IESO, Ontario Power Generation Inc. (OPG), OEFC, OEB, Hydro One Brampton and Hydro One Telecom are related parties to Hydro One because they are controlled or significantly influenced by the Province or by Hydro One Limited.

		Year ended December 31	
		2016	2015
Related Party	Transaction	(millions of dollars)	
Province[1]	Dividends paid	–	888
IESO	Power purchased	2,096	2,318
	Revenues for transmission services	1,549	1,548
	Distribution revenues related to rural rate protection	125	127
	Distribution revenues related to the supply of electricity to remote northern communities	32	32
	Funding received related to Conservation and Demand Management programs	63	70
OPG	Power purchased	6	11
	Revenues related to provision of construction and equipment maintenance services	4	7
	Costs expensed related to the purchase of services	1	1
OEFC	Payments in lieu of corporate income taxes[2]	–	2,933
	Power purchased from power contracts administered by the OEFC	1	6
	Indemnification fee paid (terminated effective October 31, 2015)	–	8
OEB	OEB fees	11	12
Hydro One Brampton[1]	Revenues from management, administrative and smart meter network services	3	1
Hydro One Limited	Common shares issued[3]	–	2,600
	Return of stated capital	609	–
	Dividends paid	2	–
	Stock-based compensation costs	24	10
	IPO costs subsequently reimbursed by Hydro One Limited[4]	–	7
Hydro One Telecom	Services received – costs expensed	24	4
	Services received – costs capitalized	12	2
	Revenues for services provided	3	–

[1] On August 31, 2015, Hydro One completed the spin-off of its subsidiary, Hydro One Brampton, to the Province.

[2] In 2015, Hydro One made PILs to the OEFC totalling $2.9 billion, including Departure Tax of $2.6 billion.

[3] On November 4, 2015, Hydro One issued 39,598 common shares to Hydro One Limited for proceeds of $2.6 billion.

[4] In 2015, Hydro One incurred certain IPO related expenses totalling $7 million, which were subsequently reimbursed to the Company by Hydro One Limited.

Sales to and purchases from related parties are based on the requirements of the OEB's Affiliate Relationships Code. Outstanding balances at period end are interest free and settled in cash.

The amounts due to and from related parties as a result of the transactions referred to above are as follows:

December 31 (millions of dollars)	2016	2015
Due from related parties	224	184
Due to related parties[1]	(279)	(142)

[1] Included in due to related parties at December 31, 2016 are amounts owing to the IESO in respect of power purchases of $143 million (2015 – $134 million).

27. CONSOLIDATED STATEMENTS OF CASH FLOWS

The changes in non-cash balances related to operations consist of the following:

Year ended December 31 *(millions of dollars)*	2016	2015
Accounts receivable	(59)	249
Due from related parties	(40)	40
Materials and supplies	2	2
Prepaid expenses and other assets	(17)	12
Accounts payable	18	(26)
Accrued liabilities	52	(27)
Due to related parties	113	(95)
Accrued interest	9	(4)
Long-term accounts payable and other liabilities	6	–
Post-retirement and post-employment benefit liability	84	41
	168	192

Capital Expenditures

The following table reconciles between investments in property, plant and equipment and the amount presented in the Consolidated Statements of Cash Flows after accounting for capitalized depreciation and the net change in related accruals:

Year ended December 31 *(millions of dollars)*	2016	2015
Capital investments in property, plant and equipment	(1,624)	(1,622)
Capitalized depreciation and net change in accruals included in capital investments in property, plant and equipment	30	28
Capital expenditures – property, plant and equipment	(1,594)	(1,594)

The following table reconciles between investments in intangible assets and the amount presented in the Consolidated Statements of Cash Flows after accounting for the net change in related accruals:

Year ended December 31 *(millions of dollars)*	2016	2015
Capital investments in intangible assets	(67)	(40)
Net change in accruals included in capital investments in intangible assets	6	3
Capital expenditures – intangible assets	(61)	(37)

Capital Contributions

Hydro One enters into contracts governed by the OEB Transmission System Code when a transmission customer requests a new or upgraded transmission connection. The customer is required to make a capital contribution to Hydro One based on the shortfall between the present value of the costs of the connection facility and the present value of revenues. The present value of revenues is based on an estimate of load forecast for the period of the contract with Hydro One. Once the connection facility is commissioned, in accordance with the OEB Transmission System Code, Hydro One will periodically reassess the estimated of load forecast which will lead to a decrease, or an increase in the capital contributions from the customer. The increase or decrease in capital contributions is recorded directly to fixed assets in service. In 2016, capital contributions from these reassessments totalled $21 million (2015 – $57 million), which represents the difference between the revised load forecast of electricity transmitted compared to the load forecast in the original contract, subject to certain adjustments.

Supplementary Information

Year ended December 31 *(millions of dollars)*	2016	2015
Net interest paid	418	416
Income taxes / PILs paid	30	2,928

28. CONTINGENCIES

Legal Proceedings

Hydro One is involved in various lawsuits, claims and regulatory proceedings in the normal course of business. In the opinion of management, the outcome of such matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Hydro One Inc., Hydro One Networks, Hydro One Remote Communities, and Norfolk Power Distribution Inc. are defendants in a class action suit in which the representative plaintiff is seeking up to $125 million in damages related to allegations of improper billing practices. A certification motion in the class action is pending. Due to the preliminary stage of legal proceedings, an estimate of a possible loss related to this claim cannot be made.

Transfer of Assets

The transfer orders by which the Company acquired certain of Ontario Hydro's businesses as of April 1, 1999 did not transfer title to some assets located on Reserves (as defined in the *Indian Act* (Canada)). Currently, the OEFC holds these assets. Under the terms of the transfer orders, the Company is required to manage these assets until it has obtained all consents necessary to complete the transfer of title of these assets to itself. The Company cannot predict the aggregate amount that it may have to pay, either on an annual or one-time basis, to obtain the required consents. In 2016, the Company paid approximately $1 million (2015 – $1 million) in respect of consents obtained. If the Company cannot obtain the required consents, the OEFC will continue to hold these assets for an indefinite period of time. If the Company cannot reach a satisfactory settlement, it may have to relocate these assets to other locations at a cost that could be substantial or, in a limited number of cases, to abandon a line and replace it with diesel-generation facilities. The costs relating to these assets could have a material adverse effect on the Company's results of operations if the Company is not able to recover them in future rate orders.

29. COMMITMENTS

The following table presents a summary of Hydro One's commitments under leases, outsourcing and other agreements due in the next 5 years and thereafter.

December 31, 2016 *(millions of dollars)*	2017	2018	2019	2020	2021	Thereafter
Outsourcing agreements	165	102	94	2	2	9
Long-term software/meter agreement	17	17	16	17	1	5
Operating lease commitments	9	9	4	8	2	2

Outsourcing Agreements

Inergi LP (Inergi), an affiliate of Capgemini Canada Inc., provides services to Hydro One, including settlements, source to pay services, pay operations services, information technology, finance and accounting services. The agreement with Inergi for these services expires in December 2019. In addition, Inergi provides customer service operations outsourcing services to Hydro One. The agreement for these services expires in February 2018.

Brookfield Global Integrated Solutions (formerly Brookfield Johnson Controls Canada LP) (Brookfield) provides services to Hydro One, including facilities management and execution of certain capital projects as deemed required by the Company. The agreement with Brookfield for these services expires in December 2024.

Long-term software/meter agreement

Trilliant Holdings Inc. and Trilliant Networks (Canada) Inc. (collectively Trilliant) provide services to Hydro One for the supply, maintenance and support services for smart meters and related hardware and software, including additional software licences, as well as certain professional services.The agreement with Trilliant for these services expires in December 2025, but Hydro One has the option to renew for an additional term of five years at its sole discretion.

Operating Leases

Hydro One is committed as lessee to irrevocable operating lease contracts for buildings used in administrative and service-related functions. These leases have typical terms of between three and five years, but several leases have lesser or greater terms to address special circumstances and/or opportunities. Renewal options, which are generally prevalent in most leases, have similar terms of three to five years. All leases include a clause to enable upward revision of the rental charge on an annual basis or on renewal according to prevailing market conditions or pre-established rents. There are no restrictions placed upon Hydro One by entering into these leases. During the year ended December 31, 2016, the Company made lease payments totalling $10 million (2015 – $6 million).

Other Commitments

Prudential Support

Purchasers of electricity in Ontario, through the IESO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. As at December 31, 2016, Hydro One provided prudential support to the IESO on behalf of its subsidiaries using parental guarantees of $329 million (2015 – $329 million), and on behalf of a distributor using guarantees of $1 million (2015 – $1 million). In addition, as at December 31, 2016, Hydro One provided letters of credit in the amount of $24 million (2015 – $15 million), including $17 million (2015 – $15 million) to the IESO. The IESO could draw on these guarantees and/or letters of credit if these subsidiaries or distributor fail to make a payment required by a default notice issued by the IESO. The maximum potential payment is the face value of any letters of credit plus the amount of the parental guarantees.

Retirement Compensation Arrangements

Bank letters of credit have been issued to provide security for the Company's liability under the terms of a trust fund established pursuant to the supplementary pension plan for eligible employees of Hydro One. The supplementary pension plan trustee is required to draw upon these letters of credit if Hydro One is in default of its obligations under the terms of this plan. Such obligations include the requirement to provide the trustee with an annual actuarial report as well as letters of credit sufficient to secure the Company's liability under the plan, to pay benefits payable under the plan and to pay the letter of credit fee. The maximum potential payment is the face value of the letters of credit. At December 31, 2016, Hydro One had letters of credit of $150 million (2015 – $139 million) outstanding relating to retirement compensation arrangements.

30. SEGMENTED REPORTING

Hydro One has three reportable segments:

- The Transmission Business, which comprises the transmission of high voltage electricity across the province, interconnecting more than 70 local distribution companies and certain large directly connected industrial customers throughout the Ontario electricity grid;
- The Distribution Business, which comprises the delivery of electricity to end customers and certain other municipal electricity distributors; and
- Other Business, which includes certain corporate activities. The comparative information also includes the operations of Hydro One Telecom up to November 4, 2015.

The designation of segments has been based on a combination of regulatory status and the nature of the services provided. Operating segments of the Company are determined based on information used by the chief operating decision maker in deciding how to allocate resources and evaluate the performance of each of the segments. The Company evaluates segment performance based on income before financing charges and income taxes from continuing operations (excluding certain allocated corporate governance costs).

The accounting policies followed by the segments are the same as those described in the summary of significant accounting policies (see note 2).

Year ended December 31, 2016 *(millions of dollars)*	**Transmission**	**Distribution**	**Other**	**Consolidated**
Revenues	1,587	4,915	–	6,502
Purchased power	–	3,427	–	3,427
Operation, maintenance and administration	410	613	20	1,043
Depreciation and amortization	390	379	–	769
Income (loss) before financing charges and income taxes	787	496	(20)	1,263
Capital investments	988	703	–	1,691

Year ended December 31, 2015 *(millions of dollars)*	**Transmission**	**Distribution**	**Other**	**Consolidated**
Revenues	1,536	4,949	44	6,529
Purchased power	–	3,450	–	3,450
Operation, maintenance and administration	415	633	82	1,130
Depreciation and amortization	374	380	3	757
Income (loss) before financing charges and income taxes	747	486	(41)	1,192
Capital investments	943	711	8	1,662

Total Assets by Segment:

December 31 *(millions of dollars)*	2016	2015
Transmission	13,083	12,045
Distribution	9,393	9,200
Other	2,834	2,924
Total assets	25,310	24,169

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

31. SUBSEQUENT EVENTS

Return of Stated Capital

On February 9, 2017, a return of stated capital in the amount of $147 million was approved.

HYDRO ONE NETWORKS INC.

DISTRIBUTION BUSINESS

FINANCIAL STATEMENTS

DECEMBER 31, 2017

To the Directors of Hydro One Networks Inc.

We have audited the accompanying carve-out financial statements of the Distribution Business (a business of Hydro One Networks Inc.), which comprise the carve-out balance sheet as at December 31, 2017, the carve-out statements of operations and comprehensive income, and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information. The carve-out financial statements have been prepared by management in accordance with the basis of accounting in Note 2 to the carve-out financial statements.

Management's Responsibility for the Carve-out Financial Statements

Management of Hydro One Networks Inc. is responsible for the preparation of these carve-out financial statements in accordance with the basis of accounting in Note 2 to the carve-out financial statements; this includes determining that the basis of accounting is an acceptable basis for the preparation of these carve-out financial statements in the circumstances, and for such internal control as management determines is necessary to enable the preparation of carve-out financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the carve-out financial statements as at and for the year ended December 31, 2017 are prepared, in all material respects, in accordance with the basis of accounting in Note 2 to the carve-out financial statements.

Basis of Accounting and Restriction of Use

Without modifying our opinion, we draw attention to Note 2 to the carve-out financial statements, which describes the basis of preparation used in these carve-out financial statements. In particular, in preparing the carve-out financial statements, long-term debt, shared functions and service costs, and income taxes have been allocated to the Distribution Business (a business of Hydro One Networks Inc.) using the method of allocation described in Note 2 to the carve-out financial statements. As a result, the carve-out financial statements may not necessarily be identical to the balance sheet, results of operations and cash flows that would have resulted had the Distribution Business (a business of Hydro One Networks Inc.) historically operated on a stand-alone basis. The carve-out financial statements are prepared to assist Hydro One Networks Inc. to comply with its reporting requirements of the Ontario Energy Board. As a result, the carve-out financial statements may not be suitable for another purpose.

Our report is intended solely for the Directors of Hydro One Networks Inc. and the Ontario Energy Board and should not be used by parties other than Hydro One Networks Inc. or the Ontario Energy Board.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Canada
April 27, 2018

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
For the years ended December 31, 2017 and 2016

Year ended December 31 *(millions of Canadian dollars)*	**2017**	**2016**
Revenues		
Energy sales	4,005	4,609
Rural rate protection *(Note 23)*	247	125
Other	63	58
	4,315	4,792
Costs		
Purchased power *(Note 23)*	2,875	3,365
Operation, maintenance and administration *(Note 23)*	567	567
Depreciation and amortization *(Note 5)*	388	375
	3,830	4,307
Income before financing charges and income taxes	**485**	**485**
Financing charges *(Notes 6, 23)*	165	156
Income before income taxes	**320**	**329**
Income taxes *(Note 7)*	55	58
Net income	**265**	**271**
Other comprehensive income	—	—
Comprehensive income	**265**	**271**

See accompanying notes to Financial Statements.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
BALANCE SHEETS
At December 31, 2017 and 2016

December 31 *(millions of Canadian dollars)*	**2017**	**2016**
Assets		
Current assets:		
Cash and cash equivalents	—	9
Accounts receivable *(Note 8)*	588	786
Due from related parties *(Note 23)*	138	33
Other current assets *(Note 9)*	38	44
	764	872
Property, plant and equipment *(Note 10)*	7,324	7,098
Other long-term assets:		
Regulatory assets *(Note 12)*	638	867
Intangible assets *(Note 11)*	289	268
Goodwill	168	168
Other assets	1	1
	1,096	1,304
Total assets	**9,184**	**9,274**
Liabilities		
Current liabilities:		
Inter-company demand facility *(Note 23)*	167	74
Long-term debt payable within one year *(Notes 15, 16, 23)*	337	195
Accounts payable and other current liabilities *(Note 13)*	679	638
Due to related parties *(Note 23)*	218	178
	1,401	1,085
Long-term liabilities:		
Long-term debt *(Notes 15, 16, 23)*	3,498	3,837
Deferred income tax liabilities *(Note 7)*	499	492
Regulatory liabilities *(Note 12)*	84	81
Other long-term liabilities *(Note 14)*	934	1,013
	5,015	5,423
Total liabilities	**6,416**	**6,508**
Contingencies and Commitments (Notes 25, 26)		
Subsequent Events (Note 27)		
Excess of assets over liabilities *(Notes 17, 21)*	2,768	2,766
Total liabilities and excess of assets over liabilities	**9,184**	**9,274**

See accompanying notes to Financial Statements.

On behalf of the Board of Directors:

Philip Orsino
Chair, Audit Committee

Mayo Schmidt
Director

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2017 and 2016

Year ended December 31 *(millions of Canadian dollars)*	**2017**	**2016**
Operating activities		
Net income	265	271
Environmental expenditures	(15)	(12)
Adjustments for non-cash items:		
Depreciation and amortization (excluding asset removal costs)	337	320
Regulatory assets and liabilities	172	(11)
Deferred income taxes	(44)	36
Other	5	4
Changes in non-cash balances related to operations *(Note 24)*	219	126
Net cash from operating activities	**939**	**734**
Financing activities		
Long-term debt issued	—	1,050
Long-term debt repaid	(195)	(200)
Payments to finance dividends and return on stated capital	(263)	(293)
Change in inter-company demand facility	92	(613)
Other	—	(5)
Net cash used in financing activities	**(366)**	**(61)**
Investing activities		
Capital expenditures *(Note 24)*		
Property, plant and equipment	(522)	(635)
Intangible assets	(56)	(38)
Other	(4)	7
Net cash used in investing activities	**(582)**	**(666)**
Net change in cash and cash equivalents	(9)	7
Cash and cash equivalents, beginning of year	9	2
Cash and cash equivalents, end of year	**—**	**9**

See accompanying notes to Financial Statements.

1. DESCRIPTION OF THE BUSINESS

Hydro One Inc. (Hydro One) was incorporated on December 1, 1998, under the *Business Corporations Act* (Ontario) and is wholly-owned by Hydro One Limited. The principal businesses of Hydro One are the transmission and distribution of electricity to customers within Ontario.

Hydro One Networks Inc. (Hydro One Networks or the Company) was incorporated on March 4, 1999 under the *Business Corporations Act* (Ontario) and is a wholly owned subsidiary of Hydro One. The Company owns and operates regulated transmission and distribution businesses. The regulated distribution business (Distribution Business) operates a low-voltage electrical distribution network that distributes electricity from the transmission system, or directly from generators, to customers within Ontario. The Distribution Business is regulated by the Ontario Energy Board (OEB).

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

These Financial Statements are prepared and presented in accordance with the accounting policies summarized below and in Canadian dollars. These policies are consistent with United States (US) Generally Accepted Accounting Principles (GAAP), with the exception that business combinations of entities under common control have been accounted for as of the date of the transfer, such that (1) the Financial Statements were not prepared as though the transfer of entities under common control had occurred at the beginning of the year in which the transfer occurred and (2) the comparative year information has not been retrospectively adjusted.

These Financial Statements have been prepared for the specific use of the OEB and as a result, may not be suitable for any other purpose. Consolidated Financial Statements of Hydro One for the year ended December 31, 2017 have been prepared and are publicly available.

These Financial Statements have been prepared on a carve-out basis to provide the financial position, results of operations and cash flows of the Company's regulated Distribution Business on a basis approved by the OEB. The Financial Statements are considered by management to be a reasonable representation, prepared on a rational, systematic and consistent basis, of the financial results of the Company's Distribution Business. As a result of this basis of accounting, these Financial Statements may not necessarily be identical to the financial position and results of operations that would have resulted had the Distribution Business historically operated on a stand-alone basis.

The Financial Statements have been constructed primarily through specific identification of assets, liabilities (other than debt), revenues and expenses that relate to the Distribution Business. The Company's long-term debt is allocated based on the respective borrowing requirements of the Company's transmission and distribution businesses. A portion of the Company's shared functions and services costs is allocated to the Distribution Business on a fully allocated-cost basis, consistent with OEB-approved independent studies. Income tax expense has been recorded at effective rates based on income taxes as reported in the Statements of Operations and Comprehensive Income as though the Distribution Business was a separate taxpaying entity. However, income taxes paid and the deferred tax asset recognized by the Company in relation to the Company losing its exemption from tax under the Federal Tax Regime have been excluded as they represent transactions that are not included in the rate-setting process of the Distribution Business. Certain other amounts presented in these Financial Statements represent allocations subject to review and approval by the OEB.

Hydro One Networks performed an evaluation of subsequent events through to April 27, 2018, the date these Financial Statements were available to be issued, to determine whether any events or transactions warranted recognition and disclosure in these Financial Statements. See note 27 - Subsequent Events.

Use of Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains and losses during the reporting periods. Management evaluates these estimates on an ongoing basis based upon historical experience, current conditions, and assumptions believed to be reasonable at the time the assumptions are made, with any adjustments being recognized in results of operations in the period they arise. Significant estimates relate to regulatory assets and regulatory liabilities, environmental liabilities, post-retirement and post-employment benefits, asset retirement obligations, asset impairments, contingencies, and deferred income tax assets and liabilities. Actual results may differ significantly from these estimates.

Rate Setting

In March 2015, the OEB approved Hydro One Networks' distribution revenue requirements of $1,326 million for 2015, $1,430 million for 2016 and $1,486 million for 2017. The OEB has subsequently approved updated revenue requirements of $1,410 million for 2016 and $1,415 million for 2017.

Regulatory Accounting

The OEB has the general power to include or exclude revenues, costs, gains or losses in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have been applied in an unregulated company. Such change in timing involves the application of rate-regulated accounting, giving rise to the recognition of regulatory assets and liabilities. The Distribution Business' regulatory assets represent amounts receivable from future customers and costs that have been deferred for accounting purposes because it is probable that they will be recovered in future rates. In addition, the Distribution Business has recorded regulatory liabilities that generally represent amounts that are refundable to future customers. The Distribution Business continually assesses the likelihood of recovery of each of its regulatory assets and continues to believe that it is probable that the OEB will include its regulatory assets and liabilities in setting future rates. If, at some future date, the Distribution Business judges that it is no longer probable that the OEB will include a regulatory asset or liability in setting future rates, the appropriate carrying amount would be reflected in results of operations in the period that the assessment is made.

Revenue Recognition

Distribution revenues attributable to the delivery of electricity are based on OEB-approved distribution rates and are recognized on an accrual basis and include billed and unbilled revenues. Billed revenues are based on electricity delivered as measured from customer meters. At the end of each month, electricity delivered to customers since the date of the last billed meter reading is estimated, and the corresponding unbilled revenue is recorded. The unbilled revenue estimate is affected by energy consumption, weather, and changes in the composition of customer classes. Distribution revenue also includes an amount relating to rate protection for rural, residential, and remote customers, which is received from the Independent Electricity System Operator (IESO) based on a standardized customer rate that is approved by the OEB. Revenues are recorded net of indirect taxes.

Accounts Receivable and Allowance for Doubtful Accounts

Billed accounts receivable are recorded at the invoiced amount, net of allowance for doubtful accounts. Unbilled accounts receivable are recorded at their estimated value. Overdue amounts related to regulated billings bear interest at OEB-approved rates. The allowance for doubtful accounts reflects the Distribution Business' best estimate of losses on billed accounts receivable balances. The Distribution Business estimates the allowance for doubtful accounts on billed accounts receivable by applying internally developed loss rates to the outstanding receivable balances by aging category. Loss rates applied to the billed accounts receivable balances are based on historical overdue balances, customer payments and write-offs. Accounts receivable are written-off against the allowance when they are deemed uncollectible. The allowance for doubtful accounts is affected by changes in volume, prices and economic conditions.

Income Taxes

Current and deferred income taxes are computed based on the tax rates and tax laws enacted as at the balance sheet date. Tax benefits associated with income tax positions taken, or expected to be taken, in a tax return are recorded only when the "more-likely-than-not" recognition threshold is satisfied and are measured at the largest amount of benefit that has a greater than 50% likelihood of being realized upon settlement. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. Significant management judgment is required to determine recognition thresholds and the related amount of tax benefits to be recognized in the Financial Statements. Management re-evaluates tax positions each period using new information about recognition or measurement as it becomes available.

Deferred Income Taxes

Deferred income taxes are provided for using the liability method. Under this method, deferred income tax liabilities are recognized on all taxable temporary differences between the tax bases and carrying amounts of assets and liabilities. Deferred income tax assets are recognized for deductible temporary differences between tax bases and carrying amounts of assets and liabilities, the carry forward unused tax credits and tax losses to the extent that it is more-likely-than-not that these deductions, credits, and losses can be utilized. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized, based on the tax rates and tax laws that have been enacted as at the balance sheet date. Deferred income taxes that are not included in the rate-setting process are charged or credited to the Statements of Operations and Comprehensive Income.

Management reassesses the deferred income tax assets at each balance sheet date and reduces the amount to the extent that it is more-likely-than-not that the deferred income tax asset will not be realized. Previously unrecognized deferred income tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become more-likely-than-not that the tax benefit will be realized.

The Distribution Business records regulatory assets and liabilities associated with deferred income tax assets and liabilities that will be included in the rate-setting process.

The Distribution Business uses the flow-through method to account for investment tax credits (ITCs) earned on eligible scientific research and experimental development expenditures, and apprenticeship job creation. Under this method, only non-refundable ITCs are recognized as a reduction to income tax expense.

Inter-company Demand Facility

Hydro One maintains pooled bank accounts for its use and for the use of its subsidiaries, and implicitly, by the regulated businesses of its subsidiaries. The balance in the inter-company demand facility represents the cumulative net effect of all deposits and withdrawals made by the Distribution Business to and from the pooled bank accounts. Interest is earned on positive inter-company balances based on the average of the bankers' acceptance rate at the beginning and end of the month, less 0.02%. Interest is charged on overdraft inter-company balances based on the same bankers' acceptance rate, plus 0.15%.

Materials and Supplies

Materials and supplies represent consumables, small spare parts and construction materials held for internal construction and maintenance of property, plant and equipment. These assets are carried at average cost less any impairments recorded.

Property, Plant and Equipment

Property, plant and equipment is recorded at original cost, net of customer contributions, and any accumulated impairment losses. The cost of additions, including betterments and replacement asset components, is included on the Balance Sheets as property, plant and equipment.

The original cost of property, plant and equipment includes direct materials, direct labour (including employee benefits), contracted services, attributable capitalized financing costs, asset retirement costs, and direct and indirect overheads that are related to the capital project or program. Indirect overheads include a portion of corporate costs such as finance, treasury, human resources, information technology and executive costs. Overhead costs, including corporate functions and field services costs, are capitalized on a fully allocated basis, consistent with an OEB-approved methodology.

Property, plant and equipment in service consists of distribution, communication, administration and service assets and land easements. Property, plant and equipment also includes future use assets, such as land, major components and spare parts, and capitalized project development costs associated with deferred capital projects.

<u>Distribution</u>

Distribution assets include assets related to the distribution of low-voltage electricity, including lines, poles, switches, transformers, protective devices and metering systems.

<u>Communication</u>

Communication assets include fibre optic and microwave radio systems, optical ground wire, towers, telephone equipment and associated buildings.

<u>Administration and Service</u>

Administration and service assets include administrative buildings, personal computers, transport and work equipment, tools and other minor assets.

Intangible Assets

Intangible assets separately acquired or internally developed are measured on initial recognition at cost, which comprises purchased software, direct labour (including employee benefits), consulting, engineering, overheads and attributable capitalized financing charges. Following initial recognition, intangible assets are carried at cost, net of any accumulated amortization and accumulated impairment losses. The Distribution Business' intangible assets primarily represent major computer applications.

Capitalized Financing Costs

Capitalized financing costs represent interest costs attributable to the construction of property, plant and equipment or development of intangible assets. The financing cost of attributable borrowed funds is capitalized as part of the acquisition cost of such assets. The capitalized financing costs are a reduction of financing charges recognized in the Statements of Operations and Comprehensive Income. Capitalized financing costs are calculated using the Company's weighted average effective cost of debt.

Construction and Development in Progress

Construction and development in progress consists of the capitalized cost of constructed assets that are not yet complete and which have not yet been placed in service.

Depreciation and Amortization

The cost of property, plant and equipment and intangible assets is depreciated or amortized on a straight-line basis based on the estimated remaining service life of each asset category, except for transport and work equipment, which is depreciated on a declining balance basis.

The Company periodically initiates an external independent review of its property, plant and equipment and intangible asset depreciation and amortization rates, as required by the OEB. Any changes arising from OEB approval of such a review are implemented on a remaining service life basis, consistent with their inclusion in electricity rates. The most recent review resulted in changes to rates effective January 1, 2015 for Hydro One Networks' distribution business. A summary of average service lives and depreciation and amortization rates for the various classes of assets is included below:

	Average	Rate	
	Service Life	Range	Average
Property, plant and equipment:			
Distribution	46 years	1% - 7%	2%
Communication	8 years	1% - 15%	10%
Administration and service	20 years	1% - 20%	6%
Intangible assets	10 years	10%	10%

In accordance with group depreciation practices, the original cost of property, plant and equipment, or major components thereof, and intangible assets that are normally retired, is charged to accumulated depreciation, with no gain or loss being reflected in results of operations. Where a disposition of property, plant and equipment occurs through sale, a gain or loss is calculated based on proceeds and such gain or loss is included in depreciation expense.

Acquisitions and Goodwill

The Company accounts for business acquisitions using the acquisition method of accounting and, accordingly, the assets and liabilities of the acquired entities are primarily measured at their estimated fair value at the date of acquisition. Costs associated with pending acquisitions are expensed as incurred. Goodwill represents the cost of acquired companies that is in excess of the fair value of the net identifiable assets acquired at the acquisition date. Goodwill is not included in rate base.

Goodwill is evaluated for impairment on an annual basis, or more frequently if circumstances require. The Company performs a qualitative assessment to determine whether it is more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount. If the Company determines, as a result of its qualitative assessment, that it is not more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount, no further testing is required. If the Company determines, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount, a goodwill impairment assessment is performed using a two-step, fair value-based test. The first step compares the fair value of the applicable reporting unit to its carrying amount, including goodwill. If the carrying amount of the applicable reporting unit exceeds its fair value, a second step is performed. The second step requires an allocation of fair value to the individual assets and liabilities using purchase price allocation in order to determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount, an impairment loss is recorded as a reduction to goodwill and as a charge to results of operations.

Based on assessment performed as at September 30, 2017, the Company has concluded that goodwill was not impaired at December 31, 2017.

Long-Lived Asset Impairment

When circumstances indicate the carrying value of long-lived assets may not be recoverable, the Company evaluates whether the carrying value of such assets, excluding goodwill, has been impaired. For such long-lived assets, the Company evaluates whether impairment may exist by estimating future estimated undiscounted cash flows expected to result from the use and eventual disposition of the asset. When alternative courses of action to recover the carrying amount of a long-lived asset are under consideration, a probability-weighted approach is used to develop estimates of future undiscounted cash flows. If the carrying value of the long-lived asset is not recoverable based on the estimated future undiscounted cash flows, an impairment loss is recorded, measured as the excess of the carrying value of the asset over its fair value. As a result, the asset's carrying value is adjusted to its estimated fair value.

The carrying costs of most of the Distribution Business' long-lived assets are included in rate base where they earn an OEB-approved rate of return. Asset carrying values and the related return are recovered through approved rates. As a result, such assets are only tested for impairment in the event that the OEB disallows recovery, in whole or in part, or if such a disallowance is judged to be probable. As at December 31, 2017 and 2016, no asset impairment had been recorded.

Costs of Arranging Debt Financing

For financial liabilities classified as other than held-for-trading, the Company defers its proportionate share of the relevant Hydro One external transaction costs related to obtaining debt financing and presents such amounts net of related debt on the Balance Sheets. Deferred debt issuance costs are amortized over the contractual life of the related debt on an effective-interest basis and the amortization is included within financing charges in the Statements of Operations and Comprehensive Income. Transaction costs for items classified as held-for-trading are expensed immediately.

Comprehensive Income

Comprehensive income is comprised of net income and other comprehensive income (OCI). OCI and net income are presented in a single continuous Statement of Operations and Comprehensive Income.

Financial Assets and Liabilities

All financial assets and liabilities are classified into one of the following five categories: held-to-maturity; loans and receivables; held-for-trading; other liabilities; or available-for-sale. Financial assets and liabilities classified as held-for-trading are measured at fair value. All other financial assets and liabilities are measured at amortized cost, except accounts receivable and amounts due from related parties, which are measured at the lower of cost or fair value. Accounts receivable and amounts due from related parties are classified as loans and receivables. The Company considers the carrying amounts of accounts receivable and amounts due from related parties to be reasonable estimates of fair value because of the short time to maturity of these instruments. Provisions for impaired accounts receivable are recognized as adjustments to the allowance for doubtful accounts and are recognized when there is objective evidence that the Company will not be able to collect amounts according to the original terms. All financial instrument transactions are recorded at trade date.

Derivative instruments are measured at fair value. Gains and losses from fair valuation are included within financing charges in the period in which they arise. The Company determines the classification of its financial assets and liabilities at the date of initial recognition. The Company designates certain of its financial assets and liabilities to be held at fair value, when it is consistent with the Company's risk management policy disclosed in Note 16 - Fair Value of Financial Instruments and Risk Management.

Derivative Instruments and Hedge Accounting

Hydro One closely monitors the risks associated with changes in interest rates on its operations and, where appropriate, uses various instruments to hedge these risks. Certain of these derivative instruments qualify for hedge accounting and are designated as accounting hedges, while others either do not qualify as hedges or have not been designated as hedges (hereinafter referred to as undesignated contracts) as they are part of economic hedging relationships. Hydro One's derivative instruments, or portions thereof, are mirrored down to Hydro One Networks, and are allocated between the Company's transmission and distribution businesses. The derivative instruments are classified as fair value hedges or undesignated contracts, consistent with Hydro One's derivative instruments classification.

The accounting guidance for derivative instruments requires the recognition of all derivative instruments not identified as meeting the normal purchase and sale exemption as either assets or liabilities recorded at fair value on the Balance Sheets. For derivative instruments that qualify for hedge accounting, Hydro One may elect to designate such derivative instruments as either cash flow hedges or fair value hedges. Hydro One offsets fair value amounts recognized on its Balance Sheets related to derivative instruments executed with the same counterparty under the same master netting agreement.

For derivative instruments that qualify for hedge accounting and which are designated as cash flow hedges, the effective portion of any gain or loss, net of tax, is reported as a component of accumulated OCI (AOCI) and is reclassified to results of operations in the same period or periods during which the hedged transaction affects results of operations. Any gains or losses on the derivative instrument that represent either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in results of operations. For fair value hedges, changes in fair value of both the derivative instrument and the underlying hedged exposure are recognized in the Statements of Operations and Comprehensive Income in the current period. The gain or loss on the derivative instrument is included in the same line item as the offsetting gain or loss on the hedged item in the Statements of Operations and Comprehensive Income. The changes in fair value of the undesignated derivative instruments are reflected in results of operations.

Embedded derivative instruments are separated from their host contracts and are carried at fair value on the Balance Sheets when: (a) the economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract; (b) the hybrid instrument is not measured at fair value, with changes in fair value recognized in results of operations each period; and (c) the embedded derivative itself meets the definition of a derivative. Hydro One does not engage in derivative trading or speculative activities and had no embedded derivatives at December 31, 2017 or 2016.

Hydro One periodically develops hedging strategies taking into account risk management objectives. At the inception of a hedging relationship where the Company has elected to apply hedge accounting, Hydro One formally documents the relationship between the hedged item and the hedging instrument, the related risk management objective, the nature of the specific risk exposure being hedged, and the method for assessing the effectiveness of the hedging relationship. Hydro One also assesses, both at the inception of the hedge and on a quarterly basis, whether the hedging instruments are effective in offsetting changes in fair values or cash flows of the hedged items.

Employee Future Benefits

Employee future benefits provided by Hydro One include pension, post-retirement and post-employment benefits. The costs of the Hydro One's pension, post-retirement and post-employment benefit plans are recorded over the periods during which employees render service.

Hydro One recognizes the funded status of its defined benefit pension, post-retirement and post-employment plans on its Consolidated Balance Sheets and subsequently recognizes the changes in funded status at the end of each reporting year. Defined benefit pension, post-retirement and post-employment plans are considered to be underfunded when the projected benefit obligation exceeds the fair value of the plan assets. Liabilities are recognized on the Consolidated Balance Sheets for any net underfunded projected benefit obligation. The net underfunded projected benefit obligation may be disclosed as a current liability, long-term liability, or both. The current portion is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next 12 months exceeds the fair value of plan assets. If the fair value of plan assets exceeds the projected benefit obligation of the plan, an asset is recognized equal to the net overfunded projected benefit obligation. The post-retirement and post-employment benefit plans are unfunded because there are no related plan assets.

Hydro One recognizes its contributions to the defined contribution pension plan as pension expense, with a portion being capitalized as part of labour costs included in capital expenditures. The expensed amount is included in operation, maintenance and administration costs in the Consolidated Statements of Operations and Comprehensive Income.

Defined Benefit Pension

Hydro One has a contributory defined benefit pension plan covering most regular employees of Hydro One and its subsidiaries, including Hydro One Networks. The Hydro One pension plan does not segregate assets in a separate account for individual subsidiaries, nor is the obligation of the pension plan allocated to, or funded separately by, entities within the consolidated group. Accordingly, for purposes of these Financial Statements, the pension plan is accounted for as a defined contribution plan and no pension benefit asset or liability is recorded.

Post-retirement and Post-employment Benefits

Hydro One has post-retirement and post-employment benefit plans covering all regular employees of Hydro One and its subsidiaries, including Hydro One Networks. The benefit obligations of these post-retirement and post-employment benefit plans are not segregated, or funded separately, for Hydro One Networks. Accordingly, for purposes of these Financial Statements, the post-retirement and post-employment benefit obligations are allocated to the Company based on base pensionable earnings.

The Company records a regulatory asset equal to its allocated share of Hydro One's incremental net unfunded projected benefit obligation for post-retirement and post-employment plans at each year end based on annual actuarial reports. The regulatory asset for the incremental net unfunded projected benefit obligation for post-retirement and post-employment plans, in absence of regulatory accounting, would be recognized in AOCI. A regulatory asset is recognized because management considers it to be probable that post-retirement and post-employment benefit costs will be recovered in the future through the rate-setting process.

Post-retirement and post-employment benefits are recorded and included in rates on an accrual basis. Costs are determined by independent actuaries using the projected benefit method prorated on service and based on assumptions that reflect management's best estimates. Past service costs from plan amendments are amortized to results of operations based on the expected average remaining service period.

For post-retirement benefits, all actuarial gains or losses are deferred using the "corridor" approach. The amount calculated above the "corridor" is amortized to results of operations on a straight-line basis over the expected average remaining service life of active Hydro One employees in the plan and over the remaining life expectancy of inactive Hydro One employees in the plan. The post-retirement benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment.

For post-employment obligations, the actuarial gains and losses that are incurred during the year are recognized immediately to results of operations. The post-employment benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment.

All post-retirement and post-employment future benefit costs are attributed to labour and are either charged to results of operations or capitalized as part of the cost of property, plant and equipment and intangible assets.

Stock-Based Compensation

Share Grant Plans

The Company measures share grant plans based on fair value of share grants as estimated based on the grant date Hydro One Limited common share price. The costs are recognized in the financial statements using the graded-vesting attribution method for share grant plans that have both a performance condition and a service condition. The Company records a regulatory asset equal to the accrued costs of share grant plans recognized in each period. Costs are transferred from the regulatory asset to labour costs at the time the share grants vest and are issued, and are recovered in rates. Forfeitures are recognized as they occur.

Deferred Share Unit (DSU) Plans

The Company records the liabilities associated with the Directors' and Management DSU Plans at fair value at each reporting date until settlement, recognizing compensation expense over the vesting period on a straight-line basis. The fair value of the DSU liability is based on the Hydro One Limited common share closing price at the end of each reporting period.

Long-term Incentive Plan (LTIP)

The Company measures the restricted share units (RSUs) and performance share units (PSUs), issued under Hydro One Limited's LTIP, at fair value based on the grant date Hydro One Limited common share price. The related compensation expense is recognized over the vesting period on a straight-line basis. Forfeitures are recognized as they occur.

Loss Contingencies

Hydro One and its subsidiaries are involved in certain legal and environmental matters that arise in the normal course of business. In the preparation of the Distribution Business' Financial Statements, management makes judgments regarding the future outcome of contingent events and records a loss for a contingency based on its best estimate when it is determined that such loss is probable and the amount of the loss can be reasonably estimated. Where the loss amount is recoverable in future rates, a regulatory asset is also recorded. When a range estimate for the probable loss exists and no amount within the range is a better estimate than any other amount, the Distribution Business records a loss at the minimum amount within the range.

Management regularly reviews current information available to determine whether recorded provisions should be adjusted and whether new provisions are required. Estimating probable losses may require analysis of multiple forecasts and scenarios that often depend on judgments about potential actions by third parties, such as federal, provincial and local courts or regulators. Contingent liabilities are often resolved over long periods of time. Amounts recorded in the Financial Statements may differ from the actual outcome once the contingency is resolved. Such differences could have a material impact on future results of operations, financial position and cash flows of the Distribution Business.

Provisions are based upon current estimates and are subject to greater uncertainty where the projection period is lengthy. A significant upward or downward trend in the number of claims filed, the nature of the alleged injuries, and the average cost of resolving each claim could change the estimated provision, as could any substantial adverse or favourable verdict at trial. A federal or provincial legislative outcome or structured settlement could also change the estimated liability. Legal fees are expensed as incurred.

Environmental Liabilities

Environmental liabilities are recorded in respect of past contamination when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated. The Distribution Business records a liability for the estimated future expenditures associated with contaminated land assessment and remediation and for the phase-out and destruction of polychlorinated biphenyl (PCB)-contaminated mineral oil removed from electrical equipment, based on the present value of these estimated future expenditures. The Company determines the present value with a discount rate equal to its credit-adjusted risk-free interest rate on financial instruments with comparable maturities to the pattern of future environmental expenditures. As the Company anticipates that the future expenditures will continue to be recoverable in future rates, an offsetting regulatory asset has been recorded to reflect the future recovery of these environmental expenditures from customers. Hydro One reviews its estimates of future environmental expenditures annually, or more frequently if there are indications that circumstances have changed.

Asset Retirement Obligations

Asset retirement obligations are recorded for legal obligations associated with the future removal and disposal of long-lived assets. Such obligations may result from the acquisition, construction, development and/or normal use of the asset. Conditional asset retirement obligations are recorded when there is a legal obligation to perform a future asset retirement activity but where the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Company. In such a case, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement.

When recording an asset retirement obligation, the present value of the estimated future expenditures required to complete the asset retirement activity is recorded in the period in which the obligation is incurred, if a reasonable estimate can be made. In general, the present value of the estimated future expenditures is added to the carrying amount of the associated asset and the resulting asset retirement cost is depreciated over the estimated useful life of the asset. Where an asset is no longer in service when an asset retirement obligation is recorded, the asset retirement cost is recorded in results of operations.

Some of the Company's distribution assets, particularly those located on unowned easements and rights-of-way, may have asset retirement obligations, conditional or otherwise. The majority of the Company's easements and rights-of-way are either of perpetual duration or are automatically renewed annually. Land rights with finite terms are generally subject to extension or renewal. As the Distribution Business expects to use the majority of its facilities in perpetuity, no asset retirement obligations have been recorded for these assets. If, at some future date, a particular facility is shown not to meet the perpetuity assumption, it will be reviewed to determine whether an estimable asset retirement obligation exists. In such a case, an asset retirement obligation would be recorded at that time.

The Distribution Business' asset retirement obligations recorded to date relate to estimated future expenditures associated with the removal and disposal of asbestos-containing materials installed in some of its facilities.

3. NEW ACCOUNTING PRONOUNCEMENTS

The following tables present Accounting Standards Updates (ASUs) issued by the Financial Accounting Standards Board that are applicable to Hydro One Networks:

Recently Adopted Accounting Guidance

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2016-06	March 2016	Contingent call (put) options that are assessed to accelerate the payment of principal on debt instruments need to meet the criteria of being "clearly and closely related" to their debt hosts.	January 1, 2017	No impact upon adoption

Recently Issued Accounting Guidance Not Yet Adopted

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2014-09 2015-14 2016-08 2016-10 2016-12 2016-20 2017-05 2017-10 2017-13 2017-14	May 2014 – November 2017	ASU 2014-09 was issued in May 2014 and provides guidance on revenue recognition relating to the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. ASU 2015-14 deferred the effective date of ASU 2014-09 by one year. Additional ASUs were issued in 2016 and 2017 that simplify transition and provide clarity on certain aspects of the new standard.	January 1, 2018	Hydro One Networks has completed the review of all its revenue streams and has concluded that there will be no material impact upon adoption.
2016-02 2018-01	February 2016 – January 2018	Lessees are required to recognize the rights and obligations resulting from operating leases as assets (right to use the underlying asset for the term of the lease) and liabilities (obligation to make future lease payments) on the balance sheet. ASU 2018-01 permits an entity to elect an optional practical expedient to not evaluate under Topic 842 land easements that exist or expired before the entity's adoption of Topic 842 and that were not previously accounted for as leases under Topic 840.	January 1, 2019	An initial assessment is currently underway encompassing a review of existing leases, which will be followed by a review of relevant contracts. No quantitative determination has been made at this time. The Company is on track for implementation of this standard by the effective date.
2016-15	August 2016	The amendments provide guidance for eight specific cash flow issues with the objective of reducing the existing diversity in practice.	January 1, 2018	No material impact
2017-01	January 2017	The amendment clarifies the definition of a business and provides additional guidance on evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses.	January 1, 2018	No material impact
2017-04	January 2017	The amendment removes the second step of the current two-step goodwill impairment test to simplify the process of testing goodwill.	January 1, 2020	Under assessment

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2017-07	March 2017	Service cost components of net benefit cost associated with defined benefit plans are required to be reported in the same line as other compensation costs arising from services rendered by the Company's employees. All other components of net benefit cost are to be presented in the income statement separately from the service cost component. Only the service cost component is eligible for capitalization where applicable.	January 1, 2018	Hydro One Networks has applied for a regulatory deferral account to maintain the capitalization of OPEB related costs. As such, there will be no material impact.
2017-09	May 2017	Changes to the terms or conditions of a share-based payment award will require an entity to apply modified accounting unless the modified award meets all conditions stipulated in this ASU.	January 1, 2018	No impact
2017-11	July 2017	When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock.	January 1, 2019	Under assessment
2017-12	August 2017	Amendments will better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results.	January 1, 2019	Under assessment

4. BUSINESS COMBINATIONS

Haldimand Hydro Transfer

On August 31, 2016, the common shares of Haldimand County Utilities Inc. (Haldimand Hydro) were transferred to Hydro One Networks by Hydro One. The transfer was accounted as a non-monetary transfer, based on Haldimand Hydro's carrying values at August 31, 2016. On September 1, 2016, Haldimand Hydro started dissolution proceedings and, as a result, its net assets were transferred to Hydro One Networks.

The following table summarizes the assets and liabilities that were transferred to Hydro One Networks' Distribution Business at September 1, 2016:

(millions of dollars)	
Working capital	10
Property, plant and equipment	52
Intangible assets	1
Deferred tax assets	1
Goodwill	33
Inter-company demand facility	(18)
Regulatory liabilities	(3)
	76

Woodstock Hydro Transfer

On August 31, 2016, the common shares of Woodstock Hydro Holdings Inc. (Woodstock Hydro) were transferred to Hydro One Networks by Hydro One. The transfer was accounted as a non-monetary transfer, based on Woodstock Hydro's carrying values at August 31, 2016. On September 1, 2016, Woodstock Hydro started dissolution proceedings and, as a result, its net assets were transferred to Hydro One Networks.

The following table summarizes the assets and liabilities that were transferred to Hydro One Networks' Distribution Business at September 1, 2016:

(millions of dollars)	
Working capital	9
Property, plant and equipment	28
Deferred tax assets	2
Goodwill	22
Inter-company demand facility	(23)
Regulatory liabilities	(3)
Post-retirement and post-employment benefit liability	(1)
Other long-term liabilities	(1)
	33

5. DEPRECIATION AND AMORTIZATION

Year ended December 31 *(millions of dollars)*	**2017**	**2016**
Depreciation of property, plant and equipment	278	269
Asset removal costs	51	55
Amortization of intangible assets	44	39
Amortization of regulatory assets	15	12
	388	375

6. FINANCING CHARGES

Year ended December 31 *(millions of dollars)*	**2017**	**2016**
Interest on long-term debt *(Note 23)*	170	161
Interest on inter-company demand facility *(Note 23)*	2	4
Other	4	3
Less: Interest capitalized on construction and development in progress	(11)	(12)
	165	156

7. INCOME TAXES

Income tax expense differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rate. The reconciliation between the statutory and the effective tax rates is provided as follows:

Year ended December 31 *(millions of dollars)*	**2017**	**2016**
Income before income taxes	320	329
Income taxes at statutory rate of 26.5% (2016 - 26.5%)	85	87
Increase (decrease) resulting from:		
Net temporary differences recoverable in future rates charged to customers:		
Capital cost allowance in excess of depreciation and amortization	(15)	(12)
Pension contributions in excess of pension expense	(6)	(7)
Overheads capitalized for accounting but deducted for tax purposes	(7)	(7)
Interest capitalized for accounting but deducted for tax purposes	(3)	(3)
Environmental expenditures	(4)	(3)
Post-retirement and post-employment benefit expense in excess of cash payments	3	3
Other	1	(1)
Net temporary differences	(31)	(30)
Net permanent differences	1	1
Total income taxes	55	58

The major components of income tax expense are as follows:

Year ended December 31 *(millions of dollars)*	2017	2016
Current income taxes	99	22
Deferred income taxes	(44)	36
Total income taxes	55	58
Effective income tax rate	17.2%	17.6%

Deferred Income Tax Assets and Liabilities

Deferred income tax assets and liabilities expected to be included in the rate-setting process are offset by regulatory assets and liabilities to reflect the anticipated recovery or disposition of these balances within future electricity rates. Deferred income tax assets and liabilities arise from differences between the tax basis and the carrying amounts of the assets and liabilities. At December 31, 2017 and 2016, deferred income tax assets and liabilities consisted of the following:

December 31 *(millions of dollars)*	2017	2016
Deferred income tax assets (liabilities)		
Capital cost allowance in excess of depreciation and amortization	(808)	(740)
Regulatory amounts that are not recognized for tax purposes	(17)	(109)
Goodwill	(10)	(10)
Post-retirement and post-employment benefits expense in excess of cash payments	311	337
Environmental expenditures	30	34
Non-capital losses	1	1
Other	(6)	(5)
Total deferred income tax liabilities	(499)	(492)

8. ACCOUNTS RECEIVABLE

December 31 *(millions of dollars)*	2017	2016
Accounts receivable – billed	276	396
Accounts receivable – unbilled	341	425
Accounts receivable, gross	617	821
Allowance for doubtful accounts	(29)	(35)
Accounts receivable, net	588	786

The following table shows the movements in the allowance for doubtful accounts for the years ended December 31, 2017 and 2016:

Year ended December 31 *(millions of dollars)*	2017	2016
Allowance for doubtful accounts – beginning	(35)	(59)
Write-offs	25	35
Additions to allowance for doubtful accounts	(19)	(11)
Allowance for doubtful accounts – ending	(29)	(35)

9. OTHER CURRENT ASSETS

December 31 *(millions of dollars)*	2017	2016
Regulatory assets *(Note 12)*	22	24
Prepaid expenses and other assets	12	16
Materials and supplies	4	4
	38	44

10. PROPERTY, PLANT AND EQUIPMENT

December 31, 2017 *(millions of dollars)*	Property, Plant and Equipment[1]	Accumulated Depreciation	Construction in Progress	Total
Distribution	10,155	3,488	147	6,814
Communication	145	99	2	48
Administration and service	991	561	25	455
Easements	11	4	—	7
	11,302	4,152	174	7,324

[1] Includes future use assets totalling $57 million.

December 31, 2016 *(millions of dollars)*	Property, Plant and Equipment[1]	Accumulated Depreciation	Construction in Progress	Total
Distribution	9,607	3,281	242	6,568
Communication	135	81	—	54
Administration and service	1,057	621	32	468
Easements	11	3	—	8
	10,810	3,986	274	7,098

[1] Includes future use assets totalling $51 million.

Financing charges capitalized on property, plant and equipment under construction were $9 million in 2017 (2016 - $11 million).

11. INTANGIBLE ASSETS

December 31, 2017 *(millions of dollars)*	Intangible Assets	Accumulated Amortization	Development in Progress	Total
Computer applications software	428	201	23	250
Other	49	12	2	39
	477	213	25	289

December 31, 2016 *(millions of dollars)*	Intangible Assets	Accumulated Amortization	Development in Progress	Total
Computer applications software	384	177	30	237
Other	37	9	3	31
	421	186	33	268

Financing charges capitalized to intangible assets under development were $2 million in 2017 (2016 - $1 million). The estimated annual amortization expense for intangible assets is as follows: 2018 - $47 million; 2019 - $43 million; 2020 - $34 million; 2021 - $33 million; and 2022 - $32 million.

12. REGULATORY ASSETS AND LIABILITIES

Regulatory assets and liabilities arise as a result of the rate-setting process. The Distribution Business has recorded the following regulatory assets and liabilities:

December 31 *(millions of dollars)*	2017	2016
Regulatory assets:		
Deferred income tax regulatory asset	513	462
Environmental	83	95
Stock-based compensation	20	17
Post-retirement and post-employment benefits	20	136
Distribution system code exemption	10	10
Retail settlement variance accounts	—	145
2015-2017 rate rider	—	7
Pension cost variance	—	8
Other	14	11
Total regulatory assets	660	891
Less: current portion	(22)	(24)
	638	867
Regulatory liabilities:		
Green Energy expenditure variance	60	69
Pension cost variance	13	—
2015-2017 rate rider	6	—
PST savings deferral	4	5
Other	12	7
Total regulatory liabilities	95	81
Less: current portion	(11)	—
	84	81

Deferred Income Tax Regulatory Asset and Liability

Deferred income taxes are recognized on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable income. The Distribution Business has recognized regulatory assets and liabilities that correspond to deferred income taxes that flow through the rate-setting process. In the absence of rate-regulated accounting, the Distribution Business' income tax expense would have been recognized using the liability method and there would be no regulatory accounts established for taxes to be recovered through future rates. As a result, the 2017 income tax expense would have been higher by approximately $38 million (2016 - $31 million).

On September 28, 2017, the OEB issued its Decision and Order on Hydro One Networks' 2017 and 2018 transmission rates revenue requirements (Decision). In its Decision, the OEB concluded that the net deferred tax asset resulting from transition from the payments in lieu of tax regime under the Electricity Act (Ontario) to tax payments under the federal and provincial tax regime should not accrue entirely to Hydro One's shareholders and that a portion should be shared with ratepayers. On November 9, 2017, the OEB issued a Decision and Order that calculated the portion of the tax savings that should be shared with ratepayers. The OEB's calculation would result in an impairment of Hydro One Networks' transmission deferred income tax regulatory asset of up to approximately $515 million. If the OEB were to apply the same calculation for sharing in Hydro One Networks' 2018-2022 distribution rates, for which a decision is currently outstanding, it would result in an impairment of up to approximately $370 million related to Hydro One Networks' distribution deferred income tax regulatory asset. In October 2017, the Company filed a Motion to Review and Vary (Motion) the Decision and filed an appeal with the Divisional Court of Ontario (Appeal). On December 19, 2017, the OEB granted a hearing of the merits of the Motion which was held on February 12, 2018. In both cases, the Company's position is that the OEB made errors of fact and law in its determination of allocation of the tax savings between the shareholders and ratepayers. The Appeal is being held in abeyance pending the outcome of the Motion. If the Decision is upheld, based on the facts known at this time, the exposure from the potential impairments would be a one-time decrease in net income of up to approximately $370 million. Based on the assumptions that the OEB applies established rate making principles in a manner consistent with its past practice and does not exercise its discretion to take other policy considerations into account, management is of the view that it is likely that the Company's Motion will be granted and the aforementioned tax savings will be allocated to the benefit of Hydro One shareholders.

Environmental

The Distribution Business records a liability for the estimated future expenditures required to remediate environmental contamination. Because such expenditures are expected to be recoverable in future rates, the Company has recorded an equivalent amount as a regulatory asset. In 2017, the environmental regulatory asset increased by $2 million (2016 - decreased by $6 million) to reflect related changes in the Company's PCB liability, and decreased by $3 million (2016 - $5 million) due to changes in the land assessment and remediation liability. The environmental regulatory asset is amortized to results of operations based on the pattern of actual expenditures incurred and charged to environmental liabilities. The OEB has the discretion to examine and assess the prudency and the timing of recovery of all of the Distribution Business' actual environmental expenditures. In the absence of rate-regulated accounting, 2017 operation, maintenance and administration expenses would have been lower by $1 million (2016 - $11 million). In addition, 2017 amortization expense would have been lower by $15 million (2016 - $12 million), and 2017 financing charges would have been higher by $4 million (2016 - $4 million).

Post-Retirement and Post-Employment Benefits

The Distribution Business recognizes the net unfunded status of post-retirement and post-employment obligations on the Balance Sheets with an incremental offset to the associated regulatory assets. A regulatory asset is recognized because management considers it to be probable that post-retirement and post-employment benefit costs will be recovered in the future through the rate-setting process. The post-retirement and post-employment benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment. In the absence of rate-regulated accounting, 2017 OCI would have been higher by $116 million (2016 - lower by $2 million).

Stock-Based Compensation

The Distribution Business recognizes costs associated with share grant plans in a regulatory asset as management considers it probable that share grant plans' costs will be recovered in the future through the rate-setting process. In the absence of rate-regulated accounting, 2017 operation, maintenance and administration expenses would have been higher by $4 million (2016 - $5 million). Share grant costs are transferred to labour costs at the time the share grants vest and are issued, and are recovered in rates in accordance with recovery of said labour costs.

Distribution System Code (DSC) Exemption

In June 2010, Hydro One Networks filed an application with the OEB regarding the OEB's new cost responsibility rules contained in the OEB's October 2009 Notice of Amendment to the DSC, with respect to the connection of certain renewable generators that were already connected or that had received a connection impact assessment prior to October 21, 2009. The application sought approval to record and defer the unanticipated costs incurred by Hydro One Networks that resulted from the connection of certain renewable generation facilities. The OEB ruled that identified specific expenditures can be recorded in a deferral account subject to the OEB's review in subsequent Hydro One Networks distribution applications. In March 2015, the OEB approved the disposition of the DSC exemption deferral account balance at December 31, 2013, including accrued interest, which was recovered through the 2015-2017 Rate Rider. In addition, the OEB also approved Hydro One's request to discontinue this deferral account. There were no additions to this regulatory account in 2017 or 2016. The remaining balance in this account at December 31, 2016, including accrued interest, was requested for recovery through the 2018-2022 distribution rate application.

Retail Settlement Variance Account (RSVA)

Hydro One has deferred certain retail settlement variance amounts under the provisions of Article 490 of the OEB's Accounting Procedures Handbook. In March 2015, the OEB approved the disposition of the total RSVA balance accumulated from January 2012 to December 2013, including accrued interest, to be recovered through the 2015-2017 Rate Rider.

2015-2017 Rate Rider

In March 2015, as part of its decision on Hydro One Networks' distribution rate application for 2015-2019, the OEB approved the disposition of certain deferral and variance accounts, including RSVAs and accrued interest. The 2015-2017 Rate Rider account included the balances approved for disposition by the OEB and was disposed of in accordance with the OEB decision over a 32-month period ended on December 31, 2017. The balance remaining in the account represents an over-collection to be returned to ratepayers in a future rate application. We have not requested recovery of the remaining balance of this account in the current distribution rate application.

Green Energy Expenditure Variance

In April 2010, the OEB requested the establishment of deferral accounts which capture the difference between the revenue recorded on the basis of Green Energy Plan expenditures incurred and the actual recoveries received.

Pension Cost Variance

A pension cost variance account was established for the Distribution Business to track the difference between the actual pension expenses incurred and estimated pension costs approved by the OEB. The balance in this regulatory account reflects the deficit of pension costs paid as compared to OEB-approved amounts. In September 2017, the OEB approved the disposition of the distribution business portion of the total pension cost variance account as at December 31, 2015, including accrued interest, which is being recovered over a two-year period ending December 31, 2018. In the absence of rate-regulated accounting, 2017 revenue would have been higher by $21 million (2016 - $15 million).

PST Savings Deferral Account

The provincial sales tax (PST) and goods and services tax (GST) were harmonized in July 2010. Unlike the GST, the PST was included in operation, maintenance and administration expenses or capital expenditures for past revenue requirements approved during a full cost-of-service hearing. Under the harmonized sales tax (HST) regime, the HST included in operation, maintenance and administration expenses or capital expenditures is not a cost ultimately borne by the Company and as such, a refund of the prior PST element in the approved revenue requirement is applicable, and calculations for tracking and refund were requested by the OEB. For Hydro One Networks' distribution revenue requirement, PST was included between July 1, 2010 and December 31, 2015 and recorded in a deferral account, as directed by the OEB. In March 2015, the OEB approved the disposition of the PST Savings Deferral account at December 31, 2013, including accrued interest, which will be recovered through the 2015-2017 Rate Rider.

13. ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

December 31 *(millions of dollars)*	2017	2016
Accrued liabilities	562	529
Accounts payable	66	67
Accrued interest *(Note 23)*	40	42
Regulatory liabilities *(Note 12)*	11	—
	679	638

14. OTHER LONG-TERM LIABILITIES

December 31 *(millions of dollars)*	2017	2016
Post-retirement and post-employment benefit liability *(Note 18)*	838	906
Environmental liabilities *(Note 19)*	66	79
Long-term inter-company payable *(Note 23)*	18	14
Long-term accounts payable and other liabilities	8	10
Asset retirement obligations *(Note 20)*	4	4
	934	1,013

15. DEBT

Hydro One issues notes for long-term financing under its Medium-Term Note (MTN) Program. The terms of certain issuances are mirrored down to Hydro One Networks through the issuance of inter-company debt, and are allocated between the Company's transmission and distribution businesses. The following table presents long-term debt allocated to the Distribution Business outstanding at December 31, 2017 and 2016:

December 31 *(millions of dollars)*	2017	2016
Long-term debt	3,846	4,041
Add: Net unamortized debt premiums	8	8
Add: Unrealized mark-to-market gain[1]	(4)	(1)
Less: Deferred debt issuance costs	(15)	(16)
Less: Long-term debt payable within one year	(337)	(195)
Long-term debt	3,498	3,837

[1] The unrealized mark-to-market net gain relates to $30 million of notes due in 2020 and $200 million notes due in 2019. The unrealized mark-to-market net gain is offset by a $4 million (2016 - $1 million) unrealized mark-to-market net loss on the related fixed-to-floating interest-rate swap agreements, which are accounted for as fair value hedges.

In 2017, Hydro One did not issue any long-term debt. In 2016, Hydro One issued $2,300 million of long-term debt under its MTN Program, of which $2,290 million was mirrored down to Hydro One Networks and $1,050 million was allocated to the Company's Distribution Business.

In 2017, Hydro One repaid $600 million (2016 – $500 million) of maturing long-term debt under its MTN Program. On the same date, Hydro One Networks repaid inter-company debt of $600 million (2016 – $500 million) to Hydro One, of which $195 million (2016 – $200 million) was allocated to the Company's Distribution Business.

Principal and Interest Payments

Principal repayments and related weighted average interest rates are summarized by the number of years to maturity in the following table:

Years to Maturity	Long-term Debt Principal Repayments (millions of dollars)	Weighted Average Interest Rate (%)
1 year	337	2.8
2 years	291	1.8
3 years	150	3.9
4 years	250	2.1
5 years	261	3.2
	1,289	2.6
6 – 10 years	245	3.0
Over 10 years	2,312	5.2
	3,846	4.2

Interest payment obligations related to long-term debt are summarized by year in the following table:

Year	Interest Payments (millions of dollars)
2018	162
2019	151
2020	145
2021	140
2022	132
	730
2023-2027	630
2028+	1,588
	2,948

16. FAIR VALUE OF FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition focuses on an exit price, which is the price that would be received in the sale of an asset or the amount that would be paid to transfer a liability.

The Company classifies its fair value measurements based on the following hierarchy, as prescribed by the accounting guidance for fair value, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that Hydro One Networks has the ability to access. An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information.

Level 2 inputs are those other than quoted market prices that are observable, either directly or indirectly, for an asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted market prices that are observable for the asset or liability, such as interest-rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk and default rates. A Level 2 measurement cannot have more than an insignificant portion of the valuation based on unobservable inputs.

Level 3 inputs are any fair value measurements that include unobservable inputs for the asset or liability for more than an insignificant portion of the valuation. A Level 3 measurement may be based primarily on Level 2 inputs.

Non-Derivative Financial Assets and Liabilities

At December 31, 2017 and 2016, the carrying amounts of accounts receivable, due from related parties, inter-company demand facility, accounts payable, and due to related parties are representative of fair value due to the short-term nature of these instruments.

Fair Value Measurements of Long-Term Debt

The fair values and carrying values of the Distribution Business' long-term debt at December 31, 2017 and 2016 are as follows:

December 31 *(millions of dollars)*	2017 Carrying Value	2017 Fair Value	2016 Carrying Value	2016 Fair Value
$30 million notes due 2020	29	29	30	30
$200 million notes due 2019	197	197	199	199
Other notes and debentures	3,609	4,159	3,803	4,291
Long-term debt, including current portion	3,835	4,385	4,032	4,520

Fair Value Measurements of Derivative Instruments

Hydro One enters into interest-rate swaps agreements with respect to its long-term debt. The terms of certain of these interest-rate swap agreements are mirrored down to Hydro One Networks, and are allocated between the Company's transmission and distribution businesses.

At December 31, 2017, the Distribution Business' share of the Company's derivative instruments include $230 million (2016 – $230 million) of interest-rate swaps that were used to convert fixed-rate debt to floating-rate debt. These swaps are classified as fair value hedges. The Distribution Business' fair value hedge exposure was approximately 6% (2016 – 6%) of its total long-term debt. At December 31, 2017, the Distribution Business' interest-rate swaps designated as fair value hedges were as follows:

- a $30 million fixed-to-floating interest-rate swap agreement to convert $30 million of the $350 million notes maturing April 30, 2020 into three-month variable rate debt; and
- $200 million fixed-to-floating interest-rate swap agreements to convert the $200 million notes maturing November 18, 2019 into three-month variable rate debt.

At December 31, 2017 and 2016, the Company had no interest-rate swaps classified as undesignated contracts.

Fair Value Hierarchy

The fair value hierarchy of financial assets and liabilities at December 31, 2017 and 2016 is as follows:

December 31, 2017 *(millions of dollars)*	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Liabilities:					
Inter-company demand facility	167	167	167	—	—
Long-term debt, including current portion	3,835	4,385	—	4,385	—
Derivative instruments					
Fair value hedges – interest-rate swaps	4	4	—	4	—
	4,006	4,556	167	4,389	—

December 31, 2016 *(millions of dollars)*	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	9	9	9	—	—
	9	9	9	—	—
Liabilities:					
Inter-company demand facility	74	74	74	—	—
Long-term debt, including current portion	4,032	4,520	—	4,520	—
Derivative instruments					
Fair value hedges – interest-rate swaps	1	1	—	1	—
	4,107	4,595	74	4,521	—

The fair value of the hedged portion of the long-term debt is primarily based on the present value of future cash flows using a swap yield curve to determine the assumption for interest rates. The fair value of the unhedged portion of the long-term debt is based on unadjusted period-end market prices for the same or similar debt of the same remaining maturities.

There were no transfers between any of the fair value levels during the years ended December 31, 2017 or 2016.

Risk Management

Exposure to market risk, credit risk and liquidity risk arises in the normal course of the Company's business.

Market Risk

Market risk refers primarily to the risk of loss which results from changes in costs, foreign exchange rates and interest rates. The Company is exposed to fluctuations in interest rates, as its regulated return on equity is derived using a formulaic approach that takes anticipated interest rates into account. The Company is not currently exposed to material commodity price risk or material foreign exchange risk.

The Company uses a combination of fixed and variable-rate debt to manage the mix of its debt portfolio. The Company also uses derivative financial instruments to manage interest-rate risk. The Company utilizes interest-rate swaps, which are typically designated as fair value hedges, as a means to manage its interest rate exposure to achieve a lower cost of debt. The Company may also utilize interest-rate derivative instruments to lock in interest-rate levels in anticipation of future financing.

A hypothetical 100 basis points increase in interest rates associated with variable-rate debt would not have resulted in a significant decrease in Distribution Business' net income for the years ended December 31, 2017 and 2016.

For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the Statements of Operations and Comprehensive Income. The Distribution Business' net unrealized loss (gain) on the hedged debt and the related interest-rate swaps for the years ended December 31, 2017 and 2016 was not material.

Credit Risk

Financial assets create a risk that a counterparty will fail to discharge an obligation, causing a financial loss. At December 31, 2017 and 2016, there were no significant concentrations of credit risk with respect to any class of financial assets. The Distribution Business' revenue is earned from a broad base of customers. As a result, the Distribution Business did not earn a material amount of revenue from any single customer. At December 31, 2017 and 2016, there was no material accounts receivable balance due from any single customer.

At December 31, 2017, the Company's provision for bad debts was $29 million (2016 – $35 million). Adjustments and write-offs are determined on the basis of a review of overdue accounts, taking into consideration historical experience. At December 31, 2017, approximately 5% (2016 – 6%) of the Distribution Business' net accounts receivable were outstanding for more than 60 days.

Hydro One manages its counterparty credit risk through various techniques including: entering into transactions with highly rated counterparties; limiting total exposure levels with individual counterparties; entering into master agreements which enable net settlement and the contractual right of offset; and monitoring the financial condition of counterparties. Hydro One monitors current credit exposure to counterparties both on an individual and an aggregate basis. The Company's counterparty credit risk profile is consistent with Hydro One. The Distribution Business' credit risk for accounts receivable is limited to the carrying amounts on the Balance Sheets.

Derivative financial instruments result in exposure to credit risk since there is a risk of counterparty default. The credit exposure of derivative contracts, before collateral, is represented by the fair value of contracts at the reporting date. At December 31, 2017 and 2016, the counterparty credit risk exposure on the fair value of these interest-rate swap contracts was not material. At December 31, 2017, Hydro One's credit exposure for all derivative instruments, and applicable payables and receivables, had a credit rating of investment grade, with four financial institutions as the counterparties.

Liquidity Risk

Liquidity risk refers to the Company's ability to meet its financial obligations as they come due. Hydro One Networks meets its short-term liquidity requirements through the inter-company demand facility with Hydro One and funds from operations. The short-term liquidity available to the Company is expected to be sufficient to fund normal operating requirements.

17. CAPITAL MANAGEMENT

The Distribution Business' objectives with respect to its capital structure are to maintain effective access to capital on a long-term basis at reasonable rates, and to deliver appropriate financial returns. At December 31, 2017 and 2016, the Distribution Business' capital structure was as follows:

December 31 *(millions of dollars)*	2017	2016
Long-term debt payable within one year	337	195
Inter-company demand facility	167	74
Less: cash and cash equivalents	—	9
	504	260
Long-term debt	3,498	3,837
Excess of assets over liabilities	2,768	2,766
Total capital	6,770	6,863

The following table shows the movements in the excess of assets over liabilities for the years ended December 31, 2017 and 2016:

Year ended December 31 *(millions of dollars)*	2017	2016
Excess of assets over liabilities - beginning	2,766	2,679
Net income	265	271
Payments to Hydro One to finance dividends and return of stated capital	(263)	(293)
Transfers *(Note 4)*	—	109
Excess of assets over liabilities - ending	2,768	2,766

18. PENSION AND POST-RETIREMENT AND POST-EMPLOYMENT BENEFITS

Hydro One has a defined benefit pension plan (Pension Plan), a defined contribution pension plan (DC Plan), a supplemental pension plan (Supplemental Plan), and post-retirement and post-employment benefit plans.

DC Plan

Hydro One established a DC Plan effective January 1, 2016. The DC Plan covers eligible management employees hired on or after January 1, 2016, as well as management employees hired before January 1, 2016 who were not eligible or had not irrevocably elected to join the Pension Plan as of September 30, 2015. Members of the DC Plan have an option to contribute 4%, 5% or 6% of their pensionable earnings, with matching contributions by Hydro One.

Hydro One Networks contributions to the DC Plan for the year ended December 31, 2017 were less than $1 million (2016 - less than $1 million). At December 31, 2017 and 2016, Company contributions payable included in accrued liabilities on the Balance Sheets were not significant.

Pension Plan and Supplemental Plan

The Pension Plan is a defined benefit contributory plan which covers eligible regular employees of Hydro One and its subsidiaries. The Pension Plan provides benefits based on highest three-year average pensionable earnings. For management employees who commenced employment on or after January 1, 2004, and for The Society of Energy Professionals (The Society)-represented staff hired after November 17, 2005, benefits are based on highest five-year average pensionable earnings. After retirement, pensions are indexed to inflation. Membership in the Pension Plan was closed to management employees who were not eligible or had not irrevocably elected to join the Pension Plan as of September 30, 2015. These employees are eligible to join the DC Plan.

Hydro One and employee contributions to the Pension Plan are based on actuarial valuations performed at least every three years. Annual Pension Plan contributions for 2017 of $87 million (2016 - $108 million) were based on an actuarial valuation effective December 31, 2016 (2016 - based on an actuarial valuation effective December 31, 2015) and the level of pensionable earnings. Estimated annual Pension Plan contributions for 2018 and 2019 are approximately $71 million for each year based on the actuarial valuation as at December 31, 2016 and projected levels of pensionable earnings. Future minimum contributions beyond 2019 will be based on an actuarial valuation effective no later than December 31, 2019. Contributions are payable one month in arrears. All of the contributions are expected to be in the form of cash.

The Supplemental Plan provides members of the Pension Plan with benefits that would have been earned and payable under the Pension Plan but for limitations imposed by the *Income Tax Act* (Canada). The Supplemental Plan obligation is included with other post-retirement and post-employment benefit obligations on the Balance Sheets.

At December 31, 2017, the present value of Hydro One's projected pension benefit obligation was estimated to be $8,258 million (2016 - $7,774 million). The fair value of pension plan assets available for these benefits was $7,277 million (2016 - $6,874 million).

Post-Retirement and Post-Employment Plans

During the year ended December 31, 2017, the Distribution Business charged $35 million (2016 - $33 million) of post-retirement and post-employment benefit costs to operation, and capitalized $35 million (2016 - $35 million) as part of the cost of property, plant and equipment and intangible assets. Benefits paid in 2017 were $24 million (2016 - $24 million). In addition, the associated post-retirement and post-employment benefits regulatory asset was decreased by $116 million (2016 - increased by $2 million).

The Distribution Business presents its post-retirement and post-employment benefit liabilities on its Balance Sheets as follows:

December 31 *(millions of dollars)*	2017	2016
Accrued liabilities	26	28
Post-retirement and post-employment benefit liability	838	906
Net unfunded status	864	934

19. ENVIRONMENTAL LIABILITIES

The following tables show the movements in environmental liabilities for the years ended December 31, 2017 and 2016:

Year ended December 31, 2017 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Environmental liabilities - beginning	66	29	95
Interest accretion	3	1	4
Expenditures	(10)	(5)	(15)
Revaluation adjustment	2	(3)	(1)
Environmental liabilities - ending	61	22	83
Less: current portion	(12)	(5)	(17)
	49	17	66

Year ended December 31, 2016 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Environmental liabilities - beginning	77	37	114
Interest accretion	3	1	4
Expenditures	(8)	(4)	(12)
Revaluation adjustment	(6)	(5)	(11)
Environmental liabilities - ending	66	29	95
Less: current portion	(10)	(6)	(16)
	56	23	79

The following tables show the reconciliation between the undiscounted basis of the environmental liabilities and the amount recognized on the Balance Sheets after factoring in the discount rate:

December 31, 2017 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Undiscounted environmental liabilities	64	23	87
Less: discounting environmental liabilities to present value	(3)	(1)	(4)
Discounted environmental liabilities	61	22	83

December 31, 2016 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Undiscounted environmental liabilities	73	29	102
Less: discounting environmental liabilities to present value	(7)	—	(7)
Discounted environmental liabilities	66	29	95

At December 31, 2017, the estimated future environmental expenditures were as follows:

(millions of dollars)	
2018	17
2019	14
2020	16
2021	15
2022	13
Thereafter	12
	87

The Distribution Business records a liability for the estimated future expenditures for land assessment and remediation and for the phase-out and destruction of PCB-contaminated mineral oil removed from electrical equipment when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated.

There are uncertainties in estimating future environmental costs due to potential external events such as changes in legislation or regulations, and advances in remediation technologies. In determining the amounts to be recorded as environmental liabilities, the Company estimates the current cost of completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. A long-term inflation rate assumption of approximately 2% has been used to express these current cost estimates as estimated future expenditures. Future expenditures have been discounted using factors ranging from approximately 2.0% to 6.3%, depending on the appropriate rate for the period when expenditures are expected to be incurred. All factors used in estimating the Distribution Business' environmental liabilities represent management's best estimates of the present value of costs required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company's current assumptions. In addition, with respect to the PCB environmental liability, the availability of critical resources such as skilled labour and replacement assets and the ability to take maintenance outages in critical facilities may influence the timing of expenditures.

PCBs

The Environment Canada regulations, enacted under the *Canadian Environmental Protection Act, 1999*, govern the management, storage and disposal of PCBs based on certain criteria, including type of equipment, in-use status, and PCB-contamination thresholds. Under current regulations, Hydro One's PCBs have to be disposed of by the end of 2025, with the exception of specifically exempted equipment. Contaminated equipment will generally be replaced, or will be decontaminated by removing PCB-contaminated insulating oil and retro filling with replacement oil that contains PCBs in concentrations of less than 2 ppm.

The Distribution Business' best estimate of the total estimated future expenditures to comply with current PCB regulations is $64 million (2016 - $73 million). These expenditures are expected to be incurred over the period from 2018 to 2025. As a result of its annual review of environmental liabilities, the Distribution Business recorded a revaluation adjustment in 2017 to increase the PCB environmental liability by $2 million (2016 - decrease by $6 million).

Land Assessment and Remediation

The Distribution Business' best estimate of the total estimated future expenditures to complete its land assessment and remediation program is $22 million (2016 - $29 million). These expenditures are expected to be incurred over the period from 2018 to 2023. As a result of its annual review of environmental liabilities, the Distribution Business recorded a revaluation adjustment in 2017 to reduce the land assessment and remediation environmental liability by $3 million (2016 - $5 million).

20. ASSET RETIREMENT OBLIGATIONS

Hydro One Networks records a liability for the estimated future expenditures for the removal and disposal of asbestos-containing materials installed in some of its facilities. Asset retirement obligations, which represent legal obligations associated with the retirement of certain tangible long-lived assets, are computed as the present value of the projected expenditures for the future retirement of specific assets and are recognized in the period in which the liability is incurred, if a reasonable estimate can be made. If the asset remains in service at the recognition date, the present value of the liability is added to the carrying amount of the associated asset in the period the liability is incurred and this additional carrying amount is depreciated over the remaining life of the asset. If an asset retirement obligation is recorded in respect of an out-of-service asset, the asset retirement cost is charged to results of operations. Subsequent to the initial recognition, the liability is adjusted for any revisions to the estimated future cash flows associated with the asset retirement obligation, which can occur due to a number of factors including, but not limited to, cost escalation, changes in technology applicable to the assets to be retired, changes in legislation or regulations, as well as for accretion of the liability due to the passage of time until the obligation is settled. Depreciation expense is adjusted prospectively for any increases or decreases to the carrying amount of the associated asset.

In determining the amounts to be recorded as asset retirement obligations, the Company estimates the current fair value for completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. A long-term inflation assumption of approximately 2% has been used to express these current cost estimates as estimated future expenditures. Future expenditures have been discounted using factors ranging from approximately 3.0% to 5.0%, depending on the appropriate rate for the period when expenditures are expected to be incurred. All factors used in estimating the Distribution Business' asset retirement obligations represent management's best estimates of the cost required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company's current assumptions. Asset retirement obligations are reviewed annually or more frequently if significant changes in regulations or other relevant factors occur. Estimate changes are accounted for prospectively.

At December 31, 2017, Hydro One Networks had recorded asset retirement obligations of $4 million (2016 - $4 million) related to its Distribution Business, primarily consisting of the estimated future expenditures associated with the removal and disposal of asbestos-containing materials installed in some of its facilities. The amount of interest recorded is nominal.

21. HYDRO ONE NETWORKS' SHARE CAPITAL

Hydro One Networks is authorized to issue an unlimited number of common and preferred shares. At December 31, 2017 and 2016, Hydro One Networks had 207,577,181 common shares issued and outstanding and no preferred shares issued and outstanding.

During 2017, Hydro One Networks declared common share dividends in the amount of $2 million (2016 – $2 million) and made a return of stated capital of $509 million (2016 – $609 million) to Hydro One. The amount allocated to the Distribution Business to finance these dividends and return of stated capital was $263 million (2016 – $293 million).

22. STOCK-BASED COMPENSATION

The following compensation plans were established by Hydro One Limited, however they represent components of compensation costs of Hydro One and its subsidiaries, including Hydro One Networks, in current and future periods.

Share Grant Plans

Hydro One Limited has two share grant plans (Share Grant Plans), one for the benefit of certain members of the PWU (PWU Share Grant Plan) and one for the benefit of certain members of The Society (Society Share Grant Plan).

The PWU Share Grant Plan provides for the issuance of common shares of Hydro One Limited from treasury to certain eligible members of the PWU annually, commencing on April 1, 2017 and continuing until the earlier of April 1, 2028 or the date an eligible employee no longer meets the eligibility criteria of the PWU Share Grant Plan. To be eligible, an employee must be a member of the Pension Plan on April 1, 2015, be employed on the date annual share issuance occurs and continue to have under 35 years of service. The requisite service period for the PWU Share Grant Plan began on July 3, 2015, which is the date the share grant plan was ratified by the PWU. The number of common shares issued annually to each eligible employee will be equal to 2.7% of such eligible employee's salary as at April 1, 2015, divided by $20.50, being the price of the common shares of Hydro One Limited in the IPO. The aggregate number of common shares issuable under the PWU Share Grant Plan shall not exceed 3,981,763 common shares. In 2015, 2,152,519 Hydro One Limited common shares were granted under the PWU Share Grant Plan relevant to the total share based compensation recognized by the Distribution Business.

The Society Share Grant Plan provides for the issuance of common shares of Hydro One Limited from treasury to certain eligible members of The Society annually, commencing on April 1, 2018 and continuing until the earlier of April 1, 2029 or the date an eligible employee no longer meets the eligibility criteria of the Society Share Grant Plan. To be eligible, an employee must be a member of the Pension Plan on September 1, 2015, be employed on the date annual share issuance occurs and continue to have under 35 years of service. Therefore the requisite service period for the Society Share Grant Plan began on September 1, 2015. The number of common shares issued annually to each eligible employee will be equal to 2.0% of such eligible employee's salary as at September 1, 2015, divided by $20.50, being the price of the common shares of Hydro One Limited in the IPO. The aggregate number of common shares issuable under the Society Share Grant Plan shall not exceed 1,434,686 common shares. In 2015, 743,877 Hydro One Limited common shares were granted under the Society Share Grant Plan relevant to the total share based compensation recognized by the Distribution Business.

The fair value of the Hydro One Limited 2015 share grants to employees of Hydro One Networks and allocated to the Distribution Business was $59 million. The fair value was estimated based on the grant date Hydro One Limited share price of $20.50 and is recognized using the graded-vesting attribution method as the share grant plans have both a performance condition and a service condition. In 2017, 186,489 common shares were granted under the Share Grant Plans (2016 - $nil) to eligible employees of Hydro One Networks and allocated to the Distribution Business. Total stock-based compensation recognized by the Distribution Business during 2017 was $8 million (2016 - $12 million) and was recorded as a regulatory asset.

A summary of the Distribution Business' share grant activity under the Share Grant Plans during 2017 and 2016 is presented below:

Year ended December 31, 2017	Share Grants *(number of common shares)*	Weighted-Average Price
Share grants outstanding - beginning	2,853,079	$20.50
Vested and issued[1]	(186,489)	—
Forfeited	(67,420)	$20.50
Share grants outstanding - ending	2,599,170	$20.50

[1] On April 1, 2017, Hydro One Limited issued from treasury 186,489 common shares to eligible Hydro One Networks employees, which were allocated to the Distribution Business, in accordance with provisions of the PWU Share Grant Plan.

Year ended December 31, 2016	Share Grants *(number of common shares)*	Weighted-Average Price
Share grants outstanding - beginning	2,869,396	$20.50
Forfeited[1]	(43,317)	$20.50
Share grants outstanding - ending	2,826,079	$20.50

[1] Includes shares forfeited as well as shares transferred corresponding to transfer of employees between affiliate companies.

Directors' DSU Plan

Under the Directors' DSU Plan, directors can elect to receive credit for their annual cash retainer in a notional account of DSUs in lieu of cash. Hydro One Limited's Board of Directors may also determine from time to time that special circumstances exist that would reasonably justify the grant of DSUs to a director as compensation in addition to any regular retainer or fee to which the director is entitled. Each DSU represents a unit with an underlying value equivalent to the value of one Hydro One Limited common share and is entitled to accrue Hydro One Limited common share dividend equivalents in the form of additional DSUs at the time dividends are paid, subsequent to declaration by Hydro One Limited's Board of Directors.

During 2017 and 2016, Directors' DSU Plan awards granted by Hydro One Limited that related to Hydro One Networks' Distribution Business were as follows:

Year ended December 31 *(number of DSUs)*	2017	2016
DSUs outstanding - beginning	53,481	11,079
DSUs granted	20,787	42,402
DSUs outstanding - ending	74,268	53,481

For the year ended December 31, 2017, an expense of $nil (2016 - $1 million) was recognized in earnings by the Distribution Business with respect to the Directors' DSU Plan. At December 31, 2017, a liability of $1 million (2016 - $1 million), related to outstanding DSUs has been recorded at the closing price of Hydro One Limited's common shares of $22.40 and is included in long-term accounts payable and other liabilities on the Balance Sheets.

Management DSU Plan

Under the Management DSU Plan, eligible employees can elect to receive a specified proportion of their annual short-term incentive in a notional account of DSUs in lieu of cash. Each DSU represents a unit with an underlying value equivalent to the value of one common share of Hydro One Limited and is entitled to accrue common share dividend equivalents in the form of additional DSUs at the time dividends are paid, subsequent to declaration by Hydro One Limited's Board of Directors.

During 2017 and 2016, Management DSU Plan awards granted by Hydro One Limited that related to Hydro One Networks' Distribution Business were as follows:

Year ended December 31 *(number of DSUs)*	2017	2016
DSUs outstanding - beginning	—	—
Granted	25,601	—
Paid	(439)	—
DSUs outstanding - ending	25,162	—

For the year ended December 31, 2017, an expense of $1 million (2016 - $nil) was recognized in earnings by the Distribution Business with respect to the Management DSU Plan. At December 31, 2017, a liability of $1 million (2016 - $nil) related to outstanding DSUs has been recorded at the closing price of Hydro One Limited common shares of $22.40 and is included in long-term accounts payable and other liabilities on the Balance Sheets.

Employee Share Ownership Plan

In 2015, Hydro One Limited established Employee Share Ownership Plans (ESOP) for certain eligible management and non-represented employees (Management ESOP) and for certain eligible Society-represented staff (Society ESOP). Under the Management ESOP, the eligible management and non-represented employees may contribute between 1% and 6% of their base salary towards purchasing common shares of Hydro One Limited. The Company matches 50% of their contributions, up to a maximum Company contribution of $25,000 per calendar year. Under the Society ESOP, the eligible Society-represented staff may contribute between 1% and 4% of their base salary towards purchasing common shares of Hydro One Limited. The Company matches 25% of their contributions, with no maximum Company contribution per calendar year. In 2017, Company contributions made under the ESOP for the Distribution Business were $1 million (2016 - $1 million).

LTIP

Effective August 31, 2015, the Board of Directors of Hydro One Limited adopted an LTIP. Under the LTIP, long-term incentives are granted to certain executive and management employees of Hydro One Limited and its subsidiaries, and all equity-based awards will be settled in newly issued shares of Hydro One Limited from treasury, consistent with the provisions of the plan. The aggregate number of shares issuable under the LTIP shall not exceed 11,900,000 shares of Hydro One Limited.

The LTIP provides flexibility to award a range of vehicles, including RSUs, PSUs, stock options, share appreciation rights, restricted shares, deferred share units and other stock-based awards. The mix of vehicles is intended to vary by role to recognize the level of executive accountability for overall business performance.

During 2017 and 2016, LTIP awards granted by Hydro One Limited that related to Hydro One Networks' Distribution Business were as follows:

	PSUs		RSUs	
Year ended December 31 *(number of units)*	**2017**	**2016**	**2017**	**2016**
Units outstanding - beginning	74,063	—	83,394	—
Units granted	118,467	77,348	96,697	86,679
Units vested	(276)	—	(7,054)	—
Units forfeited	(23,764)	(3,285)	(21,547)	(3,285)
Units outstanding - ending	168,490	74,063	151,490	83,394

The grant date total fair value of the awards granted in 2017 was $5 million (2016 - $4 million). The compensation expense related to these awards recognized by the Distribution Business during 2017 was $2 million (2016 - $1 million).

23. RELATED PARTY TRANSACTIONS

The Distribution Business is a separately regulated business of Hydro One Networks which is indirectly owned by Hydro One Limited. The Province is a shareholder of Hydro One Limited with approximately 47.4% ownership at December 31, 2017. The IESO, Ontario Power Generation Inc. (OPG), OEFC, and the OEB, are related parties to Hydro One Networks because they are controlled or significantly influenced by the Province.

Year ended December 31 *(millions of dollars)*

Related Party	Transaction	2017	2016
IESO	Power purchased	1,583	2,044
	Amounts related to electricity rebates	357	—
	Distribution revenues related to rural rate protection	247	125
	Funding received related to Conservation and Demand Management programs	59	63
OPG	Power purchased	9	6
OEFC	Power purchased from power contracts administered by the OEFC	2	1
OEB	OEB fees	5	6
Hydro One Brampton[1]	Revenues from management, administrative and smart meter network services	—	3
Hydro One Limited and its subsidiaries[2]	Revenues for services provided	1	4
	Services received - costs expensed	16	15
	Interest expense on long-term debt	170	161
	Interest expense on inter-company demand facility	2	4
	Payments to finance dividends and return of stated capital	263	293
	Stock-based compensation costs	10	13

[1] On February 28, 2017, Hydro One Brampton was acquired by Alectra Inc. from the Province, and as such, effective this date, Hydro One Brampton is no longer a related party to Hydro One.

[2] In 2016, Hydro One transferred the assets and liabilities of Haldimand Hydro and Woodstock Hydro to Hydro One Networks' Distribution Business. See note 4.

The amounts due to and from related parties at December 31, 2017 and 2016 are as follows:

December 31 *(millions of dollars)*	2017	2016
Inter-company demand facility	(167)	(74)
Due from related parties	138	33
Due to related parties	(218)	(178)
Accrued interest	(40)	(42)
Long-term inter-company payable	(18)	(14)
Long-term debt, including current portion	(3,835)	(4,032)

24. STATEMENTS OF CASH FLOWS

The changes in non-cash balances related to operations consist of the following:

Year ended December 31 *(millions of dollars)*	2017	2016
Accounts receivable	198	(48)
Due from related parties	(105)	27
Materials and supplies	—	2
Other assets	4	(8)
Accounts payable	10	(1)
Accrued liabilities	32	50
Due to related parties	40	50
Accrued interest	(2)	6
Long-term accounts payable and other liabilities	(6)	7
Post-retirement and post-employment benefit liability	48	41
	219	126

Capital Expenditures

The following table reconciles investments in property, plant and equipment and the amounts presented in the Statements of Cash Flows after accounting for capitalized depreciation and the net change in related accruals:

Year ended December 31 *(millions of dollars)*	2017	2016
Capital investments in property, plant and equipment	(537)	(655)
Capitalized depreciation and net change in accruals included in capital investments in property, plant and equipment	15	20
Cash outflow for capital expenditures – property, plant and equipment	(522)	(635)

The following table reconciles investments in intangible assets and the amounts presented in the Statements of Cash Flows after accounting for the net change in related accruals:

Year ended December 31 *(millions of dollars)*	2017	2016
Capital investments in intangible assets	(48)	(44)
Net change in accruals included in capital investments in intangible assets	(8)	6
Cash outflow for capital expenditures – intangible assets	(56)	(38)

Supplementary Information

Year ended December 31 *(millions of dollars)*	2017	2016
Net interest paid	172	155
Income taxes paid	16	10

25. CONTINGENCIES

Hydro One Networks is involved in various lawsuits and claims in the normal course of business. In the opinion of management, the outcome of such matters will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Hydro One and certain of its subsidiaries, including Hydro One Networks, are defendants in a class action suit in which the representative plaintiff is seeking up to $125 million in damages related to allegations of improper billing practices. The plaintiff's motion for certification was dismissed by the court on November 28, 2017, but the plaintiff has appealed the court's decision, and it is likely that no decision will be rendered by the appeal court until the second half of 2018. At this time, an estimate of a possible loss related to this claim cannot be made.

The Company is a wholly owned subsidiary of Hydro One. As such, the assets of the Distribution Business are available to satisfy the debts, contingent liabilities and commitments of both the Company and Hydro One.

26. COMMITMENTS

The Company and Hydro One have numerous commitments. These commitments have not been specifically allocated to the Distribution Business. However, the assets of the Distribution Business are available to satisfy the commitments of both the Company and Hydro One.

27. SUBSEQUENT EVENTS

Payments to Finance Dividends and Return of Stated Capital

On February 12, 2018, Hydro One Networks declared common share dividends in the amount of $1 million, and a return of stated capital in the amount of $131 million was approved. The amount allocated to the Distribution Business to finance these payments was $81 million.

HYDRO ONE NETWORKS INC.

DISTRIBUTION BUSINESS

FINANCIAL STATEMENTS

DECEMBER 31, 2016

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
INDEPENDENT AUDITORS' REPORT

To the Directors of Hydro One Networks Inc.

We have audited the accompanying carve-out financial statements of the Distribution Business (a business of Hydro One Networks Inc.), which comprise the carve-out balance sheet as at December 31, 2016, the carve-out statements of operations and comprehensive income, and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information. The carve-out financial statements have been prepared by management in accordance with the basis of accounting in Note 2 to the carve-out financial statements.

Management's Responsibility for the Carve-out Financial Statements

Management of Hydro One Networks Inc. is responsible for the preparation of these carve-out financial statements in accordance with the basis of accounting in Note 2 to the carve-out financial statements; this includes determining that the basis of accounting is an acceptable basis for the preparation of these carve-out financial statements in the circumstances, and for such internal control as management determines is necessary to enable the preparation of carve-out financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the carve-out financial statements as at and for the year ended December 31, 2016 are prepared, in all material respects, in accordance with the basis of accounting in Note 2 to the carve-out financial statements.

Basis of Accounting and Restriction of Use

Without modifying our opinion, we draw attention to Note 2 to the carve-out financial statements, which describes the basis of preparation used in these carve-out financial statements. In particular, in preparing the carve-out financial statements, long-term debt, shared functions and service costs, and income taxes have been allocated to the Distribution Business (a business of Hydro One Networks Inc.) using the method of allocation described in Note 2 to the carve-out financial statements. As a result, the carve-out financial statements may not necessarily be identical to the balance sheet, results of operations and cash flows that would have resulted had the Distribution Business (a business of Hydro One Networks Inc.) historically operated on a stand-alone basis. The carve-out financial statements are prepared to assist Hydro One Networks Inc. to comply with its reporting requirements of the Ontario Energy Board. As a result, the carve-out financial statements may not be suitable for another purpose.

Our report is intended solely for the Directors of Hydro One Networks Inc. and the Ontario Energy Board and should not be used by parties other than Hydro One Networks Inc. or the Ontario Energy Board.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Canada
April 12, 2017

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
For the years ended December 31, 2016 and 2015

Year ended December 31 *(millions of Canadian dollars)*	**2016**	**2015**
Revenues		
Energy sales	4,609	4,305
Rural rate protection *(Note 23)*	125	125
Other	58	45
	4,792	4,475
Costs		
Purchased power *(Note 23)*	3,365	3,087
Operation, maintenance and administration *(Note 23)*	567	574
Depreciation and amortization *(Note 5)*	375	360
	4,307	4,021
Income before financing charges and income taxes	**485**	**454**
Financing charges *(Notes 6, 23)*	156	146
Income before income taxes	**329**	**308**
Income taxes *(Notes 7, 23)*	58	51
Net income	**271**	**257**
Other comprehensive income	–	–
Comprehensive income	**271**	**257**

See accompanying notes to Financial Statements.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
BALANCE SHEETS
At December 31, 2016 and 2015

December 31 *(millions of Canadian dollars)*	**2016**	**2015**
Assets		
Current assets:		
Cash and cash equivalents	9	2
Accounts receivable *(Note 8)*	786	716
Due from related parties *(Note 23)*	33	60
Other current assets *(Note 9)*	44	50
	872	828
Property, plant and equipment *(Note 10)*	7,098	6,663
Other long-term assets:		
Regulatory assets *(Note 12)*	867	829
Intangible assets *(Note 11)*	268	257
Goodwill	168	113
Other assets	1	1
	1,304	1,200
Total assets	**9,274**	**8,691**
Liabilities		
Current liabilities:		
Inter-company demand facility *(Note 23)*	74	642
Long-term debt payable within one year *(Notes 15, 23)*	195	200
Accounts payable and other current liabilities *(Note 13)*	638	574
Due to related parties *(Note 23)*	178	128
	1,085	1,544
Long-term liabilities:		
Long-term debt *(Notes 15, 23)*	3,837	2,987
Deferred income tax liabilities *(Note 7)*	492	426
Regulatory liabilities *(Note 12)*	81	83
Other long-term liabilities *(Note 14)*	1,013	972
	5,423	4,468
Total liabilities	**6,508**	**6,012**
Contingencies and Commitments *(Notes 25, 26)*		
Subsequent Events *(Note 27)*		
Excess of assets over liabilities *(Notes 17, 21)*	2,766	2,679
Total liabilities and excess of assets over liabilities	**9,274**	**8,691**

See accompanying notes to Financial Statements.

On behalf of the Board of Directors:

Philip Orsino
Chair, Audit Committee

Mayo Schmidt
Director

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2016 and 2015

Year ended December 31 *(millions of Canadian dollars)*	**2016**	**2015**
Operating activities		
Net income	271	257
Environmental expenditures	(12)	(11)
Adjustments for non-cash items:		
Depreciation and amortization (excluding removal costs)	320	301
Regulatory assets and liabilities	(11)	(65)
Deferred income taxes	36	(12)
Other	4	3
Changes in non-cash balances related to operations *(Note 24)*	126	235
Net cash from operating activities	734	708
Financing activities		
Long-term debt issued	1,050	30
Long-term debt retired	(200)	(220)
Payments to finance dividends and return on stated capital	(293)	(240)
Change in inter-company demand facility	(613)	384
Other	(5)	(3)
Net cash used in financing activities	(61)	(49)
Investing activities		
Capital expenditures *(Note 24)*		
Property, plant and equipment	(635)	(634)
Intangible assets	(38)	(24)
Other	7	1
Net cash used in investing activities	(666)	(657)
Net change in cash and cash equivalents	7	2
Cash and cash equivalents, beginning of year	2	–
Cash and cash equivalents, end of year	**9**	**2**

See accompanying notes to Financial Statements.

1. DESCRIPTION OF THE BUSINESS

Hydro One Inc. (Hydro One) was incorporated on December 1, 1998, under the Business Corporations Act (Ontario) and was wholly owned by the Province of Ontario (the Province) until October 31, 2015. On October 31, 2015, Hydro One Limited, a wholly owned subsidiary of the Province, acquired all issued and outstanding shares of Hydro One from the Province. The principal businesses of Hydro One are the transmission and distribution of electricity to customers within Ontario.

Hydro One Networks Inc. (Hydro One Networks or the Company) was incorporated on March 4, 1999 under the *Business Corporations Act* (Ontario) and is a wholly owned subsidiary of Hydro One. The Company owns and operates regulated transmission and distribution businesses. The regulated distribution business (Distribution Business) operates a low-voltage electrical distribution network that distributes electricity from the transmission system, or directly from generators, to customers within Ontario. The Distribution Business is regulated by the Ontario Energy Board (OEB).

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

These Financial Statements are prepared and presented in accordance with the accounting policies summarized below and in Canadian dollars. These policies are consistent with United States (US) Generally Accepted Accounting Principles (GAAP), with the exception that business combinations of entities under common control have been accounted for as of the date of the transfer, such that (1) the Financial Statements were not prepared as though the transfer of entities under common control had occurred at the beginning of the year in which the transfer occurred and (2) the comparative year information has not been retrospectively adjusted.

These Financial Statements have been prepared for the specific use of the OEB and as a result, may not be suitable for any other purpose. Consolidated Financial Statements of Hydro One for the year ended December 31, 2016 have been prepared and are publicly available.

These Financial Statements have been prepared on a carve-out basis to provide the financial position, results of operations and cash flows of the Company's regulated Distribution Business on a basis approved by the OEB. The Financial Statements are considered by management to be a reasonable representation, prepared on a rational, systematic and consistent basis, of the financial results of the Company's Distribution Business. As a result of this basis of accounting, these Financial Statements may not necessarily be identical to the financial position and results of operations that would have resulted had the Distribution Business historically operated on a stand-alone basis.

The Financial Statements have been constructed primarily through specific identification of assets, liabilities (other than debt), revenues and expenses that relate to the Distribution Business. The Company's long-term debt is allocated based on the respective borrowing requirements of the Company's transmission and distribution businesses. A portion of the Company's shared functions and services costs is allocated to the Distribution Business on a fully allocated-cost basis, consistent with OEB-approved independent studies. Income tax expense has been recorded at effective rates based on income taxes as reported in the Statements of Operations and Comprehensive Income as though the Distribution Business was a separate taxpaying entity. However, income taxes paid and the deferred tax asset recognized by the Company in relation to the Company losing its exemption from tax under the Federal Tax Regime have been excluded as they represent transactions that are not included in the rate-setting process of the Distribution Business. Certain other amounts presented in these Financial Statements represent allocations subject to review and approval by the OEB.

Hydro One Networks performed an evaluation of subsequent events through to April 12, 2017, the date these Financial Statements were available to be issued, to determine whether any events or transactions warranted recognition and disclosure in these financial statements. See note 27 – Subsequent Events.

Use of Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains and losses during the reporting periods. Management evaluates these estimates on an ongoing basis based upon historical experience, current conditions, and assumptions believed to be reasonable at the time the assumptions are made with any adjustments being recognized in results of operations in the period they arise. Significant estimates relate to regulatory assets and regulatory liabilities, environmental liabilities, post-retirement and post-employment benefits, asset retirement obligations, goodwill and asset impairments, contingencies, unbilled revenues, allowance for doubtful accounts, and deferred income tax assets and liabilities. Actual results may differ significantly from these estimates.

Rate Setting

In March 2015, the OEB approved Hydro One Networks' distribution revenue requirements of $1,326 million for 2015, $1,430 million for 2016 and $1,486 million for 2017. The OEB subsequently approved updated revenue requirements of $1,410 million for 2016 and $1,415 million for 2017.

Regulatory Accounting

The OEB has the general power to include or exclude revenues, costs, gains or losses in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have been applied in an unregulated company. Such change in timing involves the application of rate-regulated accounting, giving rise to the recognition of regulatory assets and liabilities. The Distribution Business' regulatory assets represent certain amounts receivable from future customers and costs that have been deferred for accounting purposes because it is probable that they will be recovered in future rates. In addition, the Distribution Business has recorded regulatory liabilities that generally represent amounts that are refundable to future customers. The Distribution Business continually assesses the likelihood of recovery of each of its regulatory assets and continues to believe that it is probable that the OEB will include its regulatory assets and liabilities in setting of future rates. If, at some future date, the Distribution Business judges that it is no longer probable that the OEB will include a regulatory asset or liability in setting future rates, the appropriate carrying amount would be reflected in results of operations in the period that the assessment is made.

Revenue Recognition

Distribution revenues attributable to the delivery of electricity are based on OEB-approved distribution rates and are recognized on an accrual basis and include billed and unbilled revenues. Billed revenues are based on electricity delivered as measured from customer meters. At the end of each month, electricity delivered to customers since the date of the last billed meter reading is estimated, and the corresponding unbilled revenue is recorded. The unbilled revenue estimate is affected by energy consumption, weather, and changes in the composition of customer classes. Distribution revenue also includes an amount relating to rate protection for rural, residential and remote customers, which is received from the Independent Electricity System Operator (IESO) based on a standardized customer rate that is approved by the OEB. Revenues are recorded net of indirect taxes.

Accounts Receivable and Allowance for Doubtful Accounts

Billed accounts receivable are recorded at the invoiced amount, net of allowance for doubtful accounts. Unbilled accounts receivable are recorded at their estimated value. Overdue amounts related to regulated billings bear interest at OEB-approved rates. The allowance for doubtful accounts reflects the Distribution Business' best estimate of losses on billed accounts receivable balances. The Distribution Business estimates the allowance for doubtful accounts on customer receivables by applying internally developed loss rates to the outstanding receivable balances by aging category. Loss rates applied to the accounts receivable balances are based on historical overdue balances, customer payments and write-offs. Accounts receivable are written-off against the allowance when they are deemed uncollectible. The existing allowance for doubtful accounts will continue to be affected by changes in volume, prices and economic conditions.

Income Taxes

Prior to October 31, 2015, Hydro One Networks was exempt from tax under the *Income Tax Act* (Canada) and the *Taxation Act, 2007* (Ontario) (Federal Tax Regime). However, under the *Electricity Act*, Hydro One Networks was required to make payments in lieu of tax (PILs) to the Ontario Electricity Financial Corporation (OEFC) (PILs Regime). The PILs were, in general, based on the amount of tax that Hydro One Networks would otherwise be liable to pay under the Federal Tax Regime if it was not exempt from taxes under those statutes. On October 31, 2015, Hydro One Networks' exemption from tax under the Federal Tax Regime ceased to apply. Upon exiting the PILs Regime, Hydro One Networks is required to make corporate income tax payments to the Canada Revenue Agency (CRA) under the Federal Tax Regime.

Current and deferred income taxes are computed based on the tax rates and tax laws enacted as at the balance sheet date. Tax benefits associated with income tax positions taken, or expected to be taken, in a tax return are recorded only when the "more-likely-than-not" recognition threshold is satisfied and are measured at the largest amount of benefit that has a greater than 50% likelihood of being realized upon settlement. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. Significant management judgment is required to determine recognition thresholds and the related amount of tax benefits to be recognized in the Financial Statements. Management re-evaluates tax positions each period using new information about recognition or measurement as it becomes available.

Deferred Income Taxes

Deferred income taxes are provided for using the liability method. Deferred income taxes are recognized based on the estimated future tax consequences attributable to temporary differences between the carrying amount of assets and liabilities in the Financial Statements and their corresponding tax bases.

Deferred income tax liabilities are recognized on all taxable temporary differences. Deferred tax assets are recognized to the extent that it is more-likely-than-not that these assets will be realized from taxable income available against which deductible temporary differences can be utilized.

Deferred income taxes are calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized, based on the tax rates and tax laws that have been enacted as at the balance sheet date. Deferred income taxes that are not included in the rate-setting process are charged or credited to the Statements of Operations and Comprehensive Income.

If management determines that it is more-likely-than-not that some or all of a deferred income tax asset will not be realized, a valuation allowance is recorded against the deferred income tax asset to report the net balance at the amount expected to be realized. Previously unrecognized deferred income tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become more-likely-than-not that the tax benefit will be realized.

The Distribution Business records regulatory assets and liabilities associated with deferred income taxes that will be included in the rate-setting process.

The Distribution Business uses the flow-through method to account for investment tax credits (ITCs) earned on eligible scientific research and experimental development expenditures, and apprenticeship job creation. Under this method, only non-refundable ITCs are recognized as a reduction to income tax expense.

Inter-company Demand Facility

Hydro One maintains pooled bank accounts for its use and for the use of its subsidiaries, and implicitly, by the regulated businesses of its subsidiaries. The balance in the inter-company demand facility represents the cumulative net effect of all deposits and withdrawals made by the Distribution Business to and from the pooled bank accounts. Interest is earned on positive inter-company balances based on the average of the bankers' acceptance rate at the beginning and end of the month, less 0.02%. Interest is charged on overdraft inter-company balances based on the same bankers' acceptance rate, plus 0.15%.

Materials and Supplies

Materials and supplies represent consumables, small spare parts and construction materials held for internal construction and maintenance of property, plant and equipment. These assets are carried at average cost less any impairments recorded.

Property, Plant and Equipment

Property, plant and equipment is recorded at original cost, net of customer contributions, and any accumulated impairment losses. The cost of additions, including betterments and replacement asset components, is included on the Balance Sheets as property, plant and equipment.

The original cost of property, plant and equipment includes direct materials, direct labour (including employee benefits), contracted services, attributable capitalized financing costs, asset retirement costs, and direct and indirect overheads that are related to the capital project or program. Indirect overheads include a portion of corporate costs such as finance, treasury, human resources, information technology and executive costs. Overhead costs, including corporate functions and field services costs, are capitalized on a fully allocated basis, consistent with an OEB-approved methodology.

Property, plant and equipment in service consists of distribution, communication, administration and service assets and land easements. Property, plant and equipment also includes future use assets, such as land, major components and spare parts, and capitalized project development costs associated with deferred capital projects.

Distribution

Distribution assets include assets related to the distribution of low-voltage electricity, including lines, poles, switches, transformers, protective devices and metering systems.

Communication

Communication assets include fibre optic and microwave radio systems, optical ground wire, towers, telephone equipment and associated buildings.

Administration and Service

Administration and service assets include administrative buildings, personal computers, transport and work equipment, tools and other minor assets.

Intangible Assets

Intangible assets separately acquired or internally developed are measured on initial recognition at cost, which comprises purchased software, direct labour (including employee benefits), consulting, engineering, overheads and attributable capitalized financing charges. Following initial recognition, intangible assets are carried at cost, net of any accumulated amortization and accumulated impairment losses. The Distribution Business' intangible assets primarily represent major computer applications.

Capitalized Financing Costs

Capitalized financing costs represent interest costs attributable to the construction of property, plant and equipment or development of intangible assets. The financing cost of attributable borrowed funds is capitalized as part of the acquisition cost of such assets. The capitalized financing costs are a reduction of financing charges recognized in the Statements of Operations and Comprehensive Income. Capitalized financing costs are calculated using the Company's weighted average effective cost of debt.

Construction and Development in Progress

Construction and development in progress consists of the capitalized cost of constructed assets that are not yet complete and which have not yet been placed in service.

Depreciation and Amortization

The cost of property, plant and equipment and intangible assets is depreciated or amortized on a straight-line basis based on the estimated remaining service life of each asset category, except for transport and work equipment, which is depreciated on a declining balance basis.

Hydro One periodically initiates an external independent review of its property, plant and equipment and intangible asset depreciation and amortization rates, as required by the OEB. Any changes arising from OEB approval of such a review are implemented on a remaining service life basis, consistent with their inclusion in electricity rates. The last review resulted in changes to rates effective January 1, 2015. A summary of average service lives and depreciation and amortization rates for the various classes of assets is included below:

	Average Service Life	Rate	
		Range	Average
Property, plant and equipment:			
Distribution	46 years	1% – 7%	2%
Communication	8 years	1% – 15%	12%
Administration and service	18 years	1% – 20%	7%
Intangible assets	10 years	10%	10%

In accordance with group depreciation practices, the original cost of property, plant and equipment, or major components thereof, and intangible assets that are normally retired, is charged to accumulated depreciation, with no gain or loss being reflected in results of operations. Where a disposition of property, plant and equipment occurs through sale, a gain or loss is calculated based on proceeds and such gain or loss is included in depreciation expense.

Goodwill

Goodwill represents the cost of acquired local distribution companies that is in excess of the fair value of the net identifiable assets acquired at the acquisition date. Goodwill is not included in rate base.

Goodwill is evaluated for impairment on an annual basis, or more frequently if circumstances require. The Company performs a qualitative assessment to determine whether it is more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount. If the Company determines, as a result of its qualitative assessment, that it is not more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount, no further testing is required. If the Company determines, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount, a goodwill impairment assessment is performed using a two-step, fair value-based test. The first step compares the fair value of the applicable reporting unit to its carrying amount, including goodwill. If the carrying amount of the applicable reporting unit exceeds its fair value, a second step is performed. The second step requires an allocation of fair value to the individual assets and liabilities using purchase price allocation in order to determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount, an impairment loss is recorded as a reduction to goodwill and as a charge to results of operations.

For the year ended December 31, 2016, based on the qualitative assessment performed as at September 30, 2016, the Company has determined that it is not more-likely-than-not that the fair value of each applicable reporting unit assessed is less than its carrying amount. As a result, no further testing was performed, and the Company has concluded that goodwill was not impaired at December 31, 2016.

Long-Lived Asset Impairment

When circumstances indicate the carrying value of long-lived assets may not be recoverable, the Company evaluates whether the carrying value of such assets, excluding goodwill, has been impaired. For such long-lived assets, the Company evaluates whether impairment may exist by estimating future estimated undiscounted cash flows expected to result from the use and eventual disposition of the asset. When alternative courses of action to recover the carrying amount of a long-lived asset are under consideration, a probability-weighted approach is used to develop estimates of future undiscounted cash flows. If the carrying value of the long-lived asset is not recoverable based on the estimated future undiscounted cash flows, an impairment loss is recorded, measured as the excess of the carrying value of the asset over its fair value. As a result, the asset's carrying value is adjusted to its estimated fair value.

The carrying costs of most of the Distribution Business' long-lived assets are included in rate base where they earn an OEB-approved rate of return. Asset carrying values and the related return are recovered through approved rates. As a result, such assets are only tested for impairment in the event that the OEB disallows recovery, in whole or in part, or if such a disallowance is judged to be probable. As at December 31, 2016 and 2015, no asset impairment had been recorded.

Costs of Arranging Debt Financing

For financial liabilities classified as other than held-for-trading, the Company defers its proportionate share of the relevant Hydro One external transaction costs related to obtaining debt financing and presents such amounts as deferred debt costs on the Balance Sheets. Deferred debt costs are amortized over the contractual life of the related debt on an effective-interest basis and the amortization is included within financing charges in the Statements of Operations and Comprehensive Income. Transaction costs for items classified as held-for-trading are expensed immediately.

Comprehensive Income

Comprehensive income is comprised of net income and other comprehensive income (OCI). OCI and net income are presented in a single continuous Statement of Operations and Comprehensive Income.

Financial Assets and Liabilities

All financial assets and liabilities are classified into one of the following five categories: held-to-maturity; loans and receivables; held-for-trading; other liabilities; or available-for-sale. Financial assets and liabilities classified as held-for-trading are measured at fair value. All other financial assets and liabilities are measured at amortized cost, except accounts receivable which are measured at the lower of cost or fair value. Accounts receivable are classified as loans and receivables. The Company considers the carrying amounts of accounts receivable to be reasonable estimates of fair value because of the short time to maturity of these instruments. All financial instrument transactions are recorded at trade date.

Derivative instruments are measured at fair value. Gains and losses from fair valuation are included within financing charges in the period in which they arise. Hydro One Networks determines the classification of its financial assets and liabilities at the date of initial recognition. The Company designates certain of its financial assets and liabilities to be held at fair value, when it is consistent with its risk management policy disclosed in note 16 – Fair Value of Financial Instruments and Risk Management.

Derivative Instruments and Hedge Accounting

Hydro One closely monitors the risks associated with changes in interest rates on its operations and, where appropriate, uses various instruments to hedge these risks. Certain of these derivative instruments qualify for hedge accounting and are designated as accounting hedges, while others either do not qualify as hedges or have not been designated as hedges (hereinafter referred to as undesignated contracts) as they are part of economic hedging relationships. Hydro One's derivative instruments, or portions thereof, are mirrored down to Hydro One Networks, and are allocated between the Company's transmission and distribution businesses. The derivative instruments are classified as fair value hedges or undesignated contracts, consistent with Hydro One's derivative instruments classification.

The accounting guidance for derivative instruments requires the recognition of all derivative instruments not identified as meeting the normal purchase and sale exemption as either assets or liabilities recorded at fair value on the Balance Sheets. For derivative instruments that qualify for hedge accounting, Hydro One may elect to designate such derivative instruments as either cash flow hedges or fair value hedges. Hydro One offsets fair value amounts recognized on its Balance Sheets related to derivative instruments executed with the same counterparty under the same master netting agreement.

For derivative instruments that qualify for hedge accounting and which are designated as cash flow hedges, the effective portion of any gain or loss, net of tax, is reported as a component of accumulated OCI (AOCI) and is reclassified to results of operations in the same period or periods during which the hedged transaction affects results of operations. Any gains or losses on the derivative instrument that represent either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in results of operations. For fair value hedges, changes in fair value of both the derivative instrument and the underlying hedged exposure are recognized in the Statements of Operations and Comprehensive Income in the current period. The gain or loss on the derivative instrument is included in the same line item as the offsetting gain or loss on the hedged item in the Statements of Operations and Comprehensive Income. The changes in fair value of the undesignated derivative instruments are reflected in results of operations.

Embedded derivative instruments are separated from their host contracts and are carried at fair value on the Balance Sheets when: (a) the economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract; (b) the hybrid instrument is not measured at fair value, with changes in fair value recognized in results of operations each period; and (c) the embedded derivative itself meets the definition of a derivative. Hydro One does not engage in derivative trading or speculative activities and had no embedded derivatives at December 31, 2016 or 2015.

Hydro One periodically develops hedging strategies taking into account risk management objectives. At the inception of a hedging relationship where Hydro One has elected to apply hedge accounting, Hydro One formally documents the relationship between the hedged item and the hedging instrument, the related risk management objective, the nature of the specific risk exposure being hedged, and the method for assessing the effectiveness of the hedging relationship. Hydro One also assesses, both at the inception of the hedge and on a quarterly basis, whether the hedging instruments are effective in offsetting changes in fair values or cash flows of the hedged items.

Employee Future Benefits

Employee future benefits provided by Hydro One include pension, post-retirement and post-employment benefits. The costs of Hydro One's pension, post-retirement and post-employment benefit plans are recorded over the periods during which employees render service.

Hydro One recognizes the funded status of its defined benefit pension, post-retirement and post-employment plans on its Consolidated Balance Sheets and subsequently recognizes the changes in funded status at the end of each reporting year. Defined benefit pension, post-retirement and post-employment plans are considered to be underfunded when the projected benefit obligation exceeds the fair value of the plan assets. Liabilities are recognized on the Consolidated Balance Sheets of Hydro One for any net underfunded projected benefit obligation. The net underfunded projected benefit obligation may be disclosed as a current liability, long-term liability, or both. The current portion is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next 12 months exceeds the fair value of plan assets. If the fair value of plan assets exceeds the projected benefit obligation of the plan, an asset is recognized equal to the net overfunded projected benefit obligation. The post-retirement and post-employment benefit plans are unfunded because there are no related plan assets.

Hydro One recognizes its contributions to the defined contribution pension plan as pension expense, with a portion being capitalized as part of labour costs included in capital expenditures. The expensed amount is included in operation, maintenance and administration costs in the Consolidated Statements of Operations and Comprehensive Income.

Defined Benefit Pension

Hydro One has a contributory defined benefit pension plan covering most regular employees of Hydro One and its subsidiaries, including Hydro One Networks. The Hydro One pension plan does not segregate assets in a separate account for individual subsidiaries, nor is the obligation of the pension plan allocated to, or funded separately by, entities within the consolidated group. Accordingly, for purposes of these Financial Statements, the pension plan is accounted for as a defined contribution plan and no pension benefit asset or liability is recorded.

A detailed description of Hydro One pension benefits is provided in note 18 – Pension and Post-Retirement and Post-Employment Benefits, to the Consolidated Financial Statements of Hydro One for the year ended December 31, 2016.

Post-retirement and Post-employment Benefits

Hydro One has post-retirement and post-employment benefit plans covering all regular employees of Hydro One and its subsidiaries, including Hydro One Networks. The benefit obligations of these post-retirement and post-employment benefit plans are not segregated, or funded separately, for Hydro One Networks. Accordingly, for purposes of these Financial Statements, the post-retirement and post-employment benefit obligations are allocated to the Company based on base pensionable earnings.

The Company records a regulatory asset equal to its allocated share of Hydro One's incremental net unfunded projected benefit obligation for post-retirement and post-employment plans at each year end based on annual actuarial reports. The regulatory asset for the incremental net unfunded projected benefit obligation for post-retirement and post-employment plans, in absence of regulatory accounting, would be recognized in AOCI. A regulatory asset is recognized because management considers it to be probable that post-retirement and post-employment benefit costs will be recovered in the future through the rate-setting process.

Post-retirement and post-employment benefits are recorded and included in rates on an accrual basis. Costs are determined by independent actuaries using the projected benefit method prorated on service and based on assumptions that reflect management's best estimates. Past service costs from plan amendments are amortized to results of operations based on the expected average remaining service period.

For post-retirement benefits, all actuarial gains or losses are deferred using the "corridor" approach. The amount calculated above the "corridor" is amortized to results of operations on a straight-line basis over the expected average remaining service life of active Hydro One employees in the plan and over the remaining life expectancy of inactive Hydro One employees in the plan. The post-retirement benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment.

For post-employment obligations, the actuarial gains and losses that are incurred during the year are recognized immediately to results of operations. The post-employment benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment.

All post-retirement and post-employment future benefit costs are attributed to labour and are either charged to results of operations or capitalized as part of the cost of property, plant and equipment and intangible assets.

A detailed description of Hydro One post-retirement and post-employment benefits is provided in note 18 – Pension and Post-Retirement and Post-Employment Benefits, to the Consolidated Financial Statements of Hydro One for the year ended December 31, 2016.

Stock-Based Compensation

Share Grant Plans

Hydro One measures share grant plans based on fair value of share grants as estimated based on the grant date share price of Hydro One Limited common shares. The costs are recognized in the financial statements using the graded-vesting attribution method for share grant plans that have both a performance condition and a service condition. The Company records a regulatory asset equal to the accrued costs of share grant plans recognized in each period. Forfeitures are recognized as they occur (see note 3).

Directors' Deferred Share Unit (DSU) Plan

The Company records the liabilities associated with its Directors' DSU Plan at fair value at each reporting date until settlement, recognizing compensation expense over the vesting period on a straight-line basis. The fair value of the DSU liability is based on Hydro One Limited common share closing price at the end of each reporting period.

Long-term Incentive Plan (LTIP)

The Company measures its LTIP at fair value based on the grant date share price of Hydro One Limited common shares. The related compensation expense of the Company is recognized over the vesting period on a straight-line basis. Forfeitures are recognized as they occur.

Loss Contingencies

Hydro One and its subsidiaries are involved in certain legal and environmental matters that arise in the normal course of business. In the preparation of the Distribution Business' Financial Statements, management makes judgments regarding the future outcome of contingent events and records a loss for a contingency based on its best estimate when it is determined that such loss is probable and the amount of the loss can be reasonably estimated. Where the loss amount is recoverable in future rates, a regulatory asset is also recorded. When a range estimate for the probable loss exists and no amount within the range is a better estimate than any other amount, the Distribution Business records a loss at the minimum amount within the range.

Management regularly reviews current information available to determine whether recorded provisions should be adjusted and whether new provisions are required. Estimating probable losses may require analysis of multiple forecasts and scenarios that often depend on judgments about potential actions by third parties, such as federal, provincial and local courts or regulators. Contingent liabilities are often resolved over long periods of time. Amounts recorded in the Financial Statements may differ from the actual outcome once the contingency is resolved. Such differences could have a material impact on future results of operations, financial position and cash flows of the Distribution Business.

Provisions are based upon current estimates and are subject to greater uncertainty where the projection period is lengthy. A significant upward or downward trend in the number of claims filed, the nature of the alleged injuries, and the average cost of resolving each claim could change the estimated provision, as could any substantial adverse or favorable verdict at trial. A federal or provincial legislative outcome or structured settlement could also change the estimated liability. Legal fees are expensed as incurred.

Environmental Liabilities

Environmental liabilities are recorded in respect of past contamination when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated. The Distribution Business records a liability for the estimated future expenditures associated with contaminated land assessment and remediation and for the phase-out and destruction of polychlorinated biphenyl (PCB)-contaminated mineral oil removed from electrical equipment, based on the present value of these estimated future expenditures. The Company determines the present value with a discount rate equal to its credit-adjusted risk-free interest rate on financial instruments with comparable maturities to the pattern of future environmental expenditures. As the Company anticipates that the future expenditures will continue to be recoverable in future rates, an offsetting regulatory asset has been recorded to reflect the future recovery of these environmental expenditures from customers. The Company reviews its estimates of future environmental expenditures annually, or more frequently if there are indications that circumstances have changed.

Asset Retirement Obligations

Asset retirement obligations are recorded for legal obligations associated with the future removal and disposal of long-lived assets. Such obligations may result from the acquisition, construction, development and/or normal use of the asset. Conditional asset retirement obligations are recorded when there is a legal obligation to perform a future asset retirement activity but where the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Company. In such a case, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement.

When recording an asset retirement obligation, the present value of the estimated future expenditures required to complete the asset retirement activity is recorded in the period in which the obligation is incurred, if a reasonable estimate can be made. In general, the present value of the estimated future expenditures is added to the carrying amount of the associated asset and the resulting asset retirement cost is depreciated over the estimated useful life of the asset. Where an asset is no longer in service when an asset retirement obligation is recorded, the asset retirement cost is recorded in results of operations.

Some of the Company's distribution assets, particularly those located on unowned easements and rights-of-way, may have asset retirement obligations, conditional or otherwise. The majority of the Company's easements and rights-of-way are either of perpetual duration or are automatically renewed annually. Land rights with finite terms are generally subject to extension or renewal. As the Distribution Business expects to use the majority of its facilities in perpetuity, no asset retirement obligations have been recorded for these assets. If, at some future date, a particular facility is shown not to meet the perpetuity assumption, it will be reviewed to determine whether an estimable asset retirement obligation exists. In such a case, an asset retirement obligation would be recorded at that time.

The Distribution Business' asset retirement obligations recorded to date relate to estimated future expenditures associated with the removal and disposal of asbestos-containing materials installed in some of its facilities and with the decommissioning of certain assets.

3. NEW ACCOUNTING PRONOUNCEMENTS

The following tables present Accounting Standards Updates (ASUs) issued by the Financial Accounting Standards Board (FASB) that are applicable to Hydro One Networks:

Recently Adopted Accounting Guidance

ASU	Date issued	Description	Effective date	Impact on Hydro One
2015-01	January 2015	Extraordinary items are no longer required to be presented separately in the income statement.	January 1, 2016	No material impact upon adoption
2015-03	April 2015	Debt issuance costs are required to be presented on the balance sheet as a direct deduction from the carrying amount of the related debt liability consistent with debt discounts or premiums.	January 1, 2016	Reclassification of deferred debt issuance costs and net unamortized debt premiums as an offset to long-term debt. Applied retrospectively. (See note 15)
2015-05	April 2015	Cloud computing arrangements that have been assessed to contain a software licence should be accounted for as internal-use software.	January 1, 2016	No material impact upon adoption

2015-17	November 2015	All deferred tax assets and liabilities are required to be classified as noncurrent on the balance sheet.	January 1, 2017	This ASU was early adopted as of April 1, 2016 and was applied prospectively. As a result, the current portions of the Company's deferred income tax assets are reclassified as noncurrent assets on the Balance Sheet. Prior periods were not retrospectively adjusted. (See note 7)
2016-09	March 2016	Several aspects of the accounting for stock-based payment transactions were simplified, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows.	January 1, 2017	This ASU was early adopted as of October 1, 2016 and was applied retrospectively. As a result, the Company accounts for forfeitures as they occur. There were no other material impacts upon adoption.

Recently Issued Accounting Guidance Not Yet Adopted

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2014-09 2015-14 2016-08 2016-10 2016-12 2016-20	May 2014 – December 2016	ASU 2014-09 was issued in May 2014 and provides guidance on revenue recognition relating to the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. ASU 2015-14 deferred the effective date of ASU 2014-09 by one year. Additional ASUs were issued in 2016 that simplify transition and provide clarity on certain aspects of the new standard.	January 1, 2018	The Company has completed its initial assessment and has identified relevant revenue streams. No quantitative determination has been made as a detailed assessment is now underway and will continue through to the third quarter of 2017, with the end result being a determination of the financial impact of this standard. The Company is on track for implementation of this standard by the effective date.
2016-02	February 2016	Lessees are required to recognize the rights and obligations resulting from operating leases as assets (right to use the underlying asset for the term of the lease) and liabilities (obligation to make future lease payments) on the balance sheet.	January 1, 2019	An initial assessment is currently underway encompassing a review of all existing leases, which will be followed by a detailed review of relevant contracts. No quantitative determination has been made at this time. The Company is on track for implementation of this standard by the effective date.
2016-15	August 2016	The amendments provide guidance for eight specific cash flow issues with the objective of reducing the existing diversity in practice.	January 1, 2018	Under assessment
2016-18	November 2016	The amendment requires that restricted cash or restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning and end-of-period balances in the statement of cash flows.	January 1, 2018	Under assessment
2017-04	January 2017	The amendment removes the second step of the current two-step goodwill impairment test such that the implied fair value of goodwill will not be required to be compared to the carrying value of the goodwill.	January 1, 2020	Under assessment

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4. BUSINESS COMBINATIONS

Haldimand Hydro Transfer

On August 31, 2016, the common shares of Haldimand County Utilities Inc. (Haldimand Hydro) were transferred to Hydro One Networks by Hydro One. The transfer was accounted as a non-monetary transfer, based on Haldimand Hydro's carrying values at August 31, 2016. On September 1, 2016, Haldimand Hydro started dissolution proceedings and, as a result, its net assets were transferred to Hydro One Networks.

The following table summarizes the assets and liabilities that were transferred to Hydro One Networks' Distribution Business at September 1, 2016:

(millions of dollars)	
Working capital	10
Property, plant and equipment	52
Intangible assets	1
Deferred tax assets	1
Goodwill	33
Inter-company demand facility	(18)
Regulatory liabilities	(3)
	76

Woodstock Hydro Transfer

On August 31, 2016, the common shares of Woodstock Hydro Holdings Inc. (Woodstock Hydro) were transferred to Hydro One Networks by Hydro One. The transfer was accounted as a non-monetary transfer, based on Woodstock Hydro's carrying values at August 31, 2016. On September 1, 2016, Woodstock Hydro started dissolution proceedings and, as a result, its net assets were transferred to Hydro One Networks.

The following table summarizes the assets and liabilities that were transferred to Hydro One Networks' Distribution Business at September 1, 2016:

(millions of dollars)	
Working capital	9
Property, plant and equipment	28
Deferred tax assets	2
Goodwill	22
Inter-company demand facility	(23)
Regulatory liabilities	(3)
Post-retirement and post-employment benefit liability	(1)
Other long-term liabilities	(1)
	33

Norfolk Power Transfer

On August 31, 2015, the common shares of Norfolk Power Distribution Inc. (Norfolk Power) were transferred to Hydro One Networks by Hydro One. The transfer was accounted as a non-monetary transfer, based on Norfolk Power's carrying values at August 31, 2015. On September 1, 2015, Norfolk Power started dissolution proceedings and, as a result, its net assets were transferred to Hydro One Networks.

The following table summarizes the assets and liabilities that were transferred to Hydro One Networks' Distribution Business at September 1, 2015:

(millions of dollars)	
Working capital	9
Property, plant and equipment	55
Other assets	1
Goodwill	40
Inter-company demand facility	(33)
Derivative instruments	(3)
Other liabilities	(2)
	67

5. DEPRECIATION AND AMORTIZATION

Year ended December 31 *(millions of dollars)*	**2016**	**2015**
Depreciation of property, plant and equipment	269	254
Asset removal costs	55	59
Amortization of intangible assets	39	36
Amortization of regulatory assets	12	11
	375	360

6. FINANCING CHARGES

Year ended December 31 *(millions of dollars)*	**2016**	**2015**
Interest on long-term debt *(Note 23)*	161	154
Interest on inter-company demand facility *(Note 23)*	4	3
Other	3	4
Less: Interest capitalized on construction and development in progress	(12)	(14)
Gain on interest-rate swap agreements	–	(1)
	156	146

7. INCOME TAXES

Income taxes / provision for PILs differ from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rate. The reconciliation between the statutory and the effective tax rates is provided as follows:

Year ended December 31 *(millions of dollars)*	**2016**	**2015**
Income taxes / provision for PILs at statutory rate	87	82
Increase (decrease) resulting from:		
Net temporary differences recoverable in future rates charged to customers:		
Capital cost allowance in excess of depreciation and amortization	(12)	(4)
Pension contributions in excess of pension expense	(7)	(13)
Overheads capitalized for accounting but deducted for tax purposes	(7)	(6)
Interest capitalized for accounting but deducted for tax purposes	(3)	(4)
Environmental expenditures	(3)	(3)
Other	2	(2)
Net temporary differences	(30)	(32)
Net permanent differences	1	1
Total income taxes / provision for PILs	58	51

The major components of income tax expense are as follows:

Year ended December 31 *(millions of dollars)*	**2016**	**2015**
Current income taxes / provision for PILs	22	63
Deferred income taxes / recovery of PILs	36	(12)
Total income taxes / provision for PILs	58	51
Effective income tax rate	17.6%	16.6%

The provision for current income taxes / PILs is remitted to the CRA (Federal Tax Regime) and the OEFC (PILs Regime). At December 31, 2016, $5 million (2015 – $1 million) receivable from the CRA was included in other current assets and $7 million (2015 – $10 million) receivable from the OEFC was included in due from related parties.

The 2016 total income taxes / provision for PILs included deferred income taxes of $36 million (2015 – deferred recovery of $12 million) that are not included in the rate-setting process. Deferred income tax balances expected to be included in the rate-setting process are offset by regulatory assets and liabilities to reflect the anticipated recovery or disposition of these balances within future electricity rates.

Deferred Income Tax Assets and Liabilities

Deferred income tax assets and liabilities arise from differences between the carrying amounts and tax basis of the Company's assets and liabilities. At December 31, 2016 and 2015, deferred income tax assets and liabilities consisted of the following:

December 31 *(millions of dollars)*	2016	2015
Deferred income tax assets (liabilities)		
Capital cost allowance in excess of depreciation and amortization	(740)	(686)
Regulatory amounts not recognized for tax	(109)	(112)
Goodwill	(10)	(9)
Post-retirement and post-employment benefits expense in excess of cash payments	337	319
Environmental expenditures	34	41
Non-capital losses	1	31
Other	(5)	–
Total deferred income tax liabilities	(492)	(416)
Less: current portion	–	10
	(492)	(426)

8. ACCOUNTS RECEIVABLE

December 31 *(millions of dollars)*	2016	2015
Accounts receivable – billed	396	347
Accounts receivable – unbilled	425	428
Accounts receivable, gross	821	775
Allowance for doubtful accounts	(35)	(59)
Accounts receivable, net	786	716

The following table shows the movements in the allowance for doubtful accounts for the years ended December 31, 2016 and 2015.

Year ended December 31 *(millions of dollars)*	2016	2015
Allowance for doubtful accounts – January 1	(59)	(64)
Write-offs	35	37
Additions to allowance for doubtful accounts	(11)	(32)
Allowance for doubtful accounts – December 31	(35)	(59)

9. OTHER CURRENT ASSETS

December 31 *(millions of dollars)*	2016	2015
Regulatory assets *(Note 12)*	24	28
Prepaid expenses and other assets	16	8
Materials and supplies	4	4
Deferred income tax assets *(Notes 3, 7)*	–	10
	44	50

10. PROPERTY, PLANT AND EQUIPMENT

December 31, 2016 *(millions of dollars)*	Property, Plant and Equipment[1]	Accumulated Depreciation	Construction in Progress	Total
Distribution	9,607	3,281	242	6,568
Communication	135	81	–	54
Administration and service	1,057	621	32	468
Easements	11	3	–	8
	10,810	3,986	274	7,098

[1] Includes future use assets totalling $51 million.

December 31, 2015 *(millions of dollars)*	Property, Plant and Equipment[1]	Accumulated Depreciation	Construction in Progress	Total
Distribution	9,072	3,152	236	6,156
Communication	124	65	–	59
Administration and service	996	574	18	440
Easements	11	3	–	8
	10,203	3,794	254	6,663

[1] Includes future use assets totalling $53 million.

Financing charges capitalized on property, plant and equipment under construction were $11 million in 2016 (2015 – $14 million).

11. INTANGIBLE ASSETS

December 31, 2016 *(millions of dollars)*	Intangible Assets	Accumulated Amortization	Development in Progress	Total
Computer applications software	384	177	30	237
Other	37	9	3	31
	421	186	33	268

December 31, 2015 *(millions of dollars)*	Intangible Assets	Accumulated Amortization	Development in Progress	Total
Computer applications software	352	141	17	228
Other	35	6	–	29
	387	147	17	257

Financing charges capitalized to intangible assets under development were $1 million in 2016 (2015 – $1 million). The estimated annual amortization expense for intangible assets is as follows: 2017 – $34 million; 2018 – $34 million; 2019 – $30 million; 2020 – $21 million; and 2021 – $20 million.

12. REGULATORY ASSETS AND LIABILITIES

Regulatory assets and liabilities arise as a result of the rate-setting process. The Distribution Business has recorded the following regulatory assets and liabilities:

December 31 *(millions of dollars)*	2016	2015
Regulatory assets:		
Deferred income tax regulatory asset	462	431
Retail settlement variance accounts	145	113
Post-retirement and post-employment benefits	136	134
Environmental	95	114
Stock-based compensation	17	5
Distribution system code exemption	10	10
Pension cost variance	8	23
2015-2017 rate rider	7	20
Other	11	7
Total regulatory assets	891	857
Less: current portion	24	28
	867	829
Regulatory liabilities:		
Green Energy expenditure variance	69	76
PST savings deferral	5	4
Deferred income tax regulatory liability	–	9
Other	7	4
Total regulatory liabilities	81	93
Less: current portion	–	10
	81	83

Deferred Income Tax Regulatory Asset and Liability

Deferred income taxes are recognized on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable income. The Distribution Business has recognized regulatory assets and liabilities that correspond to deferred income taxes that flow through the rate-setting process. In the absence of rate-regulated accounting, the Distribution Business' income tax expense would have been recognized using the liability method and there would be no regulatory accounts established for taxes to be recovered through future rates. As a result, the 2016 income tax expense would have been higher by approximately $31 million (2015 – $32 million).

Retail Settlement Variance Accounts (RSVA)

Hydro One has deferred certain retail settlement variance amounts under the provisions of Article 490 of the OEB's Accounting Procedures Handbook. In March 2015, the OEB approved the disposition of the total RSVA balance accumulated from January 2012 to December 2013, including accrued interest, to be recovered through the 2015-2017 Rate Rider.

Post-Retirement and Post-Employment Benefits

The Distribution Business recognizes the net unfunded status of post-retirement and post-employment obligations on the Balance Sheets with an incremental offset to the associated regulatory assets. A regulatory asset is recognized because management considers it to be probable that post-retirement and post-employment benefit costs will be recovered in the future through the rate-setting process. The post-retirement and post-employment benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the re-measurement adjustment. In the absence of rate-regulated accounting, 2016 OCI would have been lower by $2 million (2015 – higher by $20 million).

Environmental

The Distribution Business records a liability for the estimated future expenditures required to remediate environmental contamination. Because such expenditures are expected to be recoverable in future rates, an equivalent amount was recorded as a regulatory asset. In 2016, the environmental regulatory asset decreased by $6 million (2015 – $17 million) to reflect related changes in the PCB liability, and decreased by $5 million (2015 – increased by $2 million) due to changes in the LAR liability. The environmental regulatory asset is amortized to results of operations based on the pattern of actual expenditures incurred and charged to environmental liabilities. The OEB has the discretion to examine and assess the prudency and the timing of recovery of all of the Distribution Business' actual environmental expenditures. In the absence of rate-regulated accounting, 2016 operation, maintenance and administration expenses would have been lower by $11 million (2015 – $15 million). In addition, 2016 amortization expense would have been lower by $12 million (2015 – $11 million), and 2016 financing charges would have been higher by $4 million (2015 – $5 million).

Stock-based Compensation

The Distribution Business recognizes costs associated with share grant plans in a regulatory asset as management considers it probable that costs associated with share grant plans will be recovered in the future through the rate-setting process. In the absence of rate-regulated accounting, 2016 operation, maintenance and administration expenses would have been higher by $5 million (2015 – $2 million).

Distribution System Code (DSC) Exemption

In June 2010, Hydro One Networks filed an application with the OEB regarding the OEB's new cost responsibility rules contained in the OEB's October 2009 Notice of Amendment to the DSC, with respect to the connection of certain renewable generators that were already connected or that had received a connection impact assessment prior to October 21, 2009. The application sought approval to record and defer the unanticipated costs incurred by Hydro One Networks that resulted from the connection of certain renewable generation facilities. The OEB ruled that identified specific expenditures can be recorded in a deferral account subject to the OEB's review in subsequent Hydro One Network distribution applications. In March 2015, the OEB approved the disposition of the DSC exemption deferral account at December 31, 2013, including accrued interest, which will be recovered through the 2015-2017 Rate Rider. In addition, the OEB also approved Hydro One's request to discontinue this deferral account. There were no additions to this regulatory account in 2015 or 2016.

Pension Cost Variance

A pension cost variance account was established for the Distribution Business to track the difference between the actual pension expense incurred and estimated pension costs approved by the OEB. The balance in this regulatory account reflects the excess of pension costs paid as compared to OEB-approved amounts. In the absence of rate-regulated accounting, 2016 revenue would have been higher by $15 million (2015 – lower by $3 million).

2015-2017 Rate Rider

In March 2015, as part of its decision on Hydro One Networks' Distribution rate application for 2015-2019 the OEB approved the disposition of certain deferral and variance accounts, including RSVAs and accrued interest. The 2015-2017 Rate Rider account includes the balances approved for disposition by the OEB and is being disposed in accordance with the OEB decision over a 32-month period ending on December 31, 2017.

Green Energy Expenditure Variance

In April 2010, the OEB requested the establishment of deferral accounts which capture the difference between the revenue recorded on the basis of Green Energy Plan expenditures incurred and the actual recoveries received.

PST Savings Deferral Account

The provincial sales tax (PST) and goods and services tax (GST) were harmonized in July 2010. Unlike the GST, the PST was included in operation, maintenance and administration expenses or capital expenditures for past revenue requirements approved during a full cost-of-service hearing. Under the harmonized sales tax (HST) regime, the HST included in operation, maintenance and administration expenses or capital expenditures is not a cost ultimately borne by the Company and as such, a refund of the prior PST element in the approved revenue requirement is applicable, and calculations for tracking and refund were requested by the OEB. For Hydro One Networks' distribution revenue requirement, PST was included between July 1, 2010 and December 31, 2015 and recorded in a deferral account, as directed by the OEB. In March 2015, the OEB approved the disposition of the PST Savings Deferral account at December 31, 2013, including accrued interest, which will be recovered through the 2015-2017 Rate Rider.

13. ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

December 31 *(millions of dollars)*	**2016**	**2015**
Accrued liabilities	529	469
Accounts payable	67	59
Accrued interest *(Note 23)*	42	36
Regulatory liabilities *(Note 12)*	–	10
	638	574

14. OTHER LONG-TERM LIABILITIES

December 31 *(millions of dollars)*	**2016**	**2015**
Post-retirement and post-employment benefit liability *(Note 18)*	906	862
Environmental liabilities *(Note 19)*	79	99
Long-term inter-company payable *(Note 23)*	14	5
Long-term accounts payable and other liabilities	10	2
Asset retirement obligations *(Note 20)*	4	4
	1,013	972

15. DEBT

Hydro One issues notes for long-term financing under its Medium-Term Note (MTN) Program. The terms of certain issuances are mirrored down to Hydro One Networks through the issuance of inter-company debt, which is then allocated between the Company's transmission and distribution businesses.

The following table presents the outstanding long-term debt of the Distribution Business as at December 31, 2016 and 2015:

December 31 *(millions of dollars)*	**2016**	**2015**
Long-term debt	4,041	3,191
Add: Net unamortized debt premiums[1]	8	9
Add: Unrealized mark-to-market gain[2]	(1)	–
Less: Deferred debt issuance costs[1]	(16)	(13)
Less: Long-term debt payable within one year	(195)	(200)
Long-term debt	3,837	2,987

[1] Effective January 1, 2016, deferred debt issuance costs and net unamortized debt premiums were reclassified from other long-term assets and other long-term liabilities, respectively, as an offset to long-term debt upon adoption of ASU 2015-03 (see note 3). Balances as at December 31, 2015 were updated to reflect the retrospective adoption of ASU 2015-03.

[2] At December 31, 2016, the unrealized mark-to-market net gain related to Distribution Business' $200 million notes due 2019 and $30 million notes due 2020. This gain was offset by $1 million unrealized mark-to-market loss on the related fixed-to-floating interest-rate swap agreements, which are accounted for as fair value hedges.

In 2016, Hydro One issued $2,300 million (2015 – $350 million) of long-term debt under its MTN Program, of which $2,290 million (2015 – $30 million) was mirrored down to Hydro One Networks and $1,050 million (2015 – $30 million) was allocated to the Company's Distribution Business.

In 2016, Hydro One repaid $500 million (2015 – $550 million) of maturing long-term debt notes under its MTN Program. On the same date, Hydro One Networks repaid inter-company debt of $500 million (2015 – $550 million) to Hydro One, of which $200 million (2015 – $220 million) was allocated to the Company's Distribution Business.

Principal repayments and related weighted average interest rates are summarized by the number of years to maturity in the following table:

Years to Maturity	**Long-term Debt Principal Repayments** *(millions of dollars)*	**Weighted Average Interest Rate** *(%)*
1 year	195	5.2
2 years	338	2.8
3 years	291	1.6
4 years	150	3.9
5 years	250	2.1
	1,224	2.9
6 – 10 years	506	3.1
Over 10 years	2,311	5.2
	4,041	4.3

Interest payment obligations related to long-term debt are summarized by year in the following table:

Year	**Interest Payments** *(millions of dollars)*
2017	172
2018	162
2019	151
2020	145
2021	139
	769
2022-2026	641
2027 +	1,709
	3,119

16. FAIR VALUE OF FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition focuses on an exit price, which is the price that would be received in the sale of an asset or the amount that would be paid to transfer a liability.

The Company classifies its fair value measurements based on the following hierarchy, as prescribed by the accounting guidance for fair value, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that Hydro One has the ability to access. An active market for the asset or liability is one in which transactions for the asset or liability occurs with sufficient frequency and volume to provide ongoing pricing information.

Level 2 inputs are those other than quoted market prices that are observable, either directly or indirectly, for an asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted market prices that are observable for the asset or liability, such as interest rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk and default rates. A Level 2 measurement cannot have more than an insignificant portion of the valuation based on unobservable inputs.

Level 3 inputs are any fair value measurements that include unobservable inputs for the asset or liability for more than an insignificant portion of the valuation. A Level 3 measurement may be based primarily on Level 2 inputs.

Non-Derivative Financial Assets and Liabilities

At December 31, 2016 and 2015, the carrying amounts of cash and cash equivalents, accounts receivable, due from related parties, inter-company demand facility, accounts payable, and due to related parties are representative of fair value because of the short-term nature of these instruments.

Fair Value Measurements of Long-Term Debt

The fair values and carrying values of the Distribution Business' long-term debt at December 31, 2016 and 2015 are as follows:

December 31 *(millions of dollars)*	**2016 Carrying Value**	**2016 Fair Value**	**2015 Carrying Value**	**2015 Fair Value**
Long-term debt, including current portion				
$30 million notes due 2020	30	30	30	30
$200 million notes due 2019	199	199	–	–
Other notes and debentures	3,803	4,291	3,157	3,623
	4,032	4,520	3,187	3,653

Fair Value Measurements of Derivative Instruments

Hydro One enters into interest-rate swaps agreements with respect to its long-term debt. The terms of certain of these interest-rate swap agreements are mirrored down to Hydro One Networks, and are then allocated between the Company's transmission and distribution businesses.

At December 31, 2016, the Distribution Business' share of the Company's derivative instruments include $230 million (2015 – $30 million) of interest-rate swaps that were used to convert fixed-rate debt to floating-rate debt. These interest-rate swaps are classified as fair value hedges. The Distribution Business' fair value hedge exposure was equal to about 6% (2015 – 1%) of its total long-term debt. At December 31, 2016, the Distribution Business' interest-rate swaps designated as fair value hedges were as follows:

- $30 million fixed-to-floating interest-rate swap agreements to convert $30 million notes maturing on April 30, 2020 into three-month variable rate debt; and
- $200 million fixed-to-floating interest-rate swap agreements to convert $200 million notes maturing on November 18, 2019 into three-month variable rate debt.

Fair Value Hierarchy

The fair value hierarchy of financial assets and liabilities at December 31, 2016 and 2015 is as follows:

December 31, 2016 *(millions of dollars)*	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	9	9	9	–	–
	9	9	9	–	–
Liabilities:					
Inter-company demand facility	74	74	74	–	–
Long-term debt, including current portion	4,032	4,520	–	4,520	–
Derivative instruments					
Fair value hedges – interest-rate swaps	1	1	–	1	–
	4,107	4,595	74	4,521	–

December 31, 2015 *(millions of dollars)*	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	2	2	2	–	–
	2	2	2	–	–
Liabilities:					
Inter-company demand facility	642	642	642	–	–
Long-term debt, including current portion	3,187	3,653	–	3,653	–
	3,829	4,295	642	3,653	–

The fair value of the hedged portion of the long-term debt is primarily based on the present value of future cash flows using a swap yield curve to determine the assumption for interest rates. The fair value of the unhedged portion of the long-term debt is based on unadjusted period-end market prices for the same or similar debt of the same remaining maturities.

There were no significant transfers between any of the fair value levels during the years ended December 31, 2016 and 2015.

Risk Management

Exposure to market risk, credit risk and liquidity risk arises in the normal course of the Company's business.

Market Risk

Market risk refers primarily to the risk of loss that results from changes in costs, foreign exchange rates and interest rates. The Company is exposed to fluctuations in interest rates as its regulated return on equity is derived using a formulaic approach that takes into account anticipated interest rates. The Company is not currently exposed to material commodity price risk or material foreign exchange risk.

Hydro One uses a combination of fixed and variable-rate debt to manage the mix of its debt portfolio. Hydro One also uses derivative financial instruments to manage interest-rate risk. Hydro One utilizes interest-rate swaps, which are typically designated as fair value hedges, as a means to manage its interest rate exposure to achieve a lower cost of debt. The Company may also utilize interest-rate derivative instruments to lock in interest-rate levels in anticipation of future financing.

A hypothetical 100 basis points increase in interest rates associated with variable-rate debt would not have resulted in a significant decrease in Hydro One's net income for the years ended December 31, 2016 or 2015.

For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the Statements of Operations and Comprehensive Income. The Distribution Business' net unrealized loss (gain) on the hedged debt and the related interest-rate swaps for the years ended December 31, 2016 and 2015 was not significant.

Credit Risk

Financial assets create a risk that a counterparty will fail to discharge an obligation, causing a financial loss. At December 31, 2016 and 2015, there were no significant concentrations of credit risk with respect to any class of financial assets. The Distribution Business did not earn a significant amount of revenue from any single customer. At December 31, 2016 and 2015, there was no significant accounts receivable balance due from any single customer.

At December 31, 2016, the Distribution Business' provision for bad debts was $35 million (2015 – $59 million). Adjustments and write-offs were determined on the basis of a review of overdue accounts, taking into consideration historical experience.

At December 31, 2016, approximately 6% (2015 – 6%) of the Distribution Business' net accounts receivable were aged more than 60 days.

Hydro One manages its counterparty credit risk through various techniques including: entering into transactions with highly rated counterparties; limiting total exposure levels with individual counterparties; entering into master agreements which enable net settlement and the contractual right of offset; and monitoring the financial condition of counterparties. Hydro One monitors current credit exposure to counterparties both on an individual and an aggregate basis. The Company's counterparty credit risk policy is consistent with Hydro One. The Distribution Business' credit risk for accounts receivable is limited to the carrying amounts on its Balance Sheets.

Liquidity Risk

Liquidity risk refers to the Company's ability to meet its financial obligations as they come due. The Company meets its short-term liquidity requirements through the inter-company demand facility with Hydro One and funds from operations. The short-term liquidity available to the Company is expected to be sufficient to fund normal operating requirements.

At December 31, 2016, accounts payable and accrued liabilities in the amount of $596 million (2015 – $528 million) were expected to be settled in cash at their carrying amounts within the next 12 months.

17. CAPITAL MANAGEMENT

The Distribution Business' objective is to manage its capital structure consistent with the deemed capital structure for rate-setting purposes as prescribed by the OEB. At December 31, 2016 and 2015, the Distribution Business' capital structure was as follows:

December 31 *(millions of dollars)*	**2016**	**2015**
Long-term debt payable within one year	195	200
Inter-company demand facility	74	642
Less: cash and cash equivalents	9	2
	260	840
Long-term debt	3,837	2,987
Excess of assets over liabilities	2,766	2,679
Total capital	6,863	6,506

The following table shows the movements in the excess of assets over liabilities for the years ended December 31, 2016 and 2015:

December 31 *(millions of dollars)*	**2016**	**2015**
Excess of assets over liabilities, January 1	2,679	2,595
Net income	271	257
Payments to Hydro One to finance dividends and return of stated capital *(Note 21)*	(293)	(240)
Transfers *(Note 4)*	109	67
Excess of assets over liabilities, December 31	2,766	2,679

18. PENSION AND POST-RETIREMENT AND POST-EMPLOYMENT BENEFITS

Hydro One has a defined benefit pension plan (Pension Plan), a defined contribution pension plan (DC Plan), a supplementary pension plan, and post-retirement and post-employment benefit plans.

Defined Contribution Pension Plan

Hydro One established a DC Plan effective January 1, 2016. The DC Plan is mandatory and covers eligible management employees hired on or after January 1, 2016, as well as management employees hired before January 1, 2016 who were not eligible or had not irrevocably elected to join the Pension Plan as of September 30, 2015. Members of the DC Plan have an option to contribute 4%, 5% or 6% of their pensionable earnings, with matching contributions by Hydro One.

Hydro One Networks contributions to the DC Plan for the year ended December 31, 2016 were less than $1 million (2015 – $nil). At December 31, 2016, Company contributions payable included in accrued liabilities on the Balance Sheets were less than $1 million (2015 – $nil).

Defined Benefit Pension Plan

The Pension Plan is a defined benefit contributory plan which covers all regular employees of Hydro One and its subsidiaries. The Pension Plan provides benefits based on highest three-year average pensionable earnings. For management employees who commenced employment on or after January 1, 2004, and for Society of Energy Professionals-represented staff hired after November 17, 2005, benefits are based on highest five-year average pensionable earnings. After retirement, pensions are indexed to inflation. Membership in the Pension Plan was closed to management employees who were not eligible or had not irrevocably elected to join the Pension Plan as of September 30, 2015. These employees are eligible to join the DC Plan.

Hydro One and employee contributions to the Pension Plan are based on actuarial valuations performed at least every three years. Annual Pension Plan contributions for 2016 of $108 million (2015 – $177 million) were based on an actuarial valuation effective December 31, 2015 (2015 – based on an actuarial valuation effective December 31, 2013) and the level of pensionable earnings. Estimated annual Pension Plan contributions for 2017 and 2018 are approximately $105 million and $102 million, respectively, based on the actuarial valuation as at December 31, 2015 and projected levels of pensionable earnings. Future minimum contributions beyond 2018 will be based on an actuarial valuation effective no later than December 31, 2018. Contributions are payable one month in arrears. All of the contributions are expected to be in the form of cash.

The Hydro One Supplemental Pension Plan (Supplemental Plan) provides members of the Pension Plan with benefits that would have been earned and payable under the Pension Plan but for limitations imposed by the *Income Tax Act* (Canada). The Supplemental Plan obligation is included with other post-retirement and post-employment benefit obligations on the Balance Sheets.

At December 31, 2016, the present value of Hydro One's projected pension benefit obligation was estimated to be $7,774 million (2015 – $7,683 million). The fair value of pension plan assets available for these benefits was $6,874 million (2015 – $6,731 million).

Post-Retirement and Post-Employment Benefits

During the year ended December 31, 2016, the Distribution Business charged $33 million (2015 – $31 million) of post-retirement and post-employment benefit costs to operations, and capitalized $35 million (2015 – $35 million) as part of the cost of property, plant and equipment and intangible assets. Benefits paid in 2016 were $24 million (2015 – $27 million). In addition, the associated post-retirement and post-employment benefits regulatory asset was increased by $2 million (2015 – decreased by $20 million).

The Distribution Business presents its post-retirement and post-employment benefit liabilities on its Balance Sheets as follows:

December 31 *(millions of dollars)*	2016	2015
Accrued liabilities	28	26
Post-retirement and post-employment benefit liability	906	862
	934	888

19. ENVIRONMENTAL LIABILITIES

The following tables show the movements in environmental liabilities for the years ended December 31, 2016 and 2015:

Year ended December 31, 2016 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Environmental liabilities, January 1	77	37	114
Interest accretion	3	1	4
Expenditures	(8)	(4)	(12)
Revaluation adjustment	(6)	(5)	(11)
Environmental liabilities, December 31	66	29	95
Less: current portion	10	6	16
	56	23	79

Year ended December 31, 2015 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Environmental liabilities, January 1	95	40	135
Interest accretion	4	1	5
Expenditures	(5)	(6)	(11)
Revaluation adjustment	(17)	2	(15)
Environmental liabilities, December 31	77	37	114
Less: current portion	10	5	15
	67	32	99

The following tables show the reconciliation between the undiscounted basis of the environmental liabilities and the amount recognized on the Balance Sheets after factoring in the discount rate:

December 31, 2016 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Undiscounted environmental liabilities	73	29	102
Less: discounting accumulated liabilities to present value	7	–	7
Discounted environmental liabilities	66	29	95

December 31, 2015 *(millions of dollars)*	PCB	Land Assessment and Remediation	Total
Undiscounted environmental liabilities	87	38	125
Less: discounting accumulated liabilities to present value	10	1	11
Discounted environmental liabilities	77	37	114

At December 31, 2016, the estimated future environmental expenditures were as follows:

(millions of dollars)	
2017	16
2018	15
2019	14
2020	17
2021	15
Thereafter	25
	102

The Distribution Business records a liability for the estimated future expenditures for land assessment and remediation and for the phase-out and destruction of PCB-contaminated mineral oil removed from electrical equipment when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated.

There are uncertainties in estimating future environmental costs due to potential external events such as changes in legislation or regulations, and advances in remediation technologies. In determining the amounts to be recorded as environmental liabilities, the Company estimates the current cost of completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. A long-term inflation rate assumption of approximately 2% has been used to express these current cost estimates as estimated future expenditures. Future expenditures have been discounted using factors ranging from approximately 2.0% to 6.3%, depending on the appropriate rate for the period when expenditures are expected to be incurred. All factors used in estimating the Distribution Business' environmental liabilities represent management's best estimates of the present value of costs required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company's current assumptions. In addition, with respect to the PCB environmental liability, the availability of critical resources such as skilled labour and replacement assets and the ability to take maintenance outages in critical facilities may influence the timing of expenditures.

PCBs

The Environment Canada regulations, enacted under the *Canadian Environmental Protection Act,* 1999, govern the management, storage and disposal of PCBs based on certain criteria, including type of equipment, in-use status, and PCB-contamination thresholds. Under current regulations, the Company's PCBs have to be disposed of by the end of 2025, with the exception of specifically exempted equipment. Contaminated equipment will generally be replaced, or will be decontaminated by removing PCB-contaminated insulating oil and retro filling with replacement oil that contains PCBs in concentrations of less than 2 ppm.

The Distribution Business' best estimate of the total estimated future expenditures to comply with current PCB regulations is $73 million (2015 – $87 million). These expenditures are expected to be incurred over the period from 2017 to 2025. As a result of its annual review of environmental liabilities, the Distribution Business recorded a revaluation adjustment in 2016 to decrease the PCB environmental liability by $6 million (2015 – $17 million).

Land Assessment and Remediation

The Distribution Business' best estimate of the total estimated future expenditures to complete its land assessment and remediation program is $29 million (2015 – $38 million). These expenditures are expected to be incurred over the period from 2017 to 2023. As a result of its annual review of environmental liabilities, the Distribution Business recorded a revaluation adjustment in 2016 to decrease the land assessment and remediation environmental liability by $5 million (2015 – increase by $2 million).

20. ASSET RETIREMENT OBLIGATIONS

The Company records a liability for the estimated future expenditures for the removal and disposal of asbestos-containing materials installed in some of its facilities and for the decommissioning of specific switching stations located on unowned sites. Asset retirement obligations, which represent legal obligations associated with the retirement of certain tangible long-lived assets, are computed as the present value of the projected expenditures for the future retirement of specific assets and are recognized in the period in which the liability is incurred, if a reasonable estimate of fair value can be made. If the asset remains in service at the recognition date, the present value of the liability is added to the carrying amount of the associated asset in the period the liability is incurred and this additional carrying amount is depreciated over the remaining life of the asset. If an asset retirement obligation is recorded in respect of an out-of-service asset, the asset retirement cost is charged to results of operations. Subsequent to the initial recognition, the liability is adjusted for any revisions to the estimated future cash flows associated with the asset retirement obligations, which can occur due to a number of factors including, but not limited to, cost escalation, changes in technology applicable to the assets to be retired, changes in legislation or regulations, as well as for accretion of the liability due to the passage of time until the obligation is settled. Depreciation expense is adjusted prospectively for any increases or decreases to the carrying amount of the associated asset.

In determining the amounts to be recorded as asset retirement obligations, the Company estimates the current fair value for completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. A long-term inflation assumption of approximately 2% has been used to express these current cost estimates as estimated future expenditures. Future expenditures have been discounted using factors ranging from approximately 3.0% to 5.0%, depending on the appropriate rate for the period when expenditures are expected to be incurred. All factors used in estimating the Distribution Business' asset retirement obligations represent management's best estimates of the cost required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company's current assumptions. Asset retirement obligations are reviewed annually or more frequently if significant changes in regulations or other relevant factors occur. Estimate changes are accounted for prospectively.

At December 31, 2016, the Company had recorded asset retirement obligations of $4 million (2015 – $4 million) related to its Distribution Business, primarily consisting of the estimated future expenditures associated with the removal and disposal of asbestos-containing materials installed in some of its facilities. The amount of interest recorded is nominal.

21. HYDRO ONE NETWORKS' SHARE CAPITAL

Hydro One Networks is authorized to issue an unlimited number of common and preferred shares. At December 31, 2016 and 2015, Hydro One Networks had 207,577,181 common shares issued and outstanding and no preferred shares issued and outstanding.

During 2016, Hydro One Networks declared common share dividends in the amount of $2 million (2015 – $875 million), preferred share dividends of $nil (2015 – $16 million), and made a return of stated capital of $609 million (2015 – $nil) to Hydro One. The amount allocated to the Distribution Business to finance these dividends and return of stated capital was $293 million (2015 – $240 million).

22. STOCK-BASED COMPENSATION

The following compensation plans were established by Hydro One Limited, however they represent components of compensation costs of Hydro One and its subsidiaries, including Hydro One Networks, in current and future periods.

Share Grant Plans

At December 31, 2016, Hydro One Limited had two share grant plans (Share Grant Plans), one for the benefit of certain members of the Power Workers' Union (the PWU Share Grant Plan) and one for the benefit of certain members of The Society of Energy Professionals (the Society Share Grant Plan). Hydro One and Hydro One Limited entered into an intercompany agreement, such that Hydro One will pay Hydro One Limited for the compensation costs associated with these plans. The agreement requires Hydro One Networks to reimburse Hydro One for the value of shares granted to the Company's eligible employees relating to these plans.

The PWU Share Grant Plan provides for the issuance of common shares of Hydro One Limited from treasury to certain eligible members of the Power Workers' Union annually, commencing on April 1, 2017 and continuing until the earlier of April 1, 2028 or the date an eligible employee no longer meets the eligibility criteria of the PWU Share Grant Plan. To be eligible, an employee must be a member of the Pension Plan on April 1, 2015, be employed on the date annual share issuance occurs and continue to have under 35 years of service. The requisite service period for the PWU Share Grant Plan begins on July 3, 2015, which is the date the share grant plan was ratified by the PWU. The number of common shares issued annually to each eligible employee will be equal to 2.7% of such eligible employee's salary as at April 1, 2015, divided by $20.50, being the price of the common shares of Hydro One Limited in the Initial Public Offering. The aggregate number of Hydro One Limited common shares issuable under the PWU Share Grant Plan shall not exceed 3,981,763 common shares. In 2015, 2,152,519 Hydro One Limited common shares were granted under the PWU Share Grant Plan relevant to the total stock-based compensation recognized by the Distribution Business.

The Society Share Grant Plan provides for the issuance of common shares of Hydro One Limited from treasury to certain eligible members of The Society of Energy Professionals annually, commencing on April 1, 2018 and continuing until the earlier of April 1, 2029 or the date an eligible employee no longer meets the eligibility criteria of the Society Share Grant Plan. To be eligible, an employee must be a member of the Pension Plan on September 1, 2015, be employed on the date annual share issuance occurs and continue to have under 35 years of service. Therefore the requisite service period for the Society Share Grant Plan begins on September 1, 2015. The number of common shares issued annually to each eligible employee will be equal to 2.0% of such eligible employee's salary as at September 1, 2015, divided by $20.50, being the price of the common shares of Hydro One Limited in the Initial Public Offering. The aggregate number of Hydro One Limited common shares issuable under the Society Share Grant Plan shall not exceed 1,434,686 common shares. In 2015, 743,877 Hydro One Limited common shares were granted under the Society Share Grant Plan relevant to the total stock-based compensation recognized by the Distribution Business.

The 2015 fair value of Hydro One Limited shares granted to employees of Hydro One Networks and allocated to the Distribution Business was $59 million. The fair value was estimated based on the grant date Hydro One Limited share price of $20.50 and is recognized using the graded-vesting attribution method as the share grant plans have both a performance condition and a service condition. No shares were granted under the Share Grant Plans in 2016. Total stock-based compensation recognized during 2016 by the Distribution Business was $12 million (2015 – $5 million) and was recorded as a regulatory asset.

A summary of the Distribution Business' share grant activity under the Share Grant Plans during years ended December 31, 2016 and 2015 is presented below:

Year ended December 31, 2016	Share Grants *(Number of common shares)*	Weighted-Average Price
Share grants outstanding – January 1	2,896,396	$20.50
Granted (non-vested)	–	–
Forfeited[1]	(43,317)	$20.50
Share grants outstanding – December 31	2,853,079	$20.50

[1] Includes shares forfeited as well as shares transferred corresponding to transfer of employees between affiliate companies.

Year ended December 31, 2015	Share Grants *(Number of common shares)*	Weighted-Average Price
Share grants outstanding – January 1	–	–
Granted (non-vested)	2,896,396	$20.50
Share grants outstanding – December 31	2,896,396	$20.50

Directors' DSU Plan

Under the Directors' DSU Plan, directors can elect to receive credit for their annual cash retainer in a notional account of DSUs in lieu of cash. Hydro One Limited's Board of Directors may also determine from time to time that special circumstances exist that would reasonably justify the grant of DSUs to a director as compensation in addition to any regular retainer or fee to which the director is entitled.

Each DSU represents a unit with an underlying value equivalent to the value of one common share of Hydro One Limited and is entitled to accrue Hydro One Limited common share dividend equivalents in the form of additional DSUs at the time dividends are paid, subsequent to declaration by Hydro One Limited's Board of Directors.

Year ended December 31 *(number of DSUs)*	**2016**	**2015**
DSUs outstanding – January 1	11,079	–
DSUs granted	42,402	11,079
DSUs outstanding – December 31	53,481	11,079

For the year ended December 31, 2016, an expense of $1 million (2015 – less than $1 million) was recognized in earnings by the Distribution Business with respect to the DSU Plan. At December 31, 2016, a liability of $1 million (2015 – less than $1 million), related to outstanding DSUs has been recorded at the closing price of Hydro One Limited's common shares of $23.58.

Employee Share Ownership Plan

Effective December 15, 2015, Hydro One Limited established an Employee Share Ownership Plan (ESOP). Under the ESOP, certain eligible management and non-represented employees may contribute between 1% and 6% of their base salary towards purchasing common shares of Hydro One Limited. Hydro One Networks matches 50% of the employee's contributions, up to a maximum Company contribution of $25,000 per calendar year. In 2016, contributions made by the Distribution Business under the ESOP were $1 million (2015 – $nil).

Long-term Incentive Plan

Effective August 31, 2015, the Board of Directors of Hydro One Limited adopted an LTIP. Under the LTIP, long-term incentives are granted to certain executive and management employees of Hydro One Limited and its subsidiaries, and all equity-based awards will be settled in newly-issued shares of Hydro One Limited from treasury, consistent with the provisions of the plan. The aggregate number of shares issuable under the LTIP shall not exceed 11,900,000 shares of Hydro One Limited.

The LTIP provides flexibility to award a range of vehicles, including restricted share units (RSUs), performance share units (PSUs), stock options, share appreciation rights, restricted shares, deferred share units and other stock-based awards. The mix of vehicles is intended to vary by role to recognize the level of executive accountability for overall business performance.

During 2016, Hydro One Limited granted awards under its LTIP, consisting of PSUs and RSUs, all of which are equity settled in Hydro One Limited shares. A summary of the Distribution Business' share is as follows:

	Number of PSUs	**Number of RSUs**
Units outstanding – January 1, 2016	–	–
Units granted	77,348	86,679
Units forfeited	(3,285)	(3,285)
Units outstanding – December 31, 2016	74,063	83,394

The grant date total fair value of the awards was $4 million (2015 – $nil). The compensation expense recognized by the Distribution Business relating to these awards during 2016 was $1 million (2015 – $nil).

23. RELATED PARTY TRANSACTIONS

The Distribution Business is a separately regulated business of Hydro One Networks which is a subsidiary of Hydro One. Hydro One is owned by Hydro One Limited, and the Province is the majority shareholder of Hydro One Limited. The IESO, Ontario Power Generation Inc. (OPG), OEFC, OEB, Hydro One Brampton and Hydro One Telecom are related parties to Hydro One Networks because they are controlled or significantly influenced by the Province, or by Hydro One Limited.

		Year ended December 31	
		2016	2015
Related Party	**Transaction**		*(millions of dollars)*
IESO	Power purchased	2,044	1,963
	Distribution revenues related to rural rate protection	125	125
	Funding received related to Conservation and Demand Management programs	63	63
OPG	Power purchased	6	11
OEFC	Power purchased from power contracts administered by the OEFC	1	6
	Payments in lieu of corporate income taxes	–	20
	Indemnification fee paid (terminated effective October 31, 2015)	–	1
OEB	OEB fees	6	7
Hydro One Brampton[1]	Revenues from management, administrative and smart meter network services	3	1
Hydro One Limited and its subsidiaries[2]	Revenues for services provided	4	4
	Services received – costs expensed	15	16
	Interest expense on long-term debt	161	154
	Interest expense on inter-company demand facility	4	3
	Payments to finance dividends and return of stated capital	293	240
	Stock-based compensation costs	13	5

[1] On February 28, 2017, Hydro One Brampton was acquired by Alectra Inc. from the Province, and as such, effective this date, Hydro One Brampton is no longer a related party to Hydro One.

[2] In 2016, Hydro One transferred the assets and liabilities of Haldimand Hydro and Woodstock Hydro (2015 – Norfolk Power) to Hydro One Networks' Distribution Business. See note 4.

The amounts due to and from related parties at December 31, 2016 and 2015 are as follows:

December 31 *(millions of dollars)*	**2016**	**2015**
Inter-company demand facility	(74)	(642)
Due from related parties	33	60
Due to related parties	(178)	(128)
Accrued interest	(42)	(36)
Long-term inter-company payable	(14)	(5)
Long-term debt, including current portion	(4,032)	(3,187)

24. STATEMENTS OF CASH FLOWS

The changes in non-cash balances related to operations consist of the following:

Year ended December 31 *(millions of dollars)*	**2016**	**2015**
Accounts receivable	(48)	171
Due from related parties	27	38
Materials and supplies	2	3
Other assets	(8)	7
Accounts payable	(1)	(10)
Due to related parties	50	(52)
Accrued liabilities	50	41
Accrued interest	6	(2)
Long-term accounts payable and other liabilities	7	1
Post-retirement and post-employment benefit liability	41	38
	126	235

Capital Expenditures

The following table reconciles investments in property, plant and equipment and the amount presented on the Statements of Cash Flows after accounting for capitalized depreciation and the net change in related accruals:

Year ended December 31 *(millions of dollars)*	**2016**	**2015**
Capital investments in property, plant and equipment	(655)	(653)
Capitalized depreciation and net change in accruals included in capital investments in property, plant and equipment	20	19
Capital expenditures – property, plant and equipment	(635)	(634)

The following table reconciles investments in intangible assets and the amount presented in the Statements of Cash Flows after accounting for the net change in related accruals:

Year ended December 31 *(millions of dollars)*	**2016**	**2015**
Capital investments in intangible assets	(44)	(26)
Net change in accruals included in capital investments in intangible assets	6	2
Capital expenditures – intangible assets	(38)	(24)

Supplementary Information

Year ended December 31 *(millions of dollars)*	**2016**	**2015**
Net interest paid	155	156
Income taxes / PILs paid	10	21

25. CONTINGENCIES

Hydro One is involved in various lawsuits, claims and regulatory proceedings in the normal course of business. In the opinion of management, the outcome of such matters will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Hydro One and certain of its subsidiaries, including Hydro One Networks, are defendants in a class action suit in which the representative plaintiff is seeking up to $125 million in damages related to allegations of improper billing practices. A certification motion in the class action is pending. Due to the preliminary stage of legal proceedings, an estimate of a possible loss related to this claim cannot be made.

The Company is a wholly owned subsidiary of Hydro One. As such, the assets of the Distribution Business are available to satisfy the debts, contingent liabilities and commitments of both the Company and Hydro One.

26. COMMITMENTS

The Company and Hydro One have numerous commitments. These commitments have not been specifically allocated to the Distribution Business. However, the assets of the Distribution Business are available to satisfy the commitments of both the Company and Hydro One.

27. SUBSEQUENT EVENTS

Payments to Finance Dividends and Return of Stated Capital

On February 9, 2017, Hydro One Networks declared common share dividends in the amount of $2 million, and a return of stated capital in the amount of $124 million was approved. The amount allocated to the Distribution Business to finance these payments was $50 million.

ATTACHMENT 18
OPDC Growth in Revenue Requirement Related Elements

The calculation of forecast revenue requirement for the Status Quo scenario was modeled by OPDC.
For the Hydro One Residual scenario, forecast revenue requirement is calculated based on the same model used by Hydro One in the calculation of the ESM, presented in Exhibit A, Tab 3, Schedule 1, of this Application and that in EB-2016-0276.

	2010	2017	2018[1]	2019[1]	2029[1]	2030[1]	2030[1]
OPDC Operating Model Scenario	Status Quo	Status Quo	Status Quo	Status Quo	Residual	Residual	Status Quo
Significance of Year	Most recent OEB rebasing of OPDC rates	Most recent OPDC Audited Financial Year	Bridge Year of OPDC Operation	Bridge Year of OPDC Operation	Year 10 of Deferred Rebasing Period	Year 11 OPDC Rebasing Expected	Year 11 OPDC Rebasing Expected
Source of Data	EB-2009-0273	OPDC 2017 F/Statements	OPDC Forecast	OPDC Forecast	HONI Forecast	HONI Forecast	OPDC Forecast
Years Since Rebasing	N/A	7	8	9	19	20	20
	($000's)	**($000's)**	**($000's)**	**($000's)**	**($000's)**	**($000's)**	**($000's)**
Rate Base	20,806	33,683	35,241	37,742	51,215	52,906	53,678
OM&A	4,346	4,870	5,134	5,431	1,883	1,921	6,754
Depreciation	1,408	1,142	1,275	1,420	1,408	1,433	2,882
Tax	343	59	193	201	665	687	575
Cost of Capital							
Cost of Debt	739	1,197	1,252	1,341	1,329	1,373	1,300
Cost of Equity	820	1,327	1,388	1,487	1,844	1,905	1,932
Total Cost of Capital	**1,559**	**2,524**	**2,641**	**2,828**	**3,173**	**3,277**	**3,232**
Revenue Requirement	**7,656**	**8,595**	**9,243**	**9,880**	**7,129**	**7,319**	**13,443**

[1] Please refer to Attachment 20 to this Application for the list of assumptions used for this forecast period.

ATTACHMENT 19

Comparison of LDC OEB-Approved Revenue Requirement and Rate Base following 5-year IRM Applications

	2018 approvals			Last Approval					Rev Requirement Variance		Rate Base Variance	
Utility	Application	Base Revenue Requirement	Rate Base	Year	Application	Base Revenue Requirement	Rate Base		$	%	$	%
Centre Wellington	EB-2017-0032	3,665,637	17,046,778	2013	EB-2012-0113	3,023,099	11,778,959		642,538	21.3%	5,267,819	44.7%
Cooperative Hydro Em	EB-2017-0035	1,067,336	4,680,408	2014	EB-2013-0122	858,144	2,907,927		209,192	24.4%	1,772,481	61.0%
Essex	EB-2017-0039	12,351,144	58,033,511	2010	EB-2009-0143	11,208,453	41,119,714		1,142,691	10.2%	16,913,797	41.1%
Hydro Hawkesbury	EB-2017-0048	1,744,140	8,528,333	2014	EB-2013-0139	1,590,565	6,386,201		153,575	9.7%	2,142,132	33.5%
Westario	EB-2017-0084	10,669,547	50,358,448	2013	EB-2012-0176	9,631,581	41,870,815		1,037,966	10.8%	8,487,633	20.3%
								AVG		**15.3%**		**40.1%**

	2017 approvals			Last Approval					Rev Requirement Variance		Rate Base Variance	
Utility	Application	Base Revenue Requirement	Rate Base	Year	Application	Base Revenue Requirement	Rate Base		$	%	$	%
Atikokan	EB-2016-0055	1,402,256	3,435,243	2012	EB-2011-0293	1,232,815	2,799,500		169,441	13.7%	635,743	22.7%
Brantford	EB-2016-0058	17,098,955	88,429,953	2013	EB-2012-0109	15,826,563	75,737,921		1,272,392	8.0%	12,692,032	16.8%
CNP	EB-2016-0061	18,840,476	89,608,015	2013	EB-2012-0112	17,562,996	73,497,788		1,277,480	7.3%	16,110,227	21.9%
InnPower	EB-2016-0085	10,117,125	52,584,820	2013	EB-2012-0139	7,590,696	32,279,524		2,526,429	33.3%	20,305,296	62.9%
Lakefront	EB-2016-0089	4,260,112	19,540,253	2012	EB-2011-0250	4,039,506	17,660,020		220,606	5.5%	1,880,233	10.6%
London	EB-2016-0091	66,339,088	299,568,786	2013	EB-2012-0146	62,675,465	268,985,256		3,663,623	5.8%	30,583,530	11.4%
Northern Ontario	EB-2016-0096	3,411,159	7,767,615	2013	EB-2012-0153	2,916,654	7,273,107		494,505	17.0%	494,508	6.8%
Renfrew	EB-2016-0166	2,003,438	6,684,775	2010	EB-2009-0146	1,877,960	6,016,657		125,478	6.7%	668,118	11.1%
Thunder Bay	EB-2016-0105	22,770,707	109,772,927	2013	EB-2012-0167	19,210,613	93,339,122		3,560,094	18.5%	16,433,805	17.6%
Welland	EB-2016-0110	9,684,025	33,665,167	2013	EB-2012-0173	8,715,039	31,435,867		968,986	11.1%	2,229,300	7.1%
								AVG		**12.7%**		**18.9%**
							2-Year Average			**13.5%**		**26.0%**

ATTACHMENT 20

OPDC Revenue Requirement Assumptions

The "Residual" (Hydro One) Cost to Serve and the "Status Quo" (OPDC) Cost to Serve

The model used for the calculation of the Residual revenue requirement (the revenue requirement calculated by Hydro One, forecasting the results assuming the transaction is approved) is based on the same model used by Hydro One in the calculation of the ESM sharing calculation presented in A-3-1 Table 6 of EB-2016-0276.

The model used for the calculation of OPDC's Status Quo revenue requirement is provided by OPDC and assumes business continues under their current operations and management model.

List of Assumptions:

- Year 11 OM&A and Capital expenditures for each scenario, Residual or Status Quo, are based on the applicable data set lines provided in **Exhibit A, Tab 2, Schedule 1**, Table 1 (adjusted for rounding), inflated by 2% (i.e. the Year-10 value from that table is inflated by 2% to arrive at Year-11 value).
- Rate Base is calculated based on OPDC's 2019 Rate Base forecast.
- Year 1 of the deferred rebasing period for both Residual and Status Quo scenarios is assumed to be 2020.
- Rate Base in Year 1 of the Hydro One Residual scenario, is calculated using the OPDC 2019 forecast balance of OPDC's NBV of Property, Plant and Equipment ("PP&E"), as acquired from OPDC, less OPDC's 2019 forecast balance of capital contributions, plus a calculation for working capital.
- Rate base applies the half-year rule. Capital expenditures are treated as 100% in-serviced in the year incurred.
- Working capital rate;
  - Residual scenario – 7.70% per Hydro One's Distribution's 2018-2022 rate application (EB-2017-0049)
  - Status Quo scenario– 7.5% per OEB's default working capital allowance[1]
- Annual depreciation on the forecast Gross Book Value of OPDC assets.
  - Status Quo average OPDC depreciation rate used is 3.7% (equal to the average of OPDC's 2013 to 2017 average depreciation expense - relative to its Gross PP&E).
  - Residual scenario uses Hydro One's OEB-approved depreciation rates.
- Interest expense
  - Residual scenario (Hydro One rates[2])

[1] OEB letter to All Licensed Electricity Distributors, '*Allowance for Working Capital for Electricity Distribution Rate Applications*' June 3, 2015

    - Long Term – 4.47%
    - Short Term – 2.29%
  - Status Quo scenario
    - Long Term – 4.16%
    - Short Term – 2.29%
- ROE – 9.0% (Residual and Status Quo scenario are the same)
- Tax expense - federal and provincial tax rate of 26.5%.

[2] EB-2017-0049 – Exhibit Q, Tab , Schedule 1, page 10

Update: Status of Orillia Power Distribution Corporation

Current Status

On April 12, 2018, the City of Orillia received notification that the Ontario Energy Board (OEB) denied the application for the sale of the Orillia Power Distribution Corporation (OPDC). As part of the contractual agreement of the sale to seek OEB approval, the City and Hydro One have filed a motion to review and revise the OEB's decision. This motion, also referred to as an appeal, is currently before the OEB and we await next steps.

Next Steps in the Process

If the appeal is successful, the transition from OPDC to Hydro One will take several months and all customers will receive advanced notification of milestones in the process (i.e. closing, integration and billing).

What's Included in the Potential Sale

The sale includes the purchase of all shares of OPDC for $26 million and the assumption of approximately $15 million of debt ($10 million repaid to the City and $5 million to commercial debt), for a total transaction of $41 million. The City will deposit $36 million into a Legacy Fund, which will generate approximately $1 million in interest per year to be used for municipal purposes.

The sale is related to the distribution portion ONLY of Orillia Power – the poles and wires side of the business. The City of Orillia will remain in full ownership of the Orillia Power Generation Corporation, which accounts for the majority of the dividends to the City.

Hydro One Facilities

Subject to OEB approvals, Hydro One intends to build three facilities within the Horne Business Park in West Orillia. This potential investment includes building:

- Back-up Ontario Grid Control Centre/Integrated Systems Operation Centre (ISOC) on 16 acres of land.
- Provincial Warehouse on 10 acres of land.
- Regional Operations Centre on 10 acres of land.

Hydro One's three buildings will be a combined 165-210k sq. ft. For perspective, the combined Hydro One facilities will be about 1.5 to 2.5 times the size of Rotary Place or Lakehead University. Construction cost of the three buildings is estimated at more than $150 million.

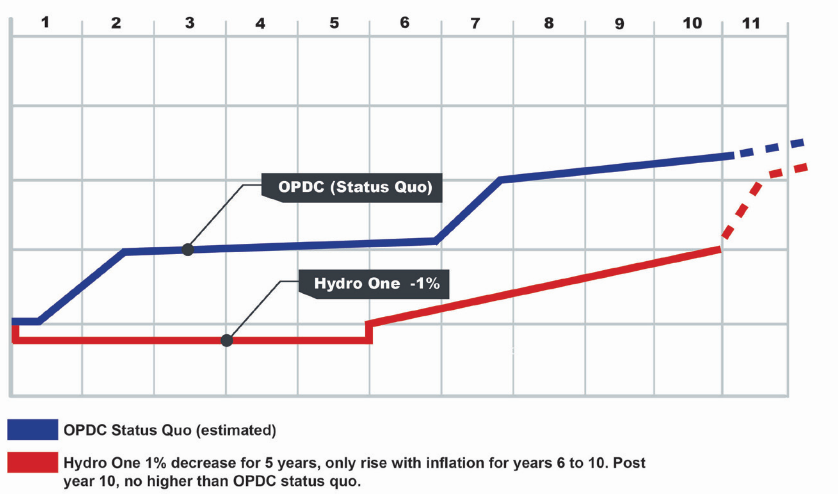
Conceptual rendering of ISOC.

Facts about Rates

The sale to Hydro One will affect approximately 20-25% of your power bill - known as "distribution rates". The remainder of your bill remains the same regardless of the distributor (Orillia Power or Hydro One).

Following the sale, **distribution rates (the 20-25% of the bill) would be reduced by 1% and frozen for 5 years, followed by only inflationary increases for years 6-10.** Through the appeal process, Hydro One has clarified that after year 10, distribution rates will be no higher than the OPDC status quo. Distribution rate adjustments after year 10 would need to be reviewed and approved by the OEB.

If the sale is not approved, OPDC would be required to file for a distribution rate increase (known as a Cost of Service rate application) with the OEB at least twice over that 10 year period. It is estimated that distribution rates would increase by an average annual rate of 2-4% over the next 10 year period. Distribution rates will be lower if the sale of OPDC to Hydro One is successful. See graph below.



The Economic Benefits for Orillia

If the sale of OPDC goes forward, the short-term economic impact of the construction of the buildings and related activity is anticipated to **inject $200 to $300 million into the Orillia economy**. Once all the facilities are operational, significant new dollars in payroll/incomes will be injected into the Orillia economy year after year. This will result in economic spin-offs through the creation of new jobs and additional spending in housing construction, retail, restaurants, personal services (i.e. dentists, taxis), schools and colleges, and many other fields throughout the Orillia economy similar to when the Ontario Provincial Police (OPP) came to Orillia.

This economic development opportunity would create improved infrastructure for other businesses and open up opportunities to entice investment in related businesses and suppliers. The opportunity has already generated significant investment with large corporations interested in investing/partnering in the City of Orillia such as Bell's Fibre investment.

Economic Benefits - Jobs at All Levels

Pending OEB approval, the three Hydro One buildings in the Horne Business Park will house anywhere from 100-300 employees at any given time. In the beginning, there will be many positions that will be filled through transfers; however, there will still be other opportunities through new positions in the warehouse, maintenance, administration, etc. Similar to the OPP, more and more of these jobs will be filled locally over time. Lakehead University and Georgian College are already looking at program development to help facilitate future job training.

Your Hydro Service

If the sale is finalized, you can expect the same great service. The same staff currently serving Orillia as Orillia Power will continue with Hydro One. All OPDC employees are guaranteed employment and receive a one-year location guarantee with Hydro One.

As for service levels, Orillia is often compared to surrounding townships serviced by Hydro One. It is important to understand the distinction and challenges between servicing rural areas, such as the townships, versus urban areas, such as the City of Orillia. There are many hundreds of miles of wires and poles scattered over large distances in the surrounding townships, which impacts the distribution system and its ability to be restored promptly during and after a storm event. It takes Orillia Power workers 11 minutes to get from one end of Orillia to the other, with switches required to restore power located extremely close together. Orillia often has the ability for a quicker recovery than a rural setting.

Investment in Orillia's Future

An investment by a municipality to facilitate economic development opportunities is common and often includes investment in the form of land or financial assistance in some manner. The City has previously made significant investments to facilitate economic development opportunities such as building and leasing a call centre to attract and retain hundreds of jobs and donating land and grants totaling $10 million to attract Lakehead University. To date, the net cost for the sale of OPDC is approximately $1 million. The anticipated cost to the City for the OEB appeal process is $18,000. If successful, the short-term economic impact of this investment is estimated at $200 to 300 million.

How we got to where we are today

- September 2015 – Orillia Council announced it was entering into negotiations with Hydro One on an opportunity that would have Hydro One locating an Advanced Technology Hub in West Orillia and purchasing the Orillia Power Distribution Corporation.
- Council endorsed negotiations based on a set of principles.
- Council held two formal public consultations (January 2016 and June 2016) to enable the public to ask questions and provide comments.
- Mayor Clarke spoke to dozens of community groups about the opportunity and numerous ward meetings were held throughout the year with this topic being discussed.
- Council members were briefed in detail about the transaction throughout the negotiations.
- Orillia Power Corporation's independent Board of Directors voted unanimously in favour of the deal on Aug. 12, 2016.
- Council voted in favour of the deal and agreements were signed by the City of Orillia and Hydro One on Aug. 15, 2016.
- On Sept. 29, 2016, Council held two open house meetings regarding the deal to enable the public to ask questions and provide comments.
- Hydro One filed their MAAD (Mergers, Acquisitions, Amalgamations and Divestitures) application with the OEB on Sept. 27, 2016, for approval for the acquisition of OPDC as required by the Ontario Energy Board Act.
- On April 12, 2018, the City of Orillia received notification that the OEB denied the application for the sale of OPDC to Hydro One Inc.
- On April 16, 2018, a special meeting of Council was held to provide Council with the next steps moving forward.
- On May 2, 2018, the City of Orillia and Hydro One Inc. filed an appeal to the OEB to review and revise their decision.
- On May 17, 2018, Council held a public meeting regarding the status of sale of OPDC to enable the public to ask questions and provide comments.

Watch the video: "Mayor Talks Transformation: What Potential Sale of OPDC Means for Orillia"

www.youtube.com/TheCityofOrillia

For more information, visit orillia.ca/techhub or contact the Mayor's Office at 705-325-2447.

30244-I-0088