



**RENEWAL ANNUAL INFORMATION FORM  
FOR THE YEAR ENDED DECEMBER 31, 2009**

**March 31, 2010**

**HYDRO ONE INC.**  
**ANNUAL INFORMATION FORM**  
**FOR THE YEAR ENDED DECEMBER 31, 2009**

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Except where otherwise indicated, all information presented herein is as at December 31, 2009.

## DEFINITIONS

For convenience, in this Annual Information Form:

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

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

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

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

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

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

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

“**Market Rules**” means the rules made under Section 32 of the *Electricity Act, 1998* that are administered by the IESO;

“**NERC**” means the North American Electric Reliability Corporation;

“**OEB**” refers to the Ontario Energy Board;

“**OEFC**” means the Ontario Electricity Financial Corporation;

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

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

“**OPA**” refers to the Ontario Power Authority;

“**OPG**” refers to Ontario Power Generation Inc.;

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

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

“**TS**” refers to a transformer station.

## CORPORATE STRUCTURE

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

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

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

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

## **FORWARD-LOOKING INFORMATION**

This Annual Information Form contains, and Hydro One's oral and written public communications often contain, forward-looking statements that are based on current expectations, estimates, forecasts and projections about the business of Hydro One and the industry in which Hydro One operates and includes beliefs and assumptions made by the management of our company. Such statements include, but are not limited to, statements about the general development of our business; statements related to the Green Energy Act and our Green Energy Plan, including the additional investments arising therefrom, and our ability to recover the costs of such investments; statements about smart meters including their capabilities, costs and cost recovery; statements related to the buildout of an advanced distribution solution for our distribution business; expectations regarding the Cornerstone project; the expected impact of CDM programs; expectations regarding connections of new generation to our transmission and distribution systems; expectations regarding future renewable energy generation; statements about our strategy; statements regarding future capital expenditures and our capital and other investment plans; statements regarding the reliability of our distribution and transmission systems including equipment performance; statements about our transmission capacity; expectations regarding load growth and new generation; statements regarding our current and future capital projects including completion dates and our ability to obtain environmental and other regulatory approvals in connection therewith; expectations regarding land expropriations necessary for the Bruce to Milton project; statements related to the attraction and retention of staff and the maintenance and development of the skills and competence of existing employees; statements about our outsourcing arrangement with Inergi LP; expectations regarding environmental expenditures and other environmental matters including the expected costs of compliance with PCB regulations, planned studies and potential future costs related to asbestos and land remediation and the need for environmental approvals and assessments; the

expected impact on transmission and distribution rates and customer bills resulting from our rate applications; statements related to our connection assets; expectations regarding developments in the statutory and operating framework for electricity distribution and transmission in Ontario including changes to codes, licences, rates, rate orders, cost recovery, rates of return and rate structures in both our transmission and distribution businesses; expectations regarding the recoverability of our expenditures in future rates; statements related to the filing and status of our rate applications and the timing of decisions from the OEB; expectations regarding our strategy for acquisitions or divestitures of distribution assets; the possibility of the Province making declarations pursuant to our memorandum of agreement with them; expectations regarding workforce demographics; statements regarding our borrowing requirements; the estimated impact of changes in the forecast long-term Government of Canada bond yield (used in determining our regulated rate of return) on our net income; expectations regarding anticipated expenditures associated with transferring assets located on Indian lands; statements regarding provincial ownership of our transmission corridors; statements regarding future pension contributions and our pension plan; our expectation regarding our need for the OEFC indemnity associated with the original transfer orders; expectations regarding implementation of health and safety programs; statements regarding labour relations; and legal proceedings in which we are currently involved. Words such as “expect,” “anticipate,” “intend,” “attempt,” “may,” “plan,” “will,” “believe,” “seek,” “estimate,” and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve assumptions and risks and uncertainties that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed, implied or forecasted in such forward-looking statements. Hydro One does not intend, and Hydro One disclaims any obligation to update any forward-looking statements, except as required by law.

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

- the risks associated with being controlled by the Province including the possibility that the Province may make declarations pursuant to our memorandum of agreement with it, as well as potential conflicts of interest that may arise between us, the Province and related parties;

- public opposition to and delays or denials of the requisite approvals and accommodations for projects necessary to increase transmission and distribution capacity;
- the risk that previously granted regulatory approvals may be subsequently challenged, appealed or overturned;
- the risks related to our work force demographic and our potential inability to attract and retain qualified personnel;
- the risks associated with the execution of our capital and maintenance programs necessary to maintain the performance of our aging asset base;
- the risk that we will be unable to source the materials necessary to support our work programs;
- the risks associated with being subject to extensive regulation including risks associated with OEB action or inaction;
- the timing and results of regulatory decisions regarding our revenue requirements, cost recovery and rates;
- the potential impact of CDM programs on our load and our revenues;
- unanticipated changes in electricity demand or in our costs;
- the risks of counter-party default on our outstanding derivative contracts;
- the risks associated with changes in interest rates or discount rates;
- the risks associated with changes in the forecast long-term Government of Canada bond yield;
- the risk that we are not able to arrange sufficient cost effective financing to repay maturing debt and to fund capital expenditures and other obligations;
- the potential impact of not being able to recover our pension costs;
- future interest rates, investment returns, changes in benefits and changes in actuarial assumptions;
- the risk to our facilities posed by severe weather conditions, natural disasters or catastrophic events and our limited insurance coverage for losses resulting from these events;
- the risk that we may incur significant costs associated with transferring assets located on Indian lands;

- the risks associated with maintaining a complex information technology system infrastructure and transitioning most of our financial and business processes to an integrated business and financial reporting system;
- the potential for substantial and currently undetermined or underestimated environmental costs and liabilities;
- the risk that assumptions that form the basis of our recorded environmental liabilities and related regulatory assets may change;
- the inability to negotiate collective agreements consistent with our rate orders or in a timely fashion and the potential for labour disputes;
- the potential that we may incur significant expenses to replace some or all of the functions currently outsourced if our agreement with Inergi LP is terminated;
- the impact of the ownership by the Province of lands underlying our transmission system; and
- the impact of the Green Energy Act on our company and the costs and expenses arising therefrom.

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

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

## **GENERAL DEVELOPMENT OF THE BUSINESS**

We are wholly owned by the Province and our transmission and distribution businesses are regulated by the OEB. Our industry, including our company, is governed within the broad legislative framework of the *Electricity Act, 1998*, as amended, and the *Ontario Energy Board Act, 1998*, as amended.

### **Regulated Price Plan Structure**

On April 1, 2005, the OEB implemented a regulated price plan structure for the cost of electricity supplied to low volume and designated customers (“RPP”). The RPP regulates only the commodity price of electricity and does not affect the rates charged for transmission and distribution of electricity. The RPP also introduced seasonal consumption thresholds. For residential customers, the price threshold between the lower tier price and the upper tier price is 600 kWh per month in the summer and 1,000 kWh per month in the winter. For non-residential customers, the price threshold between the lower tier price and the upper tier price is 750 kWh per month in both the summer and the winter. A summary of some recent prices per kWh set by the RPP follows:

<b>RPP Pricing (per kWh)</b>		
Winter (Nov. 1, 2008 – April 30, 2009)	Lower Tier Price	5.6 cents
	Upper Tier Price	6.5 cents
Summer (May 1, 2009 – Oct. 31, 2009)	Lower Tier Price	5.7 cents
	Upper Tier Price	6.6 cents
Winter (Nov. 1, 2009 – April 30, 2010)	Lower Tier Price	5.8 cents
	Upper Tier Price	6.7 cents

Prices under the RPP are reviewed and are subject to change every six months based on an updated OEB forecast and any accumulated differences between the amount that consumers paid for electricity and the amount paid to generators in the previous period.

### **Ontario Power Authority**

The Ontario Power Authority (OPA) was created by statute in 2004 under the *Electricity Restructuring Act, 2004*, and its objects are defined in Part II.1 of the *Electricity Act, 1998*. It is a non-profit corporation without share capital, and it is licensed and regulated by the OEB. The OPA's mandate is to ensure the adequacy and efficiency of electricity supply in Ontario through planning of electricity supply and demand.

On August 29, 2007, the OPA filed its first IPSP with the OEB for approval.

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

### **Smart Meters**

The *Energy Conservation Responsibility Act, 2006* originally provided the framework for the installation of smart meters in all homes and small businesses in Ontario by December 31, 2010. Electricity distributors are accountable for the deployment of smart meter infrastructure and related technology for communications to meet "minimum requirements" as defined in the regulations. The Province has now appointed the IESO to be the entity whose mandate includes the storage of all provincial hourly data. Distributors are also expected to be accountable for the implementation of time of use rates that is at present voluntary.

Hydro One Networks Inc. and Hydro One Brampton Networks Inc. have installed approximately 1.2 million smart meters as of the end of 2009 and are in the process of completing development of systems and required integration to support time-of-use rates. These meters are expected to be capable of measuring and reporting usage over predetermined periods, being read remotely, and, when combined with the systems being provided by the IESO, capable of providing customers with access to information about their electricity consumption on a daily basis. Smart meters are regarded by the Province as an integral means of promoting a culture of conservation.

Smart meter activities continue to progress largely according to plan. The current state of smart meter and communication technology remains somewhat dynamic; however we have been able to complete the majority of testing, including rural applications. Total project costs continue to be significant with expenditures in 2009 amounting to approximately \$168 million and planned expenditures in 2010 expected to be approximately \$130 million.

A Request for Proposals (“RFP”) has been issued by Hydro One Networks Inc. to build out an advanced distribution solution that will help our company effectively connect and manage large volumes of distributed generation on Hydro One Networks Inc.’s distribution system. The solution is expected to leverage our smart meter investments. Further investments in advanced technologies building on this core infrastructure will be evaluated and integrated in the advanced distribution solution based on the responses we receive to the RFP. These investments may include:

- further integration of smart meters with outage management processes;
- automation of the distribution system to enhance reliability and outage response; and
- integration of planning and analytical tools with operational data storage that captures data from the monitoring and control devices deployed for the above functions.

### **Cornerstone**

Cornerstone is a project being undertaken by our company for the planned, phased replacement of key enterprise Information Technology (IT) systems in Hydro One that have reached “end-of-life”. As well, Cornerstone is designed to transform business processes to realize value from new key enterprise IT systems and continue to meet business requirements. Together, the new enterprise IT systems and transformed business processes are expected to enable Hydro One to deliver efficiency gains back into the business. Phase One implemented the enterprise IT system to support the supply chain and work management functions and was completed in 2008. Phase Two extended the IT system functionality to replace a legacy system supporting the finance and human resource functions and was completed in 2009. Phase Three is an ongoing improvement initiative expected to be undertaken between 2010 and 2012, during which time the new enterprise IT system will be expanded within business units to derive additional benefits.

### **Conservation and Demand Management**

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

On July 13, 2006, the Ministry of Energy issued a directive to the OPA regarding the OPA assuming responsibilities for organizing the delivery and funding of CDM programs through electricity distributors in Ontario. The directive recognized that distributors have a role as delivery agents for CDM and that funding for their programs should be secure, stable and multi-year.

The directive provides guidance on key funding aspects of CDM for distributors as follows:

1. The OPA will begin organizing the delivery and funding of CDM programs through distributors, with implementation of funding to occur in the earliest practical timeframe.
2. The funding will be limited to a total of \$400 million over three consecutive years.
3. Distributors would contract to deliver programs funded by an OPA-administered distributor fund on a non-competitive basis in their service territory.
4. These funds will not include provisions for smart meters.
5. The OPA should support the OEB in its continuing efforts to reduce barriers to CDM including decreases in revenues due to distributors' conservation programs.

The OPA annually files with the OEB proposed expenditure and revenue requirements and fees for review pursuant to subsection 25.21 of the *Electricity Act, 1998*. Included in these applications are the CDM programs intended for implementation by local distribution companies such as Hydro One.

Section 27.2 of the *Ontario Energy Board Act, 1998*, proclaimed into force on Sept 9, 2009, gives the Minister of Energy and Infrastructure the power to issue a directive to the OEB to take steps to establish conservation and demand management targets to be met by LDCs and other licensees. The directive may require the OEB to specify, as a condition of a licence, the conservation targets to be met by LDCs and other licensees. To date, no such directive has been issued to the OEB.

### **Procurement of New Generation**

The OPA continues to procure, and has plans for further procurement of, new, cleaner and renewable generation in Ontario. This is reflected in the Minister of Energy and Infrastructure's September, 2008 directive to the OPA to review the IPSP with a view to (among other things) enhancing the amount and diversity of renewable energy sources in the supply mix, improving transmission capacity in Northern Ontario and other parts of Ontario, and increasing the availability of distributed generation. It is also reflected in the directive issued by the Minister of Energy and Infrastructure on September 24, 2009, which directed the OPA to develop a feed-in-tariff ("FIT") program designed to procure energy from a wide range of renewable energy sources, including wind, solar, photovoltaic, bioenergy and waterpower up to 50 MW. The OPA announced the FIT program that same day with effect as of October 1, 2009. Hydro One continues to work with successful proponents under various OPA procurements of new generation to connect these new sources of electricity to our transmission and distribution systems.

Hydro One has placed a high priority on connecting these new sources of supply reliably to our transmission and distribution systems in a timely fashion. The *Ontario Energy Board Act, 1998* now requires as deemed conditions of distribution licences issued by the OEB that distributors provide priority connection access for qualified renewable energy generation facilities and prepare plans for approval by the OEB that identify expansion or reinforcement of the distribution system required to accommodate the connection of renewable energy generation facilities.

On November 22, 2006, the OPA launched the “Renewable Energy Standard Offer Program” designed to encourage the creation of renewable generation. Since the program was introduced (subsequently replaced by the FIT program effective as of October 1, 2009), Hydro One has completed approximately 740 connection impact assessments for potential renewable generation connections to our distribution system and has connected approximately 30 generators under the program.

Hydro One has identified options for investments in infrastructure required to enable substantially more new generation to connect reliably and effectively. The options ultimately chosen were included in Hydro One’s Green Energy Plan, which was submitted for approval by the OEB with its 2010-2011 distribution rate application. See “Regulation – Rate Orders and Related Issues for Hydro One’s Business - Distribution – Current Rate Orders and Distribution Rate Structure - Connection Cost Responsibility”.

Hydro One is working proactively with the Ministry of Energy and Infrastructure, the OPA, the OEB and the IESO to develop strategies and processes to address the need for additional generation, and in particular, the impact on Hydro One’s networks. See “Risk Factors – Risks Associated with Transmission Projects.”

Hydro One Networks Inc. had filed an application with the OEB for an exemption from certain timelines prescribed in the Distribution System Code related to proposed connections of generation facilities to the distribution system. By way of an interim order, the OEB granted Hydro One Networks Inc. an exemption from those timelines from June 27, 2008 until the final disposition of the proceeding, and subsequently, on December 10, 2008, temporarily adjourned the proceeding. On September 29, 2009, Hydro One applied to withdraw its application for an exemption. The OEB granted Hydro One’s request on October 9, 2009.

### **Electricity Transfer Tax Exemption**

In October 2006, the Province announced that publicly-owned utilities will be exempt from paying the electricity transfer tax when they sell electricity distribution assets to other publicly-owned utilities in Ontario. The normal transfer tax payable is equal to 33% of the fair value of the municipality’s interest in electricity assets transferred to another entity. The transfer tax exemption became effective on October 17, 2006 and was to last for two years. The transfer tax exemption was extended for one year and was to expire on October 17, 2009. In 2009, the transfer tax exemption was made permanent with effect from October 17, 2009. The Province has indicated in the past that the transfer tax exemption is designed to encourage efficiencies and promote consolidation among Ontario’s publicly-owned electricity utilities. Hydro One remains open to strategic opportunities for acquisitions or divestitures, on a voluntary and commercial basis, where they are consistent with both our vision and direction from our shareholder. Our investment plan currently does not include any funding for LDC acquisitions or divestitures.

## **Agency Review Panel**

The Agency Review Panel (the “Panel”) was established on January 29, 2007 to review specific issues concerning Hydro One, the IESO, the OPA, OPG and the OEB (collectively, the “Institutions”). The Panel was asked to take an in-depth look at overall compensation for top executives of the Institutions and to report back to the Province on areas where energy sector effectiveness can be further strengthened, including assessments of overlap and duplication between agencies, and whether sufficient steps are being taken to address concerns about potential shortages of skilled workers in the future.

In May 2007 the Panel submitted its report concerning executive compensation at the Institutions. The Minister of Energy subsequently announced that all the recommendations of the Panel were being accepted by the Province and requested us to support the initiative. Hydro One has complied with the relevant recommendations. Some of the key recommendations included:

- Compensation should reflect the mixed commercial and public interest nature of the jobs at these Institutions.
- Using a more appropriate model for setting executive compensation that will result in reduced compensation for top executives at OPG and Hydro One.
- Further enhancing the executive salary disclosure system to make it more accessible and transparent by including the rationale for executive compensation decisions.
- Discouraging the use of perquisites for executives.

With the exception of the enhanced salary disclosure system, the recommendations cited above would apply upon the replacement, at the time of retirement, resignation, or otherwise, of the current incumbents or upon negotiation of new contracts to be entered into at the time of the expiry or renegotiation of the contracts of the current incumbents. For further information on compensation, please see “Statement of Executive Compensation – Elements of Compensation”.

In November 2007, the Panel submitted its report concerning energy sector effectiveness and human resource challenges. The Panel provided several recommendations but found that overall Ontario’s electricity sector and the provincial agencies within it appear to be functioning reasonably well. Key recommendations included:

- Combining the balance of the functions of the OPA with those of the IESO into a combined agency when it seems reasonable to the Minister to do so, but probably not before the OEB has completed its current review of the initial IPSP.
- Hydro One and IESO working together to develop a uniform approach to connection assessments that is consistent with the requirements of the Transmission System Code in order to reduce overlap, duplication and inefficiencies, for the benefit of existing and potential customers.
- Establishing an understanding or protocol among the various ministries and regulatory tribunals to create, on a temporary basis and using existing legislation, a single integrated

approvals process for electricity projects based upon existing legislative authorities to ensure the timely consideration of urgent projects set out in the IPSP or otherwise.

- Enacting legislation that would create a single integrated approvals process for electricity projects on a permanent basis.
- Continuing the independence of Ontario's Chief Energy Conservation Officer to ensure regular reports on Ontario's conservation progress.
- Creating new tools to ensure a continued and growing supply of expertise and skilled workers to meet the needs of Ontario's energy future.
- Continuing to facilitate the consolidation of local distribution companies, which deliver electricity to homes and businesses.

## **DESCRIPTION OF THE BUSINESS**

### *Overview*

We are the largest electricity transmission and distribution company in Ontario. We own and operate substantially all of Ontario's electricity transmission system, accounting for approximately 96% of Ontario's transmission capacity as measured by revenues for the year ended December 31, 2009. Our transmission system is one of the largest in North America based on assets. Our distribution system is the largest in Ontario based on assets and spans approximately 75% of Ontario, serving approximately 1.3 million customers. We have three reportable segments: (1) our transmission business; (2) our distribution business; and (3) our other business.

Our transmission business, which represented approximately \$9.12 billion of our total assets of \$15.81 billion as at December 31, 2009, transmits electricity through an approximately 28,900 circuit-kilometre high-voltage network. We transmit electricity from generators to our own distribution networks, to 51 local distribution companies and to 89 transmission connected companies. We also own and operate 26 facilities that interconnect our transmission system with systems in neighbouring provinces and states.

Our distribution business, which represented approximately \$6.53 billion of our total assets of \$15.81 billion as at December 31, 2009, distributes electricity through our approximately 123,500 circuit-kilometre low-voltage distribution system, to municipalities and to rural areas. Customers of our distribution business include 25 local distribution companies that are not directly connected to our transmission system, 36 customers with loads exceeding 5MW and approximately 1.3 million rural and urban customers. Hydro One Brampton Networks Inc. is our urban distribution company, serving approximately 130,000 customers in the GTA with approximately 2,700 circuit-kilometres of lines. We also operate through our subsidiary, Hydro One Remote Communities Inc., 19 small, regulated generation and distribution systems in 21 remote communities across Northern Ontario that are not connected to Ontario's electricity grid.

Our other business segment is primarily represented by the operations of Hydro One Telecom Inc. This subsidiary markets dark and lit fibre-optic capacity to telecommunications carriers and commercial customers with broadband network requirements. The assets of this segment

constituted approximately \$161 million of our total assets of \$ 15.81 billion as at December 31, 2009.

The OEB regulates our transmission and distribution businesses and issues rate orders to establish the rates required to recover the approved revenue requirements of these businesses plus a specified rate of return.

## **Recent Developments**

### New Director

On January 26, 2010, George L. Cooke was elected to the company's board of directors. On February 11, 2010, Mr. Cooke was appointed as a member of the Audit and Finance Committee replacing Mr. James Arnett. Mr. Cooke is President and Chief Executive Officer of The Dominion of Canada General Insurance Company.

### Compensation

On March 25, 2010, the Minister of Finance, Dwight Duncan, announced the Province's 2010 Budget. Part of his announcement explained the government's plan, through proposed legislation, to freeze for two years the compensation structures of non-bargaining political and Legislative Assembly staff as well as non-bargaining employees in the broader public sector. This legislation will apply to the non-bargaining employees of Hydro One. The proposed legislation provides for an exception regarding employees represented by collective bargaining organizations, which include trade unions certified or recognized under the *Labour Relations Act*.

## **Our Strategy**

Hydro One's corporate strategy is based on our mandate, vision and values. Our mandate is to provide safe, reliable and cost effective transmission and distribution of electricity to Ontario electricity users. Our vision is to be the leading electricity delivery company in North America. Our values include safety, stewardship, excellence and innovation. We are committed to providing innovation and leadership in renewing Ontario's power grid. To that end, we have identified eight strategic objectives:

- *Creating an injury-free workplace and maintaining public safety.* We continue to focus on creating a passion for preventing workplace injuries and ensuring public safety.
- *Satisfying our customers.* In order to satisfy our customers, we focus on reliability and power quality, communicating effectively with our customers, delivering on our commitments, partnering with the communities we serve, providing value for money, and building our reputation as a trusted steward of provincial transmission and distribution assets.
- *Continuous innovation.* We are committed to identifying and providing innovative solutions that improve the reliability and efficiency of electricity delivery and allow our customers more capability to manage their power costs.

- *Building and maintaining reliable, cost-effective power delivery systems.* Our transmission strategy is to provide a robust and reliable provincial grid that can accommodate the Province's emerging generation profile and demand requirements. Our distribution strategy entails providing greater visibility, increased control and improved customer service through advanced grid technologies, while continuing to provide reliable service over a wide range of geography and climate.
- *Protecting and sustaining the environment.* We play a central role in reducing Ontario's carbon footprint, both through the delivery of clean and renewable energy and through measures that allow our customers to manage and reduce their energy usage. We are also focusing on our work methods and equipment including fleet management and the transition of diesel generation in our remote communities to biodiesel generation.
- *Skill development and knowledge retention.* We are addressing our demographic challenges through a comprehensive program of recruitment, training in core competencies, staff development and knowledge transfer.
- *Maintenance of a commercial culture that increases value for our shareholder.* We are committed to operating on a financially sustainable basis and to maintaining or increasing the value of our assets.
- *Productivity improvement and cost-effectiveness.* To achieve our vision as the leading electricity delivery company in North America, we constantly strive to be the most productive through efficiency improvements and effective management of costs. Our goal is to be top quartile in key unit cost metrics relative to our North American electricity industry peer group.

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

## **Our Transmission Business**

### *Overview*

Our transmission system operates at 500 kV, 230 kV and 115 kV and transmits electricity to customers consisting of 51 local distribution companies, our own distribution businesses and 89 transmission connected companies. Electricity is also delivered to utilities in other jurisdictions through inter-ties. Electricity is supplied by generators, both within and outside Ontario, of which 91 in Ontario are connected directly to the transmission grid. Our transmission system serves over four million customers, directly or indirectly, and transported approximately 139 TWh of energy throughout Ontario in 2009. Revenues from our transmission business accounted for approximately 24% of our total revenues in 2009 and approximately 26% and 27% of our total revenues in 2008 and 2007, respectively.

Our transmission system forms an integrated transmission grid that can be divided into two components based on function. The integrated network, or bulk system, operates primarily at 500 kV or 230 kV over relatively long distances and links major sources of generation to

transmission stations and larger area load centres. The area supply system operates at 230 kV or 115 kV and links the bulk system to local generators and loads, such as local distribution companies, industrial customers and our own retail distribution operations. Transformer stations located near load centres step down the high voltage to the level required for retail distribution systems or end-use customers connected directly to our transmission system.

Our transmission system is interconnected with the North American eastern system that is comprised of virtually all of the electric utilities east of the Continental Divide. Our transmission business owns and operates 26 inter-ties at 345 kV, 230 kV, 115 kV and 69 kV levels with New York (7), Québec (11), Michigan (4), Manitoba (3) and Minnesota (1). Two 69kV New York inter-ties are operated in idle mode at this time. Prior to 2009, the current interconnections with Québec were operated in a radial connection mode where load and/or generation was connected to either the Ontario system or the Québec system at any one time, but not to both simultaneously. The new interconnections with Québec, placed in service in 2009, now enables the Ontario and Québec systems to be operated in a “tied” or “parallel” mode.

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

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

### *Transmission Planning*

Hydro One develops transmission plans for new transmission facilities and for refurbishment and replacement of existing transmission facilities, as required. The plans for new facilities identify proposed equipment, configuration, routing and resulting capacities for network, local area and connection/transformation investments. We also consult with customers to determine the need, timing and technical solutions for new connection/transformation facilities. We consult with affected communities, stakeholders and First Nations and Métis as part of the project development process for new or upgraded transmission lines.

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

“Environmental Screening Process”, as defined in such Regulation, and is subject to class environmental or full environmental assessment approval.

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

### *Transmission Capital Expenditure Plans*

Transmission system capital expenditures are anticipated to be significant over the 2010 to 2012 period, amounting to about \$3.7 billion overall with \$1.15 billion expected to be spent in 2010. Our capital investment plan is designed to address Ontario’s changing generation profile, accommodate load growth in areas throughout Ontario and support the expected increase in renewable energy generation in furtherance of the Green Energy Act (the “GEA”) as discussed below. Additionally, this plan seeks to sustain or improve our top quartile ranking for transmission reliability performance in North America for transmission systems of 230kV and above. This plan also furthers our ongoing objective of sustaining the performance of aging assets through refurbishment programs and end of life asset replacements.

On September 21, 2009, in a letter from the Minister of Energy and Infrastructure, the Province requested Hydro One to immediately proceed with planning and implementing 20 major transmission projects across Ontario in support of the GEA and in anticipation of the increase in renewable energy generation associated with the OPA’s FIT program (see “General Development of the Business - Procurement of New Generation”) and the associated high demand for renewable connections. Accordingly, Hydro One has commenced development activities in order to obtain approvals for eight of these projects deemed to be of greatest priority. Activities for the other projects are expected to commence later in 2010 depending on the uptake of the FIT program.

Most of the projects included within the company’s transmission system capital expenditure plans will require various approvals, including, but not limited to, OEB approvals and *Environmental Assessment Act* (Ontario) (“EA”) approvals. Set out below are our major transmission capital development projects for which we have obtained or are actively seeking the requisite approvals. The major transmission system capital development projects described below are at different stages of development and may not proceed to construction if requisite approvals are not obtained or if anticipated generation does not materialize.

### Major Transmission Capital Development Projects

- New 500kV Bruce to Milton Double Circuit Transmission Line

The IESO’s December 2007 Ontario Reliability Outlook indicated that existing transmission in southern Ontario cannot accommodate the generation expected to come into service in the Bruce area over the next few years. The Province supported this view by stating that Hydro One should engage in “expanding the transmission capacity from Bruce County and surrounding area to facilitate the transmission of electricity from several new wind farms and the Bruce [nuclear] facility” (The Government of Ontario, *A Balanced Plan for Ontario’s Electricity Future*). The OPA determined that the preferred solution to increase the transfer capability of Hydro One’s

current 500kV system is to build a new 500kV double circuit transmission line between the Bruce Nuclear Station and the Milton Switching Station to securely incorporate all eight units from the Bruce nuclear facilities and the committed and potential wind generation. The OEB approval for the 500kV line was obtained, with conditions, in September 2008. In October 2009, Niagara Escarpment Commission (“NEC”) approval was obtained but this approval is presently under appeal. The appeal hearing commenced on January 26, 2010. In December 2009, conditional approval under the *Environmental Assessment Act* (Ontario) was received. Hydro One has informed the OEB that the costs for this project are now expected to exceed original estimates. The new line is planned to be in-service by the end of 2012. On February 26, 2010, an expropriation of land application was filed with the OEB under the *Ontario Energy Board Act, 1998* and on March 16, 2010, the OEB provided a Letter of Direction to Hydro One to serve expropriation documents on affected owners, parties with registered interests on title, Aboriginal groups and the NEC. By the time the hearing concerning the expropriation action commences, it is anticipated that there will be less than 100 property owners subject to the expropriation request out of 355 property owners affected by the project. The remaining owners are expected to have signed voluntary land agreements with Hydro One.

- Install seven 230kV Capacitor Banks in Southwestern Ontario

This project has been undertaken in order to comply with the recommendation of the OPA to install seven 230kV shunt capacitor banks at three stations in southwestern Ontario as a near-term measure to increase transfer capability in the Bruce Area and southwestern Ontario. Since these installations are in existing stations, they do not require project-specific OEB or EA approvals. During the 2009 - 2010 Transmission Rate proceeding, OEB approval was obtained to include these facilities in the regulated rate base. As of the end of 2009, six of the seven new capacitor banks are in service. The last capacitor bank is expected in service by the end of April 2010.

- Claireville TS to Cherrywood TS: Unbundle 500kV Circuits

The existing 500kV transmission lines between Cherrywood TS and Claireville TS in the GTA consist of two 500kV double circuit tower lines. In order to improve the reliability of the bulk electricity system, to provide greater operating flexibility, and to reduce the adverse impact on supply to customers, the two ‘super’ circuits will be unbundled. This will effectively result in two additional 500kV circuits between Cherrywood TS and Claireville TS. New 500kV terminations will be required at both Cherrywood TS and Claireville TS to accommodate the new circuits. Since these installations are in existing stations, they do not require project-specific OEB or EA approvals. During the 2009 - 2010 Transmission Rate proceeding, OEB approval was obtained to include these facilities in the regulated rate base. The facilities are expected to be in service in late 2010.

- Northeast Transmission Reinforcement: Installation of Static Var Compensators at Porcupine TS and Kirkland Lake TS

In order to mitigate concerns about increasing congestion on the interface between Northern Ontario and Southern Ontario and to enable renewable generation in Northern Ontario as per the Province’s direction, the OPA has recommended near term measures to enhance the transfer capability between Northern Ontario and Southern Ontario and the transmission system north of Sudbury. These measures include the installation of a static var compensator (“SVC”) at

Porcupine TS and an SVC at Kirkland Lake TS. Since these installations are in existing stations, they do not require project-specific OEB or EA approvals. During the 2009 - 2010 Transmission Rate proceeding, OEB approval was obtained to include these facilities in the regulated rate base. The in-service date of this project is currently planned for late 2010.

- Southern Georgian Bay Transmission Reinforcement

The existing 115kV single circuit line between Essa TS and Stayner TS was replaced with a double 230kV circuit along the existing right of way and Stayner TS was converted from a 115kV station to a 230kV station. Transformation capacity at Stayner TS was also increased. This project was designed to improve transmission supply capacity, transformation capacity and customer reliability in the Southern Georgian Bay area while relieving other Simcoe County transformation stations to supply their own load growth. This project was placed in service in July 2009.

- Woodstock Area Transmission Reinforcement

Customer load supplied in the Woodstock area of Southern Ontario at 115kV has exceeded the reliable transmission capacity. This project is designed to increase transmission capacity through 11 km of new 230kV double-circuit line on the existing 115kV right-of-way between Ingersoll TS and a new station called Karn TS. The project also includes construction of the new Karn TS. These projects are expected to increase the transmission capacity in the Woodstock area to 290MW in preparation for future growth. All required approvals have been obtained and the in-service date of this project is currently planned for late 2010.

- Toronto Midtown Transmission Reinforcement Project

Supply to the midtown Toronto area is currently provided by three 115 kV circuits between Leaside TS and Wiltshire TS. These circuits supply Bridgman TS and Dufferin TS from Leaside TS and also provide load transfer capability between the Leaside TS and Manby TS. This project will replace a section of aging cable and is expected to provide additional capacity by adding one 115kV circuit between Leaside TS and Bridgman TS. An application for the required OEB approval for this project was submitted to the OEB in December 2009. Notice of application was posted in the February 9, 2010 edition of the Toronto Star. Hydro One responded to interrogatories on March 19, 2010. An application for EA approval is expected to be filed in mid-2010. The in-service date for this project is currently planned for mid-2013.

- Rebuild Hearn SS

The existing 115 kV Hearn switching station was originally identified by our company as due for major refurbishment within the next five years. The September 21, 2009 letter from the Minister of Energy and Infrastructure identified that the planning and development work for the upgrade of the Hearn switching station should be expedited in order to enable renewable generation in the area. As a result, preliminary engineering studies have been commenced to determine the recommended alternative for upgrading the Hearn switching station. It is possible that these studies would recommend that a new Hearn switching station be established beside the existing station for in-service in the 2012 to 2013 time frame. Since this will be classified station work, it would not require project-specific approval from the OEB. EA approval is likely to be required and if ultimately determined to be necessary, is expected to be prepared as part of the preliminary engineering work that is underway.

- Niagara Reinforcement Project

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

- Northwest Transmission Reinforcement Project

One of the eight high priority projects to be undertaken in response to the Minister of Energy and Infrastructure letter of September 21, 2009 is the Northwest Transmission Reinforcement Project. New transmission is needed to incorporate renewable generation, such as hydro-electric and wind projects, in the Lake Nipigon area and to provide additional electricity supply capability to meet the needs of existing and future customers in the area north of Lake Nipigon. This project is also expected to provide improved reliability of supply, the opportunity for remote community connections and to offer economic development potential to the region. In addition, the line would lay the groundwork for a future 230kV connection between Dryden TS and a new station in the Pickle Lake area, creating a 230kV ring to strengthen the grid's capacity in the northwest. The project consists of a single-circuit 230kV line from a new switching station in the Nipigon area, near the existing Nipigon DS, to a new switching station north of Auden and continuing to a new transformer station at Pickle Lake, near the existing Crow River DS. In late 2009, we initiated the planning for this project to prepare submissions for OEB and EA approvals.

#### Transmission Projects at the Local Load Connection Level

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

#### Transmission Sustainment

Our investment plan also includes increased program expenditures for sustainment initiatives to manage the replacement and refurbishment of our aging transmission infrastructure. Increased

emphasis is being placed on those transmission assets that are critical to support generation facilities and the unrestricted transmission of energy to our customers. Targeted component replacement programs such as gas insulated switchgear, air blast circuit breakers, and transformers, as well as improved control initiatives to protect against animal contacts, have been adopted to remain in the top quartile in transmission reliability performance in North America.

### *Transmission Assets*

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

#### Transmission Stations

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

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

Our transmission system includes 280 transmission stations whose components may include high voltage power transformers, power circuit breakers, high voltage switches, capacitor and reactor banks, protection and control systems, metering and monitoring systems together with site infrastructures such as buildings and security systems.

#### Transmission Lines

Our transmission lines are classified into bulk power lines and area supply lines. Bulk power transmission lines are main lines delivering power from generating stations or interconnections to receiving terminal stations. Bulk power transmission lines are part of the integrated transmission network and generally operate at 500kV or 230kV, with a few at 115kV. Area supply lines take power from the transmission network at the receiving stations and transmit it to customer supply transformer stations at customer load centres. The usual voltage levels of area supply lines are 230kV or 115kV. All of these lines are overhead except for approximately 281 circuit kilometres of underground cables in urban areas.

The transmission system includes approximately 28,900 circuit kilometres of high voltage lines whose major components consist of cables, conductors, wood or steel support structures, foundations, insulators, connecting hardware and grounding systems.

## Network Operations

All of our transmission assets and many of our sub-transmission assets are managed from one location, the OGCC. As owners and operators of the largest portion of the Ontario transmission network, we have the responsibility under the *Electricity Act, 1998* to ensure that our assets are operated in a safe and reliable manner which optimizes connection performance to our customers.

Accordingly, the OGCC is the controlling authority for the Hydro One transmission network and for large portions of the sub-transmission network. The OGCC reviews, approves, performs and/or authorizes all switching and control actions of our transmission system and sub-transmission system assets. The integrity of our transmission and much of our sub-transmission assets is continually monitored to ensure optimal performance of the network.

In addition, the OGCC coordinates planned distribution outages and is responsible for notifying affected customers. For forced outages, the OGCC creates outage tickets which contain all the relevant information for the outage, dispatches field crews, communicates estimated time of repair and confirms outage restoration with the Hydro One distribution customer.

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

## Telecommunications Facilities

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

### *Projects Relating to Interconnection*

#### Québec

Construction began in December 2006 and was completed in November 2009 on a new inter-tie with the Province of Québec that has increased our inter-tie capacity by approximately 1,250 MW. This consists of a new two-circuit 230kV line between the systems near Ottawa, along

with AC-DC-AC conversion facilities in Québec needed to connect the two systems in a continuous manner (before the upgrades, load or generation was required to be isolated to either system for import or export).

### Michigan

Two of our interties with the State of Michigan have been upgraded with the installation of two, three phase shifting transformers and an autotransformer. The phase shifters were put into operation during emergency situations in 2005. This equipment will provide greater control of the Michigan interties to manage power flows across the Ontario-Michigan border and indirectly across the Ontario-New York border. As a result, Ontario's export capacity will be increased by 1,000MW and our import capacity by 500MW once they are fully operational.

Michigan's International Transmission Company (the utility to which we are connected by these inter-ties) is targeting to install, at their Bunce Creek facility, two phase shifting transformers for in-service in mid-2010, at which time we expect the phase shifters will go into full operation.

### Manitoba

Hydro One continues to investigate options for a new tie between Ontario and Manitoba. Joint studies on the feasibility of using a linear corridor used by a third party utility company were completed in 2009 and the need for further study will be reassessed in 2010. A new tie with Manitoba would likely require supporting agreements to be signed between appropriate entities in Manitoba and Ontario.

### *NERC (North American Electric Reliability Corporation)/NPCC (Northeast Power Coordinating Council)*

In North America, standards to improve the reliability and security of the interconnected bulk electric system are developed by the NERC. The United States' Energy Policy Act of 2005 mandated compliance with these standards and assigned the Federal Energy Regulatory Commission ("FERC") as the regulatory agency that will approve and enforce these standards in the United States. Subsequently, FERC approved the establishment of NERC as an Electric Reliability Organization, with responsibility for developing reliability standards, monitoring compliance, assessing non-compliance, and applying sanctions for non-compliance. In 2007, FERC approved the first set of mandatory standards for which compliance and monetary sanctions came into effect on June 18, 2007.

In Ontario, the Market Rules mandate that we comply with the reliability standards established by NERC and NPCC, and our transmission licence mandates that we comply with the Market Rules.

On March 18, 2010, FERC issued a notice of proposed rulemaking in which it proposed to direct NERC to revise its definition of the term "bulk electric system" to include all electric transmission facilities with a rating of 100kV or more. If FERC's proposed approach in its current form is adopted in Ontario and Canada, significantly more transmission facilities will have to comply with NERC reliability standards with, in Hydro One's assessment, little, if any additional improved reliability of the interconnected bulk electric system. Adopting this new approach would result in significant additional costs to the transmission facility owners including

Hydro One. FERC has initiated a consultation process regarding its proposal. Hydro One, together with the IESO and other Canadian entities, intend to file responses with FERC and NERC opposing the proposal and/or seeking a process to address the issues of non-jurisdictional entities.

### *NERC Critical Infrastructure Protection Standards*

NERC Critical Infrastructure Protection (“Cyber Security”) standards came into effect in 2009. The standards are designed to ensure that utilities and other users, owners, and operators of the bulk power system in North America have appropriate procedures in place to protect critical infrastructure from cyber attack.

As a result, Hydro One’s physical and information security processes have been upgraded to meet more stringent security requirements in order to meet the NERC requirement for auditable compliance in 2010.

### *IESO*

On September 22, 2006, Ontario Regulation 452/06, made under the *Electricity Act, 1998* came into force. The regulation provided that one of the objects of the IESO was to establish and enforce standards and criteria relating to the reliability of transmission systems.

## **Our Distribution Business**

### *Overview*

Our distribution systems provide customers with electricity distribution services through a low voltage distribution network. During 2009, approximately 28.9TWh of electricity were delivered through the distribution system to approximately 1.3 million customers located in rural and urban areas (including approximately 130,000 urban retail customers located in Brampton, Ontario). The distribution systems also serve 25 local distribution companies that are not connected directly to our transmission system, another 33 local distribution companies that are connected to our transmission system and 36 customers with loads exceeding 5MW. The distribution system comprises approximately 123,500 circuit kilometres of lines operating mainly at voltages of 50kV or less and we own a total of 1,010 distribution and regulating stations. Our distribution systems distribute electricity from our transmission system and 125 small embedded generators. Unlike the systems found in densely populated areas that are designed to include built-in redundancy, our distribution systems supply mainly rural areas with low population densities. To provide a cost effective service to these areas, the distribution systems are configured as a largely radial system, meaning that they are configured in straight lines, rather than loops, so that an outage at any point along the line causes all customers further down the line to lose power. As a result, component failures require immediate repair or replacement in order to restore service. Revenues from our distribution business accounted for approximately 74% of our total revenues in 2009 and approximately 73% of our total revenues in both 2008 and 2007.

### *Distribution Capital Expenditure Plans*

Capital expenditures for the period 2010 to 2012 are estimated to be approximately \$2.7 billion. Consistent with our approved distribution rate application, capital expenditures for our

distribution business for the period 2010 - 2011 are expected to focus on new load connections, trouble calls and storm damage, wood pole replacement, and system capability reinforcement. In response to the GEA and the resulting FIT program being administered by the OPA with respect to implementing renewable energy technologies, we are also undertaking increased generation connection activity and upgrades to the distribution system to accommodate this new generation. Across Ontario, we are continuing with the replacement of distribution assets that have reached their end-of-life, with installations that operate at higher voltage and conform to current standards. In addition, we expect to continue to construct new lines and stations in response to system growth forecasts or high load relief requirements, and the connection of new generation, and expect to continue our efforts to make the distribution system more efficient. The budget also includes investments in smart grid.

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

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

#### *Distribution Assets*

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

#### **Remote Communities**

Through our subsidiary, Hydro One Remote Communities Inc., we operate 19 regulated generation and distribution systems across Northern Ontario which serve 21 remote communities that are not connected to Ontario's electricity grid, the facilities of which are owned either by us or by OEFC, or in the case of Marten Falls, by the Marten Falls First Nation. These remote communities include a total of approximately 3,500 customers. Electricity used by these remote communities is produced by 57 installed diesel generators owned or operated by us, which are supplemented by small amounts of wind or hydroelectric generation. Pursuant to Section 48.1 of the *Electricity Act, 1998* and Ontario Regulation 199/02 under the *Electricity Act, 1998* as later amended by Ontario Regulation 390/09, we are required, through one or more of our subsidiaries, to operate and maintain existing generation and distribution assets in, and supply electricity to, these remote communities.

In October 2009, Regulation 199/02 was amended to include the First Nation community of Marten Falls as part of the Hydro One Remote Communities Inc. service territory. Effective on December 16, 2009, Hydro One Remote Communities Inc.'s licence was amended accordingly to include Marten Falls.

## **Our Telecommunications Business**

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

Hydro One Telecom Inc. is a CRTC-registered, non-dominant, facilities-based carrier, providing broadband telecommunications services in Ontario with connections to Montréal and Buffalo, New York and Detroit, Michigan. Its fibre network spans over 5,000 kilometers.

## **Employees**

At the end of 2009, our Hydro One Networks Inc. subsidiary had 5,086 regular (i.e., permanent) employees comprised of 609 non-represented executive and managerial staff, 3,307 employees represented by the Power Workers' Union and 1,170 employees represented by the Society of Energy Professionals. In addition, our Hydro One Brampton Networks Inc. subsidiary had 55 non-represented regular staff, 108 active employees represented by the Canadian Auto Workers and 41 employees represented by the International Brotherhood of Electrical Workers. We also had 2,058 non-regular (i.e., temporary) employees comprised of 15 executive and managerial staff, 1,085 employees represented by the Power Workers' Union, 90 employees represented by the Society of Energy Professionals and 868 employees represented by a combination of the Canadian Union of Skilled Workers (an electrical trade union) and the 16 construction building trade unions that have collective agreements with the Electrical Power Sector Construction Association. Hydro One Inc., Hydro One Remote Communities Inc. and Hydro One Telecom Inc. together have 137 employees in total.

In 2008, we negotiated a three-year collective agreement with the Power Workers' Union which will expire on March 31, 2011. Also in 2008, we negotiated three-year agreements with the Canadian Auto Workers and the International Brotherhood of Electrical Workers in Brampton, both of which expire on March 31, 2011. Finally, we negotiated a three-year agreement with the Canadian Union of Skilled Workers which expires on April 30, 2011. Our agreement with the Society of Energy Professionals expires on March 31, 2013. See "Risk Factors – Labour Relations Risk."

We expect to continue to focus initiatives on the attraction and retention of staff and the maintenance and development of the skills and competence of all our employees to foster a productive work environment and to manage the impacts of anticipated retirements.

A key goal of ours is to manage the demographics of our workforce, an issue which we are monitoring, as the average age of our work force is over 44 years with approximately 16 years of service. In response to this issue, a comprehensive management development program, as well as a succession planning program, have been implemented. Pursuant to the succession planning program, active recruitment of new employees in key areas is underway. See "Risk Factors – Work Force Demographic Risk."

## **Outsourcing Arrangement with Inergi LP**

Through our subsidiary Hydro One Networks Inc. we entered into an outsourcing services agreement with Inergi LP as of December 28, 2001. The provision of services by Inergi LP commenced on March 1, 2002. Inergi LP is an affiliate of CapGemini Canada Inc. Under the agreement, Inergi LP provides us with customer service operations and settlements, as well as supply management services, pay operations services, enterprise technology and finance and accounting services. As part of the agreement with Inergi LP, 906 of our unionized and non-unionized employees (including 770 regular and 136 non-regular employees) were transferred to Inergi LP on March 1, 2002. Under the agreement, we continue to make available, for use by the transferred employees, the assets used by them prior to the transfer of their employment, with refurbishments as needed.

The agreement has a 10-year term and has base service fees of approximately \$1 billion over the term of the agreement. Fees are subject to decreases based on optional external benchmarking analyses every three years. Cap Gemini Ernst & Young US LLC has provided a financial guarantee, as well as a performance guarantee, of the obligations of Inergi LP. The performance guarantee covers the transition period in the event that the agreement is terminated. The agreement provides for rights of termination for each of the parties, including, on the part of our company, rights of early termination for convenience and upon the occurrence of specified business events. In such cases, we are obliged under the agreement to pay specified termination fees, as well as to contribute to resulting severance and other costs. In addition, upon expiration of the agreement, we have an obligation to contribute to employee severance costs, if any, up to a maximum amount of \$10 million. The agreement expires on February 29, 2012. Given the complexities involved, we have begun developing a plan of action for end-of-term. See “Risk Factor – Risk Associated with Outsourcing Arrangement.”

## **Financial**

We aim to maximize the value of our company while maintaining an effective borrowing capability through stable credit quality and delivering stable financial returns to our shareholder.

We remain committed to understanding and staying abreast of best utility practices in order to execute our business in the most cost effective manner possible.

We believe that cost reductions and productivity improvements can be achieved through the joint management of our transmission and distribution businesses, the Inergi LP outsourcing arrangement pursuant to which we outsourced non-core functions to Inergi LP and the consolidation of our system operations functions. For example, we consolidated our system operations functions, which were previously dispersed across Ontario, into the OGCC while maintaining a back-up facility in Toronto. This initiative has produced lower costs and better service through the introduction of more technologically sophisticated operating tools.

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

### **Pension Plan**

We established a defined benefit registered pension plan on December 31, 1999. Hydro One Inc. manages and invests the assets and liabilities of the pension fund as plan sponsor and administrator of the plan. As of December 31, 2009, there were 5,049 active members and 7,503 pensioners and disabled and deferred members. In accordance with the requirements of the *Pension Benefits Act* (Ontario), an actuarial valuation prepared as at December 31, 2006 was filed with the Financial Services Commission of Ontario on September 20, 2007. See “Risk Factors – Pension Plan Risk.”

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

### **Insurance**

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

### **Environmental**

Although primarily regulated at the provincial level, jurisdiction over the environment is shared by Canadian federal, provincial and local governments. As a result, we are subject to extensive federal, provincial and local regulation relating to the protection of the environment that governs, among other things, environmental assessments, discharges to water and land and the generation, storage, transportation, disposal and release of various hazardous substances. See “Risk Factors – Environmental Risk.”

#### *Health Safety and Environmental Management System*

As part of our Health, Safety and Environmental management system, Hydro One has an environmental management system designed to identify and assess the environmental effects of our operations and facilities and to aid in the continual improvement of our environmental performance. We continually update our environmental management system to reflect organizational changes and progress in achieving our environmental goals.

### *Permits, Licences and Approvals*

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

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

### *Releases*

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

### *Hazardous Substances*

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

## PCBs

Under Environment Canada regulations introduced in 2008, all equipment and materials with PCBs in concentrations of 500 parts per million (ppm) or more, except pole-top transformers and their pole-top auxiliary electrical equipment and light ballasts, were to be disposed of by the end of 2009. Hydro One has applied for and received a permit from Environment Canada to allow Hydro One to extend the time within which to dispose of specific equipment known or potentially contaminated with PCBs in concentrations of 500 ppm or more (the latest date being December 31, 2014). PCBs in concentrations of 50 ppm or more in pole-top transformers, pole-top auxiliary electrical equipment, light ballasts and other electrical equipment are required to be disposed of by the end of 2025. In addition, liquids with concentrations of 2 ppm or more that have been removed from equipment cannot be reused.

To date, approximately 97.7% of Hydro One's PCBs has been safely destroyed. PCB contaminated waste material is transported to a provincially-approved destruction facility where the PCB waste is either incinerated or chemically destroyed. The remaining 2.3% is found in extremely low concentrations (typically less than 500 ppm), in small volume electrical equipment, that is geographically dispersed across Ontario. Hydro One estimates that approximately 598,000 pieces of equipment will require inspection, testing, retrofilling, replacement and/or disposal in order to comply with these regulations.

Our best estimate of Hydro One's consolidated estimated future expenditures to comply with the final PCB regulations introduced in 2008 is about \$320 million, which after accounting for 2009 spending, is an increase of about \$18 million over the estimated amounts previously used to record the PCB portion of the environmental liability on our December 31, 2008 balance sheet. These expenditures are expected to be incurred in a relatively even pattern over the period from 2010 to 2025. As a result of the most recent cost estimate to comply with existing PCB regulations and Environment Canada interpretations, we increased our December 31, 2009 environmental liability by approximately \$30 million compared to September 30, 2009. This liability represents the present value of the estimated future expenditures. As Hydro One anticipates that these future expenditures will continue to be recoverable in future rates, an increase of \$30 million has also been recorded to the offsetting regulatory asset, reflecting the probability of future recovery of these PCB expenditures from customers.

## Asbestos

As a result of regulatory changes, we expect to incur future expenditures to identify, remove and dispose of asbestos-containing materials installed in some of our facilities. We plan on undertaking additional studies, using the assistance of external experts as required, to estimate the incremental expenditures associated with removing such materials prior to facility demolition. This information will allow us to reasonably estimate and record any obligation we may have to incur such expenditures. We also anticipate that such future expenditures will be recoverable in future electricity rates.

## Herbicides

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

## Wood Preservatives

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

## General

Estimated environmental liabilities are reviewed annually or more frequently if significant changes in regulation or other relevant factors occur. Estimate changes are accounted for prospectively.

## *Land Assessment and Remediation*

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

Hydro One owns 2,212 sites. The number of sites where at least one soil or groundwater sample on site was found to be above the Ontario Ministry of the Environment standards (of at least one substance of concern) is approximately 880. We have completed the clean-up of 166 sites, which include sites where underground fuel dispensing/storage tanks were removed. We have developed a risk-based property ranking system to assist in establishing priorities for Phase II sampling. This system is supplemented with visual inspections of the sites and nearby receptors. Remediation and/or risk management is occurring based on Phase II results and discussions with affected property owners and regulatory authorities. The Ontario Ministry of the Environment (at the local and head office level) and local health departments/medical officers of health are

actively involved in the program. Further work may be required in the event we sell or decommission any of these sites.

Future consolidated expenditures related to Hydro One's land assessment and remediation program for Hydro One Networks Inc. are currently estimated at approximately \$69 million. These expenditures are expected to be spent over the period ending 2020. The estimated consolidated expenditure for 2010 is approximately \$10 million.

### *Electric and Magnetic Fields*

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

In 2008, the City of Toronto adopted an electric and magnetic fields prudent avoidance policy which requires us to incorporate practical low-cost measures to reduce electric and magnetic fields emissions when new transmission equipment is installed or existing equipment is modified. The policy also requires us to prepare a health impact assessment to evaluate options to minimize any increase to the yearly average exposure to electric and magnetic fields when new high-voltage transmission lines or increases in the capacity of existing transmission lines are proposed in that municipality.

### **Legal Proceedings and Regulatory Actions**

In connection with the reorganization of Ontario Hydro, we succeeded Ontario Hydro as a party to various pending legal proceedings relating to the businesses, assets, real estate and employees transferred to us. We also assumed responsibility for future claims relating to the businesses, assets, real estate and employees acquired by us and arising out of events occurring prior to, as well as after, April 1, 1999. In addition to claims assumed by us, we are, from time to time, named as a defendant in legal actions arising in the normal course of business. The pending legal proceedings, which include material claims to which we are currently a defendant, are discussed below.

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

<sup>2</sup> Health Canada. It's Your Health: Electric and Magnetic Fields at Extremely Low Frequencies. [http://www.hc-sc.gc.ca/iyh-vsv/environ/magnet\\_e.html](http://www.hc-sc.gc.ca/iyh-vsv/environ/magnet_e.html)

On March 29, 1999, the Whitesand First Nation Band commenced an action in the Ontario Superior Court of Justice, naming as defendants the Province, the Attorney General of Canada, Ontario Hydro, OEFC, OPG and our company. On May 24, 2001, the Whitesand First Nation Band issued an almost identical claim against the same parties. The May 24, 2001 case was consolidated in 2004 with a similar claim by Red Rock First Nation Band which commenced on September 7, 2001, as all procedural issues in both matters were the same. These actions sought declaratory relief, injunctive relief and damages in an unspecified amount. The claims arose out of flooding activities of Ontario Hydro and the alleged effects of flooding on lands in which the two First Nations claim an interest. In May 2009, all parties entered into an agreement to dismiss all actions against Hydro One on a without costs basis.

## **Health and Safety**

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

Measures are in place to monitor lost time injuries and medical attention injuries as a result of a workplace injury. These indicators are monitored by management and by the Health and Safety Committee of the Board of Directors. Management compensation is tied, in part, to success in achieving annual health and safety performance targets. An effective early and safe return to work program has allowed us to ensure that, when injuries occur, employees recover and return to the workplace as soon as possible.

In the last quarter of 2009, we introduced a new safety program initiative called Journey to Zero. This initiative compares our approach to health and safety management with world class companies to see where gaps might exist. Opportunities for improvement will be prioritized and are anticipated to be implemented during 2010 and beyond.

During 2009, there has been a focus on the following areas: controlling human errors, analysis of motor vehicle incidents, Workwell Audit, skills and safety training, field coaching/mentoring and a young and new worker program. As in previous years, we continue to focus on specific areas of risk: electrical contacts, overexertions and slips and trips. Through a review of incidents, we hope to understand contributing factors and prevention.

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

## **REGULATION**

### **The Statutory and Operating Framework**

#### *General*

The *Electricity Act, 1998* and the *Ontario Energy Board Act, 1998*, as amended from time to time, primarily establish the broad legislative framework for Ontario's electricity market. The *Electricity Act, 1998* implemented the fundamental principles of the restructuring of Ontario's electricity industry, enabling the implementation of open non-discriminatory access to transmission and distribution systems. The *Ontario Energy Board Act, 1998* expanded the jurisdiction and mandate of the OEB to include regulation of the electricity and natural gas markets. Both statutes have been amended several times.<sup>3</sup>

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

In 2009, the GEA was introduced. It provides the framework to increase investment in renewable energy projects and to increase conservation. Regulations and other tools needed to fully implement the legislation were introduced throughout 2009.

### **Contractual Arrangements, Codes and Licences**

#### *Operating Agreement with the IESO*

Under the *Electricity Act, 1998*, the IESO is required to enter into agreements with transmitters giving it the authority to direct the operations of the transmitters' systems. On June 8, 2001, we signed a 10 year operating agreement with the IESO, which sets out the specific responsibilities of both parties relating to the provision of transmission service.

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

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<sup>3</sup> Amending statutes include: *Reliable Energy and Consumer Protection Act, 2002*, *Electricity Pricing, Conservation and Supply Act, 2002*, *Ontario Energy Board Amendment Act (Electricity Pricing), 2003*, *Electricity Restructuring Act, 2004*, *Ontario Energy Board Consumer Protection and Governance Act, 2003*, *Energy Conservation Responsibility Act, 2006* and the *Green Energy and Green Economy Act, 2009*.

### *Hydro One's Relationships with Other Market Participants*

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

Some market participants, such as generators and large load customers embedded within distribution systems, are supplied from the wholesale market through lines and facilities that are defined or deemed by the OEB as "distribution" and owned by local distribution companies. At a minimum, under the *Electricity Act, 1998*, local distribution companies must provide non-discriminatory access for eligible generators and customers to the wholesale markets administered by the IESO. The local distribution companies must advise the IESO of any conditions in their distribution system that may affect the ability of embedded generators and loads to participate in the broader IESO administered markets.

### *Electricity Industry Codes*

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

### *Electricity Industry Licences*

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

### *Transmission Licence*

The following are the key conditions of our transmission licence:

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

- ***Non-discriminatory Access*** – If a generator, distributor, retailer, wholesaler or customer requests that we convey electricity using our transmission system, subject to capacity constraints, we must make an offer to convey electricity on behalf of the applicant consistent with the applicable Market Rules and the Transmission System Code.
- ***Obligation to Connect and Priority Connection Access*** – We may not refuse an offer to connect to our transmission system which has been made in accordance with the terms of our transmission rate order, the Market Rules and the Transmission System Code unless we are permitted to do so by the OEB, the legislation or any codes, standards or rules with which we are obligated to comply as a condition of our licence. The connection procedures of our licence outline the respective responsibilities of Hydro One and of the connecting customer. We are required to provide priority connection access to the transmission system for qualified renewable energy generation facilities, i.e. those facilities that meet the requirements prescribed by Provincial regulations.
- ***Obligation to Maintain System Integrity*** – We must maintain our transmission system to the standards established in our agreement with the IESO, the Market Rules and any other recognized industry operating or planning standard which has been specified by the OEB.
- ***Transmission Rates*** – We may not impose charges for the transmission of electricity or connection to our transmission system except in accordance with our transmission rate order.
- ***Preparation of Plans*** – We are required to prepare plans for approval by the OEB in the manner and at the times mandated by the OEB or as prescribed by regulation, that identify expansion or reinforcement of the transmission system required to accommodate the connection of renewable energy generation facilities and to prepare plans for the development and implementation of the smart grid in relation to the transmission system.
- ***Separation of Business Activity*** – Our transmission business must separate its financial records from those of any other business of Hydro One.
- ***Expansion of the Transmission System*** – Construction, expansion or reinforcement of our transmission system is subject to legislation, regulatory approvals, licences, codes and the Market Rules. Either the IESO or the OEB may require us to expand or reinforce our transmission system if it determines that doing so is necessary for the maintenance of security, reliability or integrity of the system. See “Description of the Business – Our Transmission Business – Projects Relating to Interconnection Capacity.”
- ***Information Disclosure*** – We are required to maintain records, provide the OEB with information it may require from time to time and inform the OEB of any material change in circumstances no more than 20 days after the date of occurrence.

- ***Restrictions on Provision of Information*** – We are restricted in our use and disclosure of information pertaining to consumers, retailers, wholesalers and generators. We must obtain consent for disclosure of such information, except in certain specified situations and inform such parties of the conditions under which their information may be disclosed without their consent.

### *Distribution Licences*

The terms and conditions of our three distribution licences are similar to the terms and conditions of our transmission licence described above. In addition, these licences:

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

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

## **Rate Orders and Related Issues for Hydro One's Businesses**

The OEB approves both the revenue requirements of and the rates charged by our regulated businesses. The rates are designed to permit our businesses to recover the allowed costs and to earn a specified annual rate of return on our common equity.

The term "utility rate base" refers to the investment in regulated operations (consisting of gross plant in service, less accumulated depreciation, plus necessary working capital and in general excluding construction work in progress). Utility rate base is used to determine the capital structure for our regulated businesses, enabling a determination of approved financing charges and return on common equity for them. Recently the OEB issued a report indicating that it will consider applications on a case by case basis which include incentive mechanisms such as construction work in progress to be included in the rate base.

### *Cost of Capital Review*

In February 2009, the OEB initiated a consultative process to help determine whether the current economic and financial market conditions warranted an adjustment to any of the cost of capital parameter values used by the OEB in setting a utility's return on equity ("ROE"). Hydro One and the Coalition of Large Distributors engaged Concentric Energy Advisors to prepare a joint response for this initiative and to participate in this proceeding through workshops and written submissions.

On December 11, 2009, the OEB issued its decision to continue with a formula-based equity risk premium approach for adjusting utility ROE. However, in order to ensure that on an ongoing basis changing economic and financial conditions are adequately and appropriately accommodated, the OEB determined that its current formula-based return on equity needed to be reset and refined. The OEB determined that the initial ROE to be embedded in the modified and reset formula will be 9.75 per cent (as compared to 8.11 per cent prior to the adjustment). Adjustments were also made to the methodology for determining the short-term debt rate. The OEB will review the formula every five years with the next review to take place in 2014. The impact of using the updated ROE of 9.75 per cent for 2010 will, if approved by the OEB, increase the 2010 distribution rates by an additional 4 to 5 percent over the initial rate increase sought in Hydro One's submission for 2010 rates which was based on an ROE of 8.11 per cent. The resulting total distribution rate increase for 2010 would be approximately 14 per cent.

On February 24, 2010, the OEB advised utilities that it had revised the values for the ROE from 9.75 per cent to 9.85 per cent for 2010 and deemed the long term and short term debt rates for use in the 2010 rate year cost of service applications.

### *Transmission*

#### Current Rate Orders and Review of the Existing Transmission Rate Structure

On August 28, 2008, the OEB approved an adjustment to the Uniform Transmission Rates which allows Hydro One to recover revenues consistent with the Board-approved 2008 revenue requirement, commencing January 1, 2009. This adjustment provided for an increase of approximately 9% from the 2008 transmission rates, resulting in an approximately 1% total bill impact for a typical customer.

Uniform Transmission Rates are based on the fully allocated cost associated with providing each of the following three transmission service elements:

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

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

Hydro One Networks filed its 2009 – 2010 Transmission Revenue Requirement and Rate Application with the OEB on September 30, 2008. The requested revenue requirement was \$1,233M in 2009 and \$1,341M in 2010. This would have resulted in 6.4% and 12.1% year-over-year increases in transmission rates for 2009 and 2010, respectively, as compared to the Uniform Transmission Rates in effect as of January 1, 2009 as set in August 2008. The oral hearing was held in February 2009 and the OEB issued its decision on May 28, 2009, approving a revenue requirement of \$1,180 million for 2009 resulting in an increase in transmission rates of 1.5%. The OEB disallowed development capital expenditures of \$180 million in relation to a number of projects which it felt lacked sufficient rationale, but left the door open to reconsidering this aspect of the decision if Hydro One Networks chose to submit additional evidence. Hydro One Networks submitted supplemental evidence on September 4, 2009 in respect of two projects totaling approximately \$160 million and the review process was completed with Hydro One Networks filing its reply argument on October 29, 2009. On November 5, 2009 the OEB established the ROE for 2010 at 8.39%. As previously noted, on December 11, 2009 the OEB issued its decision on ROE increasing it to 9.75% for 2010 rates. The OEB approved Hydro One's supplemental submission on December 16, 2009 and a revenue requirement of \$1,257 million for 2010, resulting in an increase in transmission rates of 9.2% in 2010 or approximately a 0.6% increase on total customer bills. On January 5, 2010 Hydro One filed a notice of motion with the OEB requesting a review and variance of its December 16, 2009 decision which directed Hydro One to file a rate order with the lower ROE (i.e. 8.39%) as opposed to using the new higher ROE. The OEB heard the motion on March 26, 2010 and will deliver a written decision.

Hydro One anticipates that it will file a Transmission Revenue Requirement and Rate Application for 2011 – 2012.

### Competition

Under the *Ontario Energy Board Act, 1998*, any licensed competitor can apply to the OEB for approval to build transmission network facilities in Ontario. The OEB's adoption of the Uniform Transmission Rate reduces the financial incentive for customers to seek alternative transmission.

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

### By-pass

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

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

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

### Facilities Applications

Transmission line expansions greater than 2 kilometres in length require prior OEB approval under section 92 of the *Ontario Energy Board Act, 1998*, as well as environmental assessment and other approvals. OEB filing requirements for transmission applications which include filing requirements for leave to construct electricity transmission projects under section 92 of the *Ontario Energy Board Act, 1998* ensure a complete review of proposed transmission projects.

Regardless of whether OEB leave to construct is received, cost recovery of approved facilities still needs a final approval from the OEB as part of a transmission rate application.

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

On September 21, 2009, the Province announced it had asked Hydro One to proceed with 20 transmission projects to support the GEA to help bring renewable energy to the grid. See “Our Transmission Business – Transmission Capital Expenditure Plan”

#### Connection Cost Responsibility and Enabler Lines

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

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

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

#### Transmission Corridors

On June 27, 2002, the Province passed the *Reliable Energy and Consumer Protection Act, 2002* that provided for, among other things, ownership of all transmission corridor and abutting lands to be transferred from us to the Province in exchange for a statutory right to use the lands for transmission and distribution purposes effective December 31, 2002. Certain of these lands have been subsequently transferred back to Hydro One. See “Interests of Management and Others in Material Transactions – Relationship with Province and Other Parties – Transmission Corridors.”

## *Distribution*

### Current Rate Orders and Distribution Rate Structure

#### Hydro One Brampton Networks Inc.

On November 7, 2008, Hydro One Brampton Networks Inc. applied for an adjustment to its distribution rates in accordance with the OEB's 2<sup>nd</sup> Generation Incentive Regulatory Mechanism. The request was for an adjustment of 0.3% to its 2008 approved basic rates and an increase to the smart meter rate adder from \$0.67 per metered customer per month to \$1.00 per metered customer per month. The net adjustment reflects the application of a price escalation factor less productivity, adjustment for capital structure and reduction in federal tax rate. On March 13, 2009, the OEB approved the requested rate adjustments for establishing 2009 distribution rates.

The OEB subsequently approved Hydro One Brampton Networks Inc. to collect an additional amount in respect of smart meters to recover the 2008 revenue requirement associated with the OEB approved costs for smart meter installations completed up to March 31, 2007. On November 6, 2009, Hydro One Brampton Networks Inc. submitted its application for 2010 distribution rates. The application for rates is in accordance with the Board's 2<sup>nd</sup> Generation Incentive Regulation Mechanism. Hydro One Brampton Networks Inc. is seeking a preliminary adjustment to its 2009 approved basic rates for the distribution of electricity of approximately - 0.11%. The reduction is due to changes in payments in lieu of taxes and Ontario capital taxes after the 2009 rates were approved.

#### Hydro One Networks Inc.

On February 19, 2007, Hydro One Networks Inc. applied for a 2007 distribution rate increase. The OEB approved a rate increase of 0.457% to Hydro One's distribution rates for 2007 commencing May 1, 2007, which factored in a 1.92% price escalation factor, less a productivity gain of 1%, less the impact of the elimination of the large corporation tax. Hydro One also sought, and was granted approval for, an increase in the rate rider for the implementation of smart meter infrastructure from \$0.27 per month per metered customer to \$0.93 per month per metered customer commencing May 1, 2007.

On August 15, 2007, Hydro One Networks Inc. filed the revenue requirement portion of its 2008 cost of service application in accordance with the OEB's multi-year distribution rate-setting plan. A distribution revenue requirement of \$1,067 million was requested for 2008. After incorporating rate rider changes, a net distribution rate increase of about 2.5% relative to 2007 rates was requested. This represented a change of less than 1% on the average total customer bill. An oral hearing was held between July 7, 2008 and July 22, 2008.

On December 18, 2008, the OEB issued its decision on our distribution rates application. The net effect of the decision was a reduction in our revenue requirement from \$1,067 million requested to about \$1,028 million. New rates were approved effective as of May 1, 2008 and were implemented February 1, 2009, resulting in the retroactive recovery of the approved revenue requirement over 27 months commencing February 1, 2009 through April 30, 2011. Approximately \$25 million of incremental revenue was recorded for accounting purposes in December 2008.

On November 7, 2008, Hydro One filed its application to the OEB for 2009 distribution rates in accordance with the OEB's 3<sup>rd</sup> Generation Incentive Regulation Mechanism ("IRM") rate setting process. On January 30, 2009, Hydro One submitted an update to its application to reflect the OEB December 18, 2008 revenue requirement decision and the associated January 28, 2009 approved rate order. The application sought an increase to 2009 distribution rates of 1% reflecting an increase in the price escalation factor less productivity and an increase of 3% for incremental capital expenditures and an increase in smart meter funding of \$1.65 per month per installed meter. These changes would have increased an average residential customer's total bill by less than 1.5%.

The OEB's decision of May 13, 2009 approved the basic IRM increase and an increase for smart meter funding to \$1.65 per metered customer per month, but modified the incremental capital amount from the requested \$21 million to \$12 million. The OEB did not approve the associated incremental capital module amount of \$21 million but rather approved a revenue requirement relief of \$12 million.

On July 13, 2009, Hydro One filed its Distribution Rate Application for 2010 and 2011 requesting a revenue requirement of \$1,181 million for 2010 and \$1,294 million for 2011. If approved, distribution rates would increase approximately 9% in 2010 and 13% in 2011. On a total bill basis, rates would, on average, increase by approximately 3% in 2010 and 4% in 2011. The revenue requirement is based upon a requested return on equity of 8.11% for 2010 and 9.09% for 2011. In response to the GEA our filing included Hydro One's Green Energy Plan, which identifies the expansion or reinforcement of the distribution system required to accommodate the connection of renewable energy generation facilities and plans for the development and implementation of the smart grid in relation to our distribution system. Hydro One filed an update to our pre-filed evidence on September 25, 2009 to reflect new information on the recovery mechanisms and amounts to be borne by Hydro One's distribution customers for the Green Energy Plan investments. The updated application seeks OEB approval of revenue requirements of approximately \$1,150 million and \$1,264 million based on a ROE of 8.11% and 9.09% for 2010 and 2011, respectively. The resulting distribution tariff rate increase is approximately 10% and 13% in 2010 and 2011, respectively, or approximately 3% and 4% on an average customer's total bill. The oral hearing began on December 7, 2009 and concluded on January 12, 2010 followed with Hydro One's oral argument on January 14, 2010. Hydro One's reply argument was delivered on February 12, 2010. In the course of the 2010-2011 distribution rates proceeding, the OEB panel indicated that the revised ROE of 9.75 % in 2010 is in accordance with the OEB's final Cost of Capital Report, and that Hydro One was not required to submit any additional evidence to support that matter. The higher ROE will increase the revenue requirement by \$44 million in 2010, with a resulting total distribution rate impact of approximately 14%. On February 18, 2010, the OEB rendered an interim decision approving, on a provisional basis, Hydro One's methodology for allocation of the Green Energy Plan costs between Hydro One and all provincial customers. Hydro One expects the OEB to render a decision in April of 2010, taking into account the February 24 letter regarding the higher ROE for 2010.

## Hydro One Remote Communities Inc.

Hydro One Remote Communities Inc.'s business is exempt from a number of sections of the *Electricity Act, 1998* which relate to the competitive market. For example, we continue to apply bundled rates to customers in remote communities. In accordance with the OEB's Multi-Year Electricity Distribution Rate Setting Plan, Hydro One Remote Communities Inc. filed a 2009 Rate Application on August 29, 2008 and updated its evidence in late November 2008 to reflect a significant change in diesel fuel costs over the intervening period. Increases to both customer rates and the required level of Rural and Remote Electricity Rate Protection ("RRRP") funding were requested due primarily to increases in diesel fuel costs occurring since the prior rates were approved in 2006. Specifically, the application sought to recover a revenue requirement of \$42.5 million and to establish the RRRP in 2009 at \$31.9 million. The previous RRRP amount collected from Ontario grid customers on behalf of Hydro One Remote Communities Inc. was \$21.1 million. The proposed average increase for Hydro One Remote Communities Inc.'s customers was 4.4%.

The OEB's decision of April 30, 2009, approved all work program expenditures, the requested 4.4% rate increase effective May 1, 2009, and the increase in the RRRP amount to approximately \$31 million. The decrease in RRRP from the amount requested was mostly due to updating the variance account to year-end 2008.

On November 4, 2009, Hydro One Remote Communities Inc. filed its application for 2010 rates under the OEB's 3<sup>rd</sup> Generation Incentive Regulation Mechanism. Hydro One Remotes Communities Inc. is seeking approval of increased basic rates for the distribution and generation of electricity of 2% effective May 1, 2010.

### Rural and Remote Rate Protection

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

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

In 2007, our remote customers received a rate reduction in the amount of \$21.1 million. This amount was set by the OEB according to the rules set out in the regulations under the *Ontario Energy Board Act, 1998*. As noted above, the OEB recently approved an increase to the amount of RRRP for remote customers from approximately \$21.1 million to approximately \$31 million. Accordingly effective May 1, 2009, the OEB approved an increase to the RRRP rate applicable to all consumers in Ontario from 0.10 cents per kilowatt-hour to 0.13 cents per kilowatt-hour.

Under the *Ontario Energy Board Act, 1998*, a distributor is entitled to be compensated for lost revenue resulting from the rate protection regime, and all consumers are required to contribute towards the amount of any compensation to the distributors, such as our company, for rate protection. As of May 1, 2002, the amounts required to compensate the distributors were collected by the IESO and paid to us for distribution in accordance with the regulation under the

*Ontario Energy Board Act, 1998*. The OEB calculates the charge to be collected by the IESO based upon the latter's forecast of the number of kilowatt-hours of electricity that will be withdrawn from the IESO-controlled grid. Hydro One Networks Inc. maintains a variance account to track any surplus or deficit in the amount received from the IESO and from the \$127 million prescribed amount.

Hydro One Remote Communities Inc.'s business is run on a break even basis. As a result, any net earnings or loss in the year, including rural and remote rate protection amounts, is deferred in a regulatory variance account for inclusion in the calculation of future customer rates.

The *Ontario Energy Board Act, 1998*, as amended by the GEA now includes a new mechanism for rate protection whereby some or all of the OEB-approved costs incurred by a distributor to make an eligible investment for the purpose of connecting or enabling the connection of renewable energy generation to its distribution system may be recovered from all provincial ratepayers rather than solely from ratepayers of the distributor making the investment. Accordingly, on September 25, 2009, the OEB advised all LDCs and other interested parties of its intent to initiate a consultation process to address how the OEB should determine what constitutes direct benefits that accrue to the consumers of a distributor which has incurred costs to make an eligible investment in its distribution system to accommodate a renewable energy generation facility. The OEB issued a staff discussion paper on December 14, 2009 seeking input from distributors and other stakeholders on the proposed mechanism for allocating costs.

### Competition

Under the *Ontario Energy Board Act, 1998*, there are instances in which it is appropriate for one distributor to transfer its customers to another distributor. The acquiring distributor is required to obtain amendments to its licence authorizing it to serve in a specific area, but not with exclusive distribution rights to it. On February 27, 2004, the OEB issued its decision, with clear principles and filing requirements to be followed for service territory amendment applications.

In July 2005, as a result of three applications by distributors, a generic proceeding was convened by the OEB to determine issues relevant to inter-utility share acquisitions and amalgamations. In a decision issued on August 31, 2005, the OEB decided that the scope of its review of these applications is appropriately dictated by Section 86 of the *Ontario Energy Board Act, 1998* and its objectives as stated. It also decided that reviews of the related transaction processes themselves were beyond its purview.

### Connection Cost Responsibility

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

- all expansion costs identified in a plan,

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

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

## **RISK FACTORS**

### **Ownership by the Province**

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

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

### **Regulatory Risk**

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

The OEB approves our transmission and distribution rates based on projected electricity load and consumption levels. If actual load or consumption falls below projected levels, our rate of return for either, or both, of these businesses could be materially adversely affected. Also, our current revenue requirements for these businesses are based on cost assumptions that may not

materialize. There is no assurance that the OEB would allow rate increases sufficient to offset unfavourable financial impacts from unanticipated changes in electricity demand or in our costs.

Our load could also be negatively affected by successful CDM programs. Current requirements for CDM call for a 5% reduction in Ontario's projected peak electricity demand by 2010. These expectations are factored into our revenue requirements for OEB approval, to ensure that the targeted CDM accomplishments do not result in deteriorated revenues. There is a risk that our revenues would be reduced if these targets are exceeded. The OEB has recognized the need to compensate utilities for such lost revenue, but the approach, level and timing of any such compensation mechanism is yet to be determined. We are also subject to risk of revenue loss from other factors.

In response to the GEA, we expect to make a significant investment in the coming years in large scale transmission and distribution infrastructure projects, and to connect new renewable generating stations. There is the possibility that we could incur unexpected capital expenditures to maintain or improve our assets particularly given that new technology is required to support renewable generation and unforeseen technical issues may be identified through implementation of projects. The distribution systems have generally been built to accommodate one directional flow of electricity from the transmission system to customers' meters. Distributed generation connected to the distribution system requires the accommodation of two directional flows. The risk exists that the OEB may not allow full recovery of such investments. To the extent possible, we aim to mitigate this risk by ensuring prudent expenditures, seeking from the regulator clear policy direction on cost responsibility, and pre-approval of the need for capital expenditures. In addition, it is possible that we may not obtain all necessary regulatory approvals for these projects or if approvals are obtained, they may be subsequently challenged, appealed or overturned. This could impact our ability to recover costs already incurred in the planning and development of such projects.

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

### **Risk Associated with Arranging Debt Financing**

We expect to borrow to repay our existing indebtedness and fund a portion of capital expenditures. We have substantial amounts of existing debt which mature between 2010 and 2013, including \$600 million maturing in 2010 and \$500 million maturing in 2011. We plan to incur capital expenditures of approximately \$2.0 billion in 2010 and capital expenditures are expected to increase to approximately \$2.1 billion in 2011. Cash generated from operations, after the payment of expected dividends, will not be sufficient to fund the repayment of our existing indebtedness and capital expenditures. Our ability to arrange sufficient and cost effective debt financing could be materially adversely affected by numerous factors, including the regulatory environment in Ontario, our results of operations and financial position, market conditions, the ratings assigned to our debt securities by credit rating agencies and general economic conditions. Any failure or inability on our part to borrow substantial amounts of debt on satisfactory terms could impair our ability to repay maturing debt, fund capital expenditures and meet other obligations and requirements and, as a result, could have a material adverse effect on our company.

## **Risk Associated with Transmission Projects**

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

In many cases, these investments are contingent upon one or more of the following approvals and/or processes: (a) environmental approval(s); (b) receipt of OEB approvals which can include expropriation; and (c) appropriate consultation processes, and where appropriate, accommodation with First Nations and Métis who may be potentially affected by a project. Obtaining these approvals and carrying out these processes may also be impacted by public opposition to the proposed site of transmission investments, thus there is a risk that necessary approvals may not be obtained in a timely fashion or at all. This will adversely affect transmission reliability and/or our service quality, both of which could have a materially adverse effect on our company.

## **Asset Condition**

We continually monitor the condition of our assets and maintain, refurbish or replace them to maintain equipment performance and provide reliable service quality. Our capital and maintenance programs have been increasing to maintain the performance of our aging asset base. Execution of these plans is partially dependent on external factors, including the fact that opportunities to remove equipment from service to accommodate construction and maintenance are becoming increasingly limited due to customer and generator priorities. Lead times for material and equipment have also increased substantially due to increased demand and limited vendor capability.

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

## **Work Force Demographic Risk**

By the end of 2009, approximately 17% of our employees were eligible for retirement and by 2011 there may be more than 25% eligible to retire. Accordingly, our success will be tied to our ability to attract and retain sufficient qualified staff to replace those retiring. This will be challenging as we expect the skilled labour market for our industry to be highly competitive in the future. In addition, many of our employees possess experience and skills that will also be highly sought after by other organizations both inside and outside the electricity sector. We have

already lost a considerable number of management staff, both those in executive positions and those who are logical successors for executive positions, to opportunities in other electricity sector positions across Canada (and, in particular, in Ontario) as well as senior positions outside of the sector. Moreover, we must also continue to advance our training and apprenticeship programs and succession plans to ensure that our future operational staffing needs will be met. If we are unable to attract and retain qualified personnel, it could have a material adverse effect on our business.

### **Environmental Risk**

Our health, safety and environmental management system is designed to ensure hazards and risks are identified and assessed, and controls are implemented to mitigate significant risks. We cannot guarantee, however, that all such risks will be identified and mitigated without significant cost and expense to our company. The following are some of the areas that may have a significant impact on our operations.

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

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

We record a liability for our best estimate of the present value of the future expenditures required to comply with Environment Canada PCB regulations and for the present value of the future expenditures to complete our land assessment and remediation program. The future expenditures required to discharge our PCB obligation are expected to be incurred over the period ending 2025 while our land assessment and remediation expenditures are expected to be incurred over the period ending 2020. Actual future environmental expenditures may vary materially from the estimates used in the calculation of the environmental liabilities on our consolidated balance sheet. We do not have insurance coverage for these environmental expenditures.

As a result of regulatory changes, we expect to incur future expenditures to identify, remove and dispose of asbestos-containing materials installed in some of our facilities. We plan on undertaking additional studies, using the assistance of external experts as required, to estimate the incremental expenditures associated with removing such materials prior to facility demolition. This information will allow us to reasonably estimate and record any obligation we may have to incur such expenditures. We also anticipate that such future expenditures will be recoverable in future electricity rates.

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

### **Risk of Natural and Other Unexpected Occurrences**

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

### **Risk Associated with Information Technology Infrastructure**

Our ability to operate effectively in the Ontario electricity market is in part dependent upon us developing, maintaining and managing complex information technology systems which are employed to operate our transmission and distribution facilities, financial and billing systems, and business systems. Our increasing reliance on information systems and expanding data networks increases our exposure to information security threats. We continue to transition most of our financial and business processes to an integrated business and financial reporting system. The conversion of these systems and processes may expose us to risk, including risks associated with our ability to capture data and to produce timely and accurate information for downstream processing and to maintain internal controls. System failures or security breaches could have a material adverse effect on our company.

### **Pension Plan Risk**

We have a defined benefit registered pension plan for the majority of our employees. Contributions to the pension plan are established by actuarial valuations which are filed with the Financial Services Commission of Ontario on a triennial basis. The most recently filed valuation was prepared as at December 31, 2006 and was filed in September, 2007. The next valuation is required to be prepared as at December 31, 2009 and will be filed in September, 2010. Contributions beyond 2009 will be based on an actuarial valuation effective December 31, 2009 and will depend on investment returns, changes in benefits or actuarial assumptions. Economic uncertainty and financial market volatility contributed to negative

returns in 2008 of approximately 22.5%. In 2009, the pension plan has experienced positive overall investment returns of approximately 17.2%. The deficit position at the end of 2009 is not expected to result in any significant change in our contribution requirements beyond 2009. A determination by the OEB that some of our pension expenditures are not recoverable from customers would have a material adverse effect on our company.

### **Market and Credit Risk**

Market risk refers primarily to the risk of loss that results from changes in commodity prices, foreign exchange rates and interest rates. We do not have commodity risk. We do have foreign exchange risk as we enter into agreements to purchase materials and equipment associated with our capital programs and projects that are settled in foreign currencies. This foreign exchange risk is not material. We could in the future decide to issue foreign currency denominated debt which we would anticipate hedging back to Canadian dollars, consistent with our company's risk management policy. We are exposed to fluctuations in interest rates as our regulated rate of return is derived using a formulaic approach, which is in part based on the forecast for long-term Government of Canada bond yields. We estimate that a 1% decrease in the forecast long-term Government of Canada bond yield used in determining our rate of return would reduce our Transmission Businesses' net income by approximately \$15 million and our Distribution Businesses' net income by approximately \$10 million. Our net income is adversely impacted by rising interest rates as our maturing long-term debt is refinanced at market rates. We periodically utilize interest rate swap agreement to mitigate elements of interest rate risk.

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

### **Labour Relations Risk**

The substantial majority of our employees are represented by either the Power Workers' Union ("PWU") or the Society of Energy Professionals ("Society"). Over the past several years, significant effort has been expended to increase our flexibility to conduct operations in a more cost efficient manner. Although we believe that we have achieved improved flexibility in our collective agreements, including a reduction in pension benefits similar to a previous reduction affecting management staff, we may not be able to achieve further improvement. The existing collective agreement with the PWU will expire on March 31, 2011 and the existing Society collective agreement will expire on March 31, 2013. We face financial risks related to our ability to negotiate collective agreements consistent with our rate orders. In addition, in the event of a labour dispute, we could face some degree of operational risk related to continued

compliance with our licence requirements of providing service to customers. Any of these could have a material adverse effect on our company.

### **Risk from Transfer of Assets Located on Indian Lands**

The transfer orders by which we acquired certain of Ontario Hydro's businesses as of April 1, 1999 did not transfer title to some assets located on lands held for bands or bodies of Indians under the *Indian Act* (Canada). See "Interest of Management and Others in Material Transactions – Relationships with the Province and Other Parties – Transfer Orders." Currently, OEFC holds these assets. Under the terms of the transfer orders, we are required to manage these assets until we have obtained all consents necessary to complete the transfer of title of these assets to us. We cannot predict the aggregate amount that we may have to pay, either on an annual or one-time basis, to obtain the required consents. However, we anticipate having to pay more than the \$822,000 that we paid to these Indian bands and bodies in 2009. If we cannot obtain consents from the Indian bands and bodies, OEFC will continue to hold these assets for an indefinite period of time. If we cannot reach a satisfactory settlement, we may have to relocate these assets from the Indian lands 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 our net income if we are not able to recover them in future rate orders.

### **Risk Associated with Outsourcing Arrangement**

Consistent with our strategy of reducing operating costs, we entered into an outsourcing services agreement in 2002 with Inergi LP. See "Description of the Business – Outsourcing Arrangement with Inergi LP." If the agreement with Inergi LP is terminated for any reason, we could be required to incur significant expenses to re-establish all or some of the functions involved, which could have a material adverse effect on our business, operating results, financial condition or prospects. The agreement expires on February 29, 2012. Given the complexities involved, we have begun developing a plan of action for end-of-term.

### **Risk from Provincial Ownership of Transmission Corridors**

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

## **DIVIDENDS**

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

Our company's policy is to declare and pay cash dividends on our common shares on the basis of a calculation involving our regulated net income net of preferred dividends and non-regulated net

income. Any factor that adversely affects our company's net income would likely be reflected in our dividend payments.

We declared and paid to the Province annual dividends on our outstanding 100,000 common shares totalling \$170 million in 2009 as compared with \$241 million in 2008 and \$307 million in 2007. We declared and paid to the Province a total annual cumulative dividend on our outstanding 12,920,000 series A preferred shares of approximately \$18 million in each of 2009, 2008, and 2007, which was calculated at a rate of \$1.375 per annum per share, as stipulated in our company's Articles of Incorporation. In addition, we made payments in lieu of taxes to the Province in 2009 in the amount of approximately \$77 million, as compared to \$145 million in 2008.

## DESCRIPTION OF CAPITAL STRUCTURE

### *General Description of Capital Structure*

The authorized share capital of our company consists of an unlimited number of common shares (the voting shares of our company) and an unlimited number of preferred shares. As at December 31, 2009, 100,000 common shares and 12,920,000 series A preferred shares were issued and outstanding, all of which are owned directly by the Province.

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

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

Our company has not issued any restricted securities.

## CREDIT RATINGS

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

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

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

Credit ratings are intended to provide investors with an independent measure of the credit quality of an issue of securities. The rating agencies rate long-term debt instruments by rating categories ranging from a high of “AAA” to a low of “D” (“C” in the case of Moody’s). Long-term debt instruments which are rated in the A category by S&P mean the obligor has a strong capacity to meet its financial commitments but are considered somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. However, the obligor’s capacity to meet its financial commitments and obligations is still strong. S&P utilizes a “+” or a “-” modifier to indicate the relative standing within the rating category. Long-term debt instruments which are rated in the A category by DBRS are considered to be of a satisfactory credit quality, with substantial protection of interest and principal. Entities in the “A” category, however, are considered to be more susceptible to adverse economic conditions and have greater cyclical tendencies than higher-rated securities. The “high” modifier indicates relative standing within this rating category by DBRS. Long-term debt instruments which are rated in the Aa category by Moody’s are judged to be of high quality and are subject to very low credit risk. Moody’s applies numerical modifiers to each generic rating classification from Aa to Caa. The modifier 3 indicates a ranking in the lower end of that generic rating category.

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

## MARKET FOR SECURITIES

Our Debentures (7.15%) due 2010, Debentures (7.35%) due 2030, Series 1 Notes (6.40%) due 2011, Series 2 Notes (6.93%) due 2032, Series 3 Notes (5.77%) due 2012, Series 4 Notes (6.35%) due 2034, Series 5 Notes (6.59%) due 2043, Series 9 Notes (5.36%) due 2036, Series 10 Notes (4.640%) due 2016, Series 11 Notes (5.000%) due 2046, Series 12 Notes (4.89%) due 2037, Series 13 Notes (5.18%) due 2017, Series 14 Notes (4.08%) due 2011, Series 15 Notes (5.00%) due 2013, Series 16 Notes (3.89%) due 2010, Series 17 Notes (6.03%) due 2039, Series 18 Notes (5.49%) due 2040, Series 19 Notes (3.13%) due 2014 and Series 20 Notes (4.4%) due 2020 are currently outstanding and are not listed on any exchange or similar market for securities.

### *Trading Price and Volume*

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

### *Prior Sales*

Our company issued the following tranches of medium term notes in 2009:

Note	Par Value (M) (\$)	Sale Price (\$)	Gross Proceeds (\$)
Series 15 (5.00%) due 2013	200	103.169	\$206,338,000
Series 16 (3.89%) due 2010	100	100.817	\$100,817,000

Note	Par Value (M) (\$)	Sale Price (\$)	Gross Proceeds (\$)
Series 17 (6.03%) due 2039	300	99.931	\$299,793,000
Series 18 (5.49%) due 2040	300	99.867	\$299,601,000
Series 19 (3.13%) due 2014	250	99.991	\$249,977,500

## DIRECTORS AND OFFICERS

### Directors

The following table sets forth the name, municipality of residence and principal occupation of each of our directors, as of December 31, 2009.

#### Name and Municipality of Residence

#### Principal Occupation

James Arnett <sup>(1) (2) (4) (7)</sup>  
Toronto, Ontario  
Canada

(Director and Chair from March 31, 2008 to December 8, 2008,  
and Director and Chair from February 17, 2009 to present)

Chair of the Board of  
Directors of Hydro One Inc.

Counsel to Fraser Milner  
Casgrain LLP

Sami Bébawi <sup>(2) (4) (5)</sup>  
Montreal, Québec  
Canada

(Director since October 8, 2004)

Advisor to the President,  
SNC-Lavalin Group Inc.

President, Geracon Inc.

Kathryn A. Bouey <sup>(3) (5) (6)</sup>  
Toronto, Ontario  
Canada

(Director since March 30, 2007)

President,  
TBG Strategic Services Inc.  
Corporate Director

Laura Formusa  
Toronto, Ontario  
Canada

(Director since March 30, 2007)

President and Chief  
Executive Officer,  
Hydro One Inc.

Don MacKinnon <sup>(4) (5)</sup>  
Chatsworth, Ontario  
Canada

(Director since June 11, 2002)

President,  
Power Workers' Union

**Name and Municipality of Residence**

**Principal Occupation**

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

Corporate Director

Walter Murray <sup>(1)(3)(6)</sup>  
Bracebridge, Ontario  
Canada  
(Director since November 10, 2005)

Corporate Director

Robert L. Pace <sup>(1)(3)</sup>  
Halifax, Nova Scotia  
Canada  
(Director since March 30, 2007)

President and Chief  
Executive Officer,  
The Pace Group Ltd.

Gale Rubenstein <sup>(2)(4)</sup>  
Toronto, Ontario  
Canada  
(Director since March 30, 2007)

Partner, Goodmans LLP

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

Corporate Director

(1) Member of the Audit and Finance Committee

(2) Member of the Corporate Governance Committee

(3) Member of the Human Resources and Public Policy Committee

(4) Member of the Regulatory and Environment Committee

(5) Member of the Health and Safety Committee

(6) Member of the Business Transformation Committee

(7) Mr. Arnett was Counsel to Fraser Milner Casgrain LLP until retiring as of January 31, 2010. He was also replaced as a member of the Audit and Finance Committee by George L. Cooke, a new director, as of February 11, 2010.

- (8) Douglas E. Speers was appointed Chair of the Board of Directors of Hydro One Inc., on an interim basis, on December 8, 2008, replacing James Arnett who was Chair of the Board from March 31, 2008 until his resignation on December 8, 2008 following his appointment as Special Advisor to the Premier of Ontario on the automobile industry. Having resigned as a Special Advisor to the Premier of Ontario, Mr. Arnett was re-appointed as Chair of the Board of Directors effective February 17, 2009.

James Arnett was appointed Chair of Hydro One Inc. on March 31, 2008 which position he held until December 8, 2008 and was re-appointed Chair of Hydro One Inc. on February 17, 2009. His distinguished career as a senior executive, corporate director and lawyer also includes special assignments with the Government of Ontario. He was Counsel to Fraser Milner Casgrain LLP until retiring as of January 31, 2010. Mr. Arnett chaired the Province of Ontario's 2007 Agency Review Panel that reviewed the way compensation is set for senior executives in Ontario's electricity sector agencies, and how those agencies can work together more efficiently. He was special advisor to the Premier of Ontario on the steel industry from 2004-2006 and on the automobile industry from 2008-2009. Mr. Arnett is a former president and CEO of Molson Inc. and between 1997 and 2000, he led Molson's transformation from a diversified holding company to a focused brewing company. Prior to that, he was a senior partner in a major Canadian law firm as the Toronto Corporate/Commercial Head and as resident partner in the firm's Washington, D.C. office. He is a Past Chair of the Toronto East General Hospital. Mr. Arnett holds a Bachelor of Arts degree and an LL.B from the University of Manitoba and an LL.M from the Harvard Law School.

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

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

Laura Formusa was appointed President and Chief Executive Officer, Hydro One Inc., on November 23, 2007, having served as the company's acting President and Chief Executive Officer since December 8, 2006. Ms. Formusa's career spans more than 30 years at Ontario

Hydro and Hydro One Inc. She practised law in the areas of corporate/commercial, regulatory and environment and held various senior positions within the company until being appointed Hydro One's General Counsel in 2003. Ms. Formusa earned her Bachelor of Laws degree at Osgoode Hall Law School and was admitted to the Law Society of Upper Canada in 1980, following her call to the Bar of Ontario. Ms. Formusa is currently serving a second term as Trustee to the Banting Research Foundation. She has been a Director of our company since March 30, 2007.

Don MacKinnon has been President of the Power Workers' Union, an electricity industry workers union, since May 2000 and a lineman by trade since 1971. He was Vice-President of the Union for 11 years prior to being elected President. In 2000, Mr. MacKinnon was appointed by the Minister of Energy, Science and Technology to the Electricity Transition Committee. He was a member of the Board of Directors of the Electrical and Utilities Safety Association and the Retail Management Board of Ontario Hydro. In 2003, Mr. MacKinnon was appointed by the Minister of Energy to the government's Electricity Conservation and Supply Task Force. In 2005, Mr. MacKinnon became a member of the Canadian Nuclear Association's Board of Directors. He is also a member of the National Round Table on the Environment and the Economy, and a member of the Minister of Energy and Infrastructure's Advisory Committee. Mr. MacKinnon has been a Director of our company since June 11, 2002.

Michael J. Mueller is a former Global leader of PricewaterhouseCoopers' (PwC) Private Company Services/Middle Market Practice and a former member of PwC's Global Audit Leadership Team, Global Advisory Leadership Team and the Global Markets Council. Prior to his retirement from PwC in July 2007, his previous positions with the firm also included National Managing Partner for Canada and Senior Relationship Partner for a number of the firm's most significant clients. He is also a Chartered Accountant, and a Chartered Business Valuator. Until 2009, he was a Certified Insolvency Practitioner. In December 2008, Mr. Mueller was appointed to the Ontario Economic Advisory Panel by the Minister of Finance of Ontario. Mr. Mueller's past community involvement includes: member of the Board of Governors of the Stratford Shakespearean Festival of Canada; President of the Windsor Symphony Society; President, Better Business Bureau of Windsor and Essex Counties; and is a current Director of the Windsor Essex Development Commission. He has been a Director of our company since March 30, 2007.

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

Robert L. Pace is the President and Chief Executive Officer of The Pace Group Ltd. The Pace Group owns and operates a number of companies across Atlantic Canada, including: Maritime Broadcasting System Ltd., a 24 radio station group; MBS Realty Ltd.; Green Waste Systems Inc. and Shredder's. He began his professional career with the Halifax law firm Chandler Moore, where he practiced family and commercial law. Between 1981 and 1984, Mr. Pace served as

Atlantic Advisor to the Prime Minister of Canada. Mr. Pace is currently a member of the Board of Directors of Canadian National Railway Company; Overland Realty Limited (Chairman of the Board); Canadian Health Care Consulting Services Ltd.; High Liner Foods Incorporated; the Atlantic Salmon Federation; the Asia Pacific Foundation; and the Public Gardens Restoration Committee (Halifax). Mr. Pace was called to the Nova Scotia Bar in 1981 following the completion of his Bachelor of Laws degree at Dalhousie University, where he also completed an MBA in 1977. He has been a Director of our company since March 30, 2007.

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

Douglas E. Speers is the former Chairman and Director of Emco Corporation, a leading Canadian distributor of building materials for the residential, commercial and industrial construction markets. Prior to his appointment as Chairman of Emco Corporation, Mr. Speers was Emco's President and CEO from 1997 - 2004. Between 1971 and 1988, he held several senior positions with Imperial Oil Ltd. in Canada and Exxon International in New York City. Mr. Speers is a Professional Engineer - Province of Ontario, a member of the Advisory Board of the Richard Ivey School of Business, and past Chair and Director of the Ivey Management Services Company. He is a member of the boards of a number of privately-held companies and has been a Director of our company since November 10, 2005.

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

### **Information Regarding Certain Directors**

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

### **Executive Officers**

The following table sets forth the name, municipality of residence and position of each of our executive officers as of December 31, 2009.

**Name and Municipality of Residence**

**Position With Our Company**

James Arnett  
Toronto, Ontario  
Canada

Chair of the Board of Directors of Hydro One  
Inc.

Laura Formusa  
Toronto, Ontario  
Canada

President and Chief Executive Officer

Sandy Struthers  
Toronto, Ontario  
Canada

Senior Vice-President and Chief Financial  
Officer (effective February 12, 2009)

Joseph Agostino  
Toronto, Ontario  
Canada

General Counsel

Myles D'Arcey  
Toronto, Ontario  
Canada

Senior Vice-President, Customer Operations

Tom Goldie  
Mississauga, Ontario  
Canada

Senior Vice-President, Corporate Services

Nairn McQueen  
Dundas, Ontario  
Canada

Senior Vice-President, Engineering &  
Construction Services (effective April 15, 2009)

Geoff Ogram  
Toronto, Ontario  
Canada

Senior Vice-President, Special Advisor to the  
President and CEO effective March 1, 2009  
(retired March 1, 2010)

Carmine Marcello  
Thornhill, Ontario  
Canada

Senior Vice-President, Asset Management and  
Corporate Projects (effective April 15, 2009)

Wayne Smith  
Toronto, Ontario  
Canada

Senior Vice-President, Grid Operations  
(effective April 15, 2009)

Peter Gregg  
Oakville, Ontario  
Canada

Senior Vice-President, Corporate & Regulatory  
Affairs

<b><u>Name and Municipality of Residence</u></b>	<b><u>Position With Our Company</u></b>
John Fraser Mississauga, Ontario Canada	Vice-President, Internal Audit & Chief Risk Officer
John Macnamara Waterdown, Ontario Canada	Vice-President, Health, Safety & Environment

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

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

Sandy Struthers was appointed as Senior Vice-President and Chief Financial Officer effective February 12, 2009. Mr. Struthers joined Hydro One in 2000 as a Director in the Finance area and has held a number of senior positions in Finance, including Director, Financial Strategy and Director, Merger & Acquisitions Finance. In 2005, he was appointed to the position of Chief Information Officer where he implemented a number of significant advancements in our company's IT infrastructure.

Joseph Agostino was appointed as General Counsel on December 13, 2007, after having served as Acting General Counsel since December 8, 2006. He joined Ontario Hydro in 1995 and has previously held the position of Assistant General Counsel of Hydro One Networks Inc.

Myles D'Arcey was appointed as Senior Vice-President, Customer Operations of Hydro One Networks Inc. on May 1, 2005. Mr. D'Arcey is also President and Chief Executive Officer of Hydro One Remote Communities Inc. He joined Ontario Hydro in 1978 and has held the position of Vice President, Station Services of Hydro One Networks Inc.

Tom Goldie was appointed as Senior Vice-President, Corporate Services of Hydro One Networks Inc. on September 16, 2002. He joined Ontario Hydro in 1977 and has held the position of Vice-President, Human Resources of Hydro One Inc.

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

Geoff Ogram was appointed Senior Vice-President, Special Advisor to the President and CEO effective March 6, 2009 after serving as Vice-President, Asset Management of Hydro One Networks Inc. from January 1, 2005. He joined Ontario Hydro in 1981 and has held the position of Vice-President, Strategy & Development of Hydro One Networks Inc. Mr. Ogram retired March 1, 2010.

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

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

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

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

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

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

### **Indebtedness of Directors and Executive Officers**

As of March 1, 2010 and since the beginning of the most recently completed financial year of Hydro One, no director, executive officer, employee, former director, former executive officer or former employee or associate of any director or executive officer of Hydro One or any of its subsidiaries had any outstanding indebtedness to Hydro One or any of its subsidiaries except routine indebtedness or had any indebtedness that was the subject of a guarantee, support agreement, letter of credit or other similar arrangement or understanding provided by Hydro One or any of its subsidiaries.

## **INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS**

### **Relationships with the Province and Other Parties**

#### *Overview*

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

The OEB is the principal regulator of Ontario's electricity industry. The Province appoints the members of the OEB and fills any vacancies on the OEB. The OEB is obligated to implement approved directives of the Province concerning general policy and objectives to be pursued by the OEB and other directives aimed at addressing existing or potential abuses of market power by industry participants. The IESO directs the operation of our transmission system. The Board of Directors of the IESO, other than its Chief Executive Officer, is appointed by the Province in accordance with the regulations in effect from time to time under the *Electricity Act, 1998*.

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

#### *Transfer Orders*

The transfer orders pursuant to which we acquired Ontario Hydro's electricity transmission, distribution and energy services businesses as of April 1, 1999 did not transfer any asset, right, liability or obligation where the transfer would constitute a breach of the terms of any such asset, right, liability or obligation or a breach of any law or order. The transfer orders also did not transfer title to some assets located on lands held for bands or bodies of Indians under the *Indian Act* (Canada). The transfer of title to these assets did not occur because authorizations originally granted by the Canadian Minister of Indian and Northern Affairs for the construction and operation of these assets could not be transferred without the consent of such Minister and the relevant Indian bands or bodies or, in several cases, because the authorizations had either expired or had never been properly issued. These assets consist primarily of approximately 82 km of transmission lines and distribution lines used to deliver electricity on reserves (of which 14 km of lines are used solely for serving customers off the reserves). OEFC holds these assets.

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

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

The transfer orders do not contain any representations or warranties from the Province or OEFC with respect to the transferred officers, employees, assets, liabilities, rights and obligations. Furthermore, under the *Electricity Act, 1998*, OEFC was released from liability in respect of all assets and liabilities transferred by the transfer orders, except for liability under our indemnity from OEFC as discussed below. By the terms of the transfer orders, each transferee indemnifies OEFC with respect to any assets and liabilities not effectively transferred, and is obligated to take all reasonable measures to complete the transfers where the transfers were not effective.

### *Indemnities*

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

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

The indemnity does not cover the first \$10,000 in value of each claim and only applies to the amount by which the total of all claims exceeds \$10 million. We are obliged to pay OEFC a fee for the indemnity of \$5 million per year until such time as the parties agree that the indemnity should be terminated. We anticipate that we will require the indemnity until all indemnifiable claims have been identified and finally determined by a non-appealable court order. The indemnity ceases to be available to any of our subsidiary corporations if we cease to control them unless the cessation of ownership results from the sale of the shares of a subsidiary in connection with the enforcement of security on such shares by an arm's-length creditor of Hydro One. The indemnity can be assigned under some conditions with the consent of the Minister of Finance.

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

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

### *Transmission Corridors*

On June 27, 2002, the Province passed the *Reliable Energy and Consumer Protection Act, 2002* that provided for, among other things, ownership of all transmission corridor and abutting lands to be transferred from us to the Province in exchange for a statutory right to use the lands for transmission and distribution purposes effective December 31, 2002. Corridor land totalling 49,673 acres with a net book value of approximately \$259 million was transferred to the Province. In addition, ownership of land assets with a net value of approximately \$7 million, not then in use, was transferred to the Province and applied as a reduction of shareholder's equity. We also retained the obligation to incur certain ongoing expenditures related to our use of this land, including maintenance, property taxes and any future environmental remediation work that may be required by the Province. The OEB is authorized to restrict or discontinue any use of the transmission corridor lands that interferes with the transmission system. The Province later decided to return certain lands to us. During 2003-2005, the Province returned approximately 7,271 acres of lands with a net book value of \$38.2 million.

### *Operational Matters*

Hydro One receives its revenues, which are in part collected by the IESO from customers, in accordance with the rules established under the *Electricity Act, 1998* and the *Ontario Energy Board Act, 1998*, as amended from time to time.

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

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

### *Payments in Lieu of Corporate Taxes*

We and our subsidiaries are exempt from taxes under the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario) and the *Taxation Act, 2007* (Ontario) because we are wholly owned by the Province and each of our subsidiaries is, in turn, wholly owned (directly or indirectly) by us. However, pursuant to the *Electricity Act, 1998*, we and each of our subsidiaries are required to pay amounts to the OEFC, which are referred to as payments in lieu of corporate taxes or proxy taxes, in respect of each taxation year, generally equal to the amount of tax that we would be liable to pay under the *Income Tax Act* (Canada) and for the taxation years ending

prior to January 1, 2009, the *Corporations Tax Act* (Ontario) and the *Taxation Act, 2007* (Ontario) thereafter if we were not exempt from taxes thereunder.

### *Memorandum of Agreement*

We entered into a memorandum of agreement with the Province in March 2008 relating to our mandate, responsibilities, performance expectations and executive compensation. Under this agreement, we must prepare investment plans for new transmission and distribution projects and prioritize investments in transmission and distribution capacity to support projects necessary to maintain ongoing grid security and reliability. This agreement also requires that we undertake special initiatives communicated from time to time by the Province by way of unanimous shareholder agreement or declaration in accordance with the provisions of the *Business Corporations Act* (Ontario). Additionally, this agreement requires that we obtain approval from the Province in advance of any proposal to issue or transfer shares in Hydro One or its subsidiaries, any major transaction, including the sale of assets, which would potentially have a material effect on the financial interest of the Province or our ability to make payments to OEFC or payments in lieu of corporate taxes (proxy taxes) under the *Electricity Act, 1998*.

Effective September 24, 2008, the Province made a declaration pursuant to the memorandum of agreement and Section 108 of the *Business Corporations Act* (Ontario) (the “Shareholder Directive”) pertaining to off-shoring of jobs under the outsourcing arrangement with Inergi LP (the “Inergi Agreement”). The declaration allows the Province to assume all decision-making power in respect of the off-shoring of jobs under the Inergi Agreement and removes these powers from the Board of Directors of Hydro One. The directors and officers of Hydro One are charged with performing that which is necessary to carry out the intention of the Shareholder Directive. Copies of the memorandum of agreement and the Shareholder Directive have been filed with the securities regulatory authorities in each province of Canada and are available at [www.sedar.com](http://www.sedar.com).

### **TRUSTEES AND REGISTRARS**

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

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

### **MATERIAL CONTRACTS**

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

- (a) (i) a third supplemental trust indenture dated as of January 31, 2003 relating to the issuance of Series 4 Notes in the aggregate principal amount of \$1,000,000,000, of which \$200,000,000 was drawn down on January 31, 2003, \$120,000,000 was drawn down on June 25, 2004 and \$65,000,000 was drawn down on August 24, 2004, pursuant to the Trust Indenture dated as of June 4, 2001 between Hydro One and Computershare Trust Company of Canada (the “Trust Indenture”);

- (ii) a fourth supplemental trust indenture dated as of April 22, 2003 relating to the issuance of Series 5 Notes in the aggregate principal amount of \$1,000,000,000, of which \$250,000,000 was drawn down on April 22, 2003 and \$65,000,000 was drawn down on August 20, 2004, pursuant to the Trust Indenture;
- (iii) a fifth supplemental trust indenture dated as of June 23, 2003 relating to the issuance of Series 6 Notes in the aggregate principal amount of \$1,000,000,000, of which \$500,000,000 was drawn down on June 23, 2003, pursuant to the Trust Indenture;
- (iv) a sixth supplemental trust indenture dated as of February 24, 2004 relating to the issuance of Series 7 Notes in the aggregate principal amount of \$1,000,000,000, of which \$250,000,000 was drawn down on February 24, 2004, and \$150,000,000 was drawn down on May 19, 2005, pursuant to the Trust Indenture;
- (v) a seventh supplemental indenture dated as of November 15, 2004 relating to the issuance of Series 8 Notes in the aggregate principal amount of \$1,000,000,000, of which \$400,000,000 was drawn down on November 15, 2004, pursuant to the Trust Indenture;
- (vi) an eighth supplemental indenture dated as of May 19, 2005 relating to the issuance of Series 9 Notes in the aggregate principal amount of \$1,000,000,000, of which \$350,000,000 was drawn down on May 19, 2005 and \$250,000,000 was drawn down on April 24, 2006, pursuant to the Trust Indenture;
- (vii) a ninth supplemental trust indenture dated as of March 3, 2006 relating to the issuance of Series 10 Notes in the aggregate principal amount of \$1,000,000,000, of which \$300,000,000 was drawn down on March 3, 2006 and \$150,000,000 was drawn down on August 22, 2006, pursuant to the Trust Indenture;
- (viii) a tenth supplemental trust indenture dated as of October 19, 2006 relating to the issuance of Series 11 Notes in the aggregate principal amount of \$1,000,000,000, of which \$75,000,000 was drawn down on October 19, 2006, pursuant to the Trust Indenture;
- (ix) an eleventh supplemental trust indenture dated as of March 13, 2007 relating to the issuance of Series 12 Notes in the aggregate principal amount of \$1,000,000,000, of which \$400,000,000 was drawn on March 13, 2007, pursuant to the Trust Indenture;
- (x) a twelfth supplemental trust indenture dated as of October 18, 2007 relating to the issuance of Series 13 Notes in the aggregate principal amount of \$1,000,000,000, of which \$300,000,000 was drawn down on October 18, 2007 and \$300,000,000 was drawn down on March 3, 2008, pursuant to the Trust Indenture;

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

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

- (b) a Dealer Agreement dated July 27, 2009 between our company and BMO Nesbitt Burns Inc., Casgrain & Company Limited, CIBC World Markets Inc., HSBC Securities (Canada) Inc., Laurentian Bank Securities Inc., National Bank Financial Inc., RBC Dominion Securities Inc., Scotia Capital Inc. and TD Securities Inc. (collectively, the “Original Dealers”), as amended by Amendment No. 1 thereto dated March 2, 2010 between our company and the Original Dealers

to add Desjardins Securities Inc. and Merrill Lynch Canada Inc. as dealers thereunder (together with the Original Dealers, the “Dealers”), relating to the public offering of unsecured medium term notes of Hydro One in a maximum aggregate principal amount of up to \$3,000,000,000. The Dealer Agreement, as amended, provides for the appointment of the Dealers as non-exclusive agents of Hydro One to solicit, from time to time, offers to purchase its medium term notes in Canada and, in certain circumstances, the United States.

Copies of these documents are available on [www.sedar.com](http://www.sedar.com).

## **INTERESTS OF EXPERTS**

For the year ended December 31, 2009, KPMG LLP provided the following services to our company:

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

For the year ended December 31, 2008, KPMG LLP provided the following services to our company:

- (a) quarterly review of our company’s consolidated financial statement;
- (b) annual audit of our company’s consolidated financial statements
- (c) annual audit of Hydro One Networks Inc.’s transmission and distribution business, Hydro One Remote Communities Inc.’s and Hydro One Brampton Network Inc.’s financial statements; and
- (d) annual audit of our company’s pension fund and the following companies which hold our alternative asset investments: HOPF\_HFG Investment Ltd., HOPF\_HFM Investments Ltd., HOPF\_PEJ Investments Ltd. and HOPF-PEP Investments Ltd.

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

For the year ended December 31, 2009, Deloitte & Touche LLP provided an annual valuation of our company’s goodwill balance (valuation report prepared).

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

- (a) annual accounting actuarial valuation (valuation report prepared) for registered and unregistered pension and other post-employment and post retirement plans;
- (b) tri-annual funding actuarial valuation (last valuation completed as of December 31, 2006, filed in September 2007); and
- (c) annual accounting actuarial valuation for supplementary pension plan for purposes of letters of credit (valuation report prepared).

#### **ADDITIONAL INFORMATION**

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

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

## STATEMENT OF EXECUTIVE COMPENSATION

### Compensation Discussion and Analysis

#### Overview

The objective of Hydro One's executive compensation program is to establish pay levels based on performance, to be competitive with Canadian utility and energy companies and other comparable companies, both publicly and privately owned, and to attract, motivate and retain executives. The recruitment and retention of a management team with the skills necessary to sustain and develop a safe, efficient and reliable electricity delivery system is critical for Hydro One's current and long-term success. Considering the risks associated with our employee demographics and the competitive market for skilled energy sector employees described below, attracting and retaining knowledgeable and motivated executives is a fundamental premise of our executive compensation program and strategy.

Hydro One faces the same challenges that other Canadian utilities presently face, and in particular the same challenges confronting the electricity industry in North America, with respect to employee demographics and the competitiveness of the market for skilled employees. The Electricity Sector Council's National Labour Market Information Study confirms significant staff shortages are expected in the executive and management ranks of the sector across Canada over the next five years. By the end of 2009, approximately 17% of Hydro One's employees were eligible for retirement and by 2011 there may be more than 25% eligible to retire. Typically, employees working in head office functions retire shortly after they become eligible to retire while those working in the field environment generally work until reaching 35 years of service or maximizing their pension benefit. To be successful, Hydro One needs to attract and retain sufficient qualified staff to replace those retiring as well as to position the company for its large work and infrastructure program. This will be challenging as the labour market for the industry continues to be highly competitive. Thus, compensation that will attract qualified people is a key objective of our program.

Many Hydro One employees possess experience and skills that are highly sought after by other organizations both inside and outside the electricity sector. Accordingly, retention of management is an important objective of our executive compensation strategy.

The company's overall compensation objective is to target total compensation (base salary, incentive plan values, pension and benefits) at the 50<sup>th</sup> percentile of total compensation (i.e. salary, plus target bonus, plus annualized net present value of long term incentive, plus benefits, plus pension) of the 50/50 blend of public and private sector entities that form our comparator group, which is discussed below.

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

## **Governance – The Human Resources and Public Policy (HRPP) Committee**

The HRPP Committee of the Hydro One Board of Directors is entirely independent of management. It is responsible for Board oversight of human resources issues including compensation. Its mandate with respect to its advisory functions on executive compensation is to annually review and recommend to the Board for approval:

- all management salary ranges;
- Hydro One’s total compensation practices for all employees;
- any adjustment to the President and Chief Executive Officer’s base salary;
- the short term incentive payout to the President and Chief Executive Officer;
- the corporate performance measures for Hydro One; and
- Hydro One’s performance against its corporate performance measures.

In connection with its exercise of its powers, the HRPP Committee annually reviews and approves:

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

The HRPP Committee engaged the services of Hugessen Consulting Inc. to provide advice on the competitiveness and effectiveness of the company’s compensation programs. During 2009, Hugessen Consulting Inc. was paid \$89,076.49 for its advice.

## **Elements of Compensation**

Compensation for executive officers consists of a base salary, performance-based pay through the Incentive Plan, pension and health and dental benefits, each of which is described in more detail below. Each of the Named Executive Officers (“NEOs”), namely, Ms. Formosa, Mr. Struthers, Mr. D’Arcey, Mr. Goldie, and Mr. Marcello was entitled under their respective employment agreements to these elements of compensation. Hydro One does not provide its senior management with personal club memberships, car allowances or entertainment accounts.

The Total Cash Compensation (“TCC”) component of the program is comprised of base salary plus the Incentive Plan. The TCC is set relative to the Total Direct Compensation (“TDC”) of the comparator group (base salary, short term incentive, and long term incentive) in aggregate. For all management employees, the maximum amount payable for the Incentive Plan payment is a percentage of base pay fixed according to the band and salary range level of the employee. For the NEOs, other than the President and Chief Executive Officer, the maximum amount payable for the Incentive Plan payment is 60% of the base salary of the NEO. For all the NEOs, the maximum achievable TCC amount is the base salary and the full award under the Incentive Plan. The value of the Incentive Plan component of TCC reflects short term incentives in the comparator group. The value of base salary tracks at a higher level than those in the comparator

group to compensate for the long term compensation component provided by many entities in the comparator group. Hydro One does not have a long term incentive plan.

In May 2007, the Agency Review Panel (See “General Development of the Business - Agency Review Panel” for additional information) made its recommendations regarding executive compensation at five named provincial electricity sector institutions (which included Hydro One) to the Minister of Energy who announced in June 2007 that the recommendations had been accepted by the Province. Hydro One complied with the relevant recommendations and implemented guidelines with respect to the compensation of new executives and senior management. For 2009 and thereafter, Hydro One established the following methodology for current and new management employees in the company including current and new executives and senior management:

- Use comparative market data based on a 50/50 blend of public and private sector companies in determining total compensation.
- Establish total compensation relative to the 50<sup>th</sup> percentile of total compensation (i.e. salary, plus target bonus, plus annualized net present value of long-term incentive, plus benefits, plus pension) of the 50/50 blended market data.

The HRPP Committee approved a new comparator group with the assistance of external compensation advisors, the Hay Group. The comparator group consists of 32 Canadian-based entities (16 public and 16 private), approximately 2/3 of which are utilities (primarily electric). Four of these entities are not reportable segments of their reporting parent and therefore financial information was not available. Of the 28 entities in the comparator group with publicly available financial information, approximately 68% are smaller in size when compared to Hydro One, based on both revenues and assets, according to their most recent publicly available annual financial statements.

The company engaged the services of an independent consultant from the Hay Group to provide advice and counsel on compensation matters, including executive compensation. These services were distinct from those provided directly to the HRPP Committee by Hugessen Consulting Inc. referred to above. During 2009, the Hay Group was paid \$18,014.60 for its advice.

The list of comparator group companies is as follows:

<b>Public Sector</b>	<b>Private Sector</b>
British Columbia Hydro and Power Authority	ArcelorMittal Dofasco Inc.
Business Development Bank of Canada	Barrick Gold Corporation
Canada Mortgage and Housing Corporation	Bell Canada
Canada Post Corporation	Bruce Power
Enersource Hydro Mississauga	CN Rail
Farm Credit Canada	Enbridge Gas Distribution Inc.
Government of Ontario	Fortis Inc.
NB Power Holding Corporation	Newfoundland Power
Newfoundland and Labrador Hydro	Nova Chemicals Corporation
Ontario Power Authority	Nova Scotia Power Inc.

<b>Public Sector</b>	<b>Private Sector</b>
Ontario Power Generation	Petro-Canada
PowerStream Inc.	Rio Tinto Alcan
SaskEnergy Incorporated	Siemens Power Corporation
Sask Power	Ultamar Ltee
Sask Tel	Vale Inco Limited
Toronto Hydro Corporation	Xstrata Nickel Canada
Total 16	Total 16

### **(1) Base Salary**

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

The actual level of base salary, within the approved range for each executive officer, including the NEOs, is determined on the basis of job function and the individual's performance and experience. The President and Chief Executive Officer annually submits a base salary recommendation to the HRPP Committee for each of her direct reports. As noted above, the HRPP Committee sets the base salary of such executives and then reports its decision to the Board of Directors. The HRPP Committee brings a base salary recommendation for the President and Chief Executive Officer to the Board of Directors for approval.

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

### **(2) Performance-Based Compensation**

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

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

For the purposes of determining the amount of short term incentive payable to the President and Chief Executive Officer, specific weightings and levels of achievement are established by the HRPP Committee and are assigned to each corporate performance measure incorporated in her performance contract. In addition, other specific qualitative and leadership goals are also taken

into account by the HRPP Committee. The assessment of the President and Chief Executive Officer is conducted by the HRPP Committee and approved by the Hydro One Board of Directors.

For management employees, the maximum allowable short term incentive is established for each band of management employees and is fixed as a percentage of base pay for that particular band. For each of the NEOs, potential awards range between 0% and a maximum of 60% of base salary. For the year ended December 31, 2009, the potential award ranges for the NEOs were as follows: between 0% and 25% of base salary for Ms. Formusa, and between 0% and 60% of base salary for each of Mr. Struthers, Mr. D'Arcey, Mr. Goldie, and Mr. Marcello. The range for Ms. Formusa was set by the HRPP Committee and approved by the Board in 2007. The range for the NEOs other than the President and Chief Executive Officer was established by the HRPP Committee and approved by the Board. These ranges for NEOs did not change from 2008 to 2009. There are two components to performance-based compensation for NEOs other than the President and Chief Executive Officer: fund determination and fund allocation. These components will be described separately.

**Fund Determination:** The maximum percentage for funding is at the discretion of the Hydro One Board of Directors, based on a recommendation by the HRPP Committee. The funds available for the direct reports of the President and Chief Executive Officer (which includes the NEOs other than the President and Chief Executive Officer) is a percentage of the total payout which would be payable assuming each individual earned his or her maximum allowable short term incentive. In 2009, the maximum percentage of funds available for direct reports to the President and Chief Executive Officer was set at 65% of this total potential payout. In 2008, this maximum percentage of funds was set at 75% of the total potential payout; accordingly, for 2009, this represented a 13% reduction of the percentage of funds available compared to 2008. This determination was made by the HRPP Committee of the Board, and recommended to, and approved by, the Board of Directors, by measuring the company's performance at the end of the year against various corporate performance targets and measures set at the beginning of the year.

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

#### (a) Corporate Performance Measures and Targets

The HRPP Committee develops Hydro One's corporate performance measures and targets annually at the beginning of each year through the use of a balanced scorecard. A balanced scorecard is designed to measure corporate performance broadly, covering all key aspects of corporate performance. Measures included in the scorecard are designed to ensure that corporate productivity is enhanced and the corporate strategy is achieved.

In the fall of each year, Hydro One's management identifies the key measures and targets which it believes will drive corporate performance during the course of the following year and presents

these recommended measures and targets to the HRPP Committee. For 2009, the corporate performance measures were tied to Hydro One’s corporate strategy which was approved in November 2008. See “Description of the Business - Our Strategy” for additional information. Over the next few months, management and the HRPP Committee reviewed, considered and assessed the measures and targets to ensure they covered all key aspects of corporate performance and were robust enough to drive superior performance and corporate strategy implementation. The HRPP Committee then recommended the measures and targets to the full Board of Directors for approval. These measures and targets are based on Hydro One’s key strategic goals in the areas of safety, customer satisfaction, continuous innovation, reliable transmission and distribution, protecting the environment, recruitment and knowledge transfer, shareholder value and productivity.

The following table sets out Hydro One’s corporate performance measures for 2009, which were aligned to its strategic objectives and the targets for each of those measures. In 2009, Hydro One met or exceeded 8 of the 13 targets. The context of those targets is described in more detail under each strategic objective heading below.

Strategic Objective	Performance Measure	Year-End	
		Actual	Target
<b>Injury-free Workplace</b>	Lost Time Injuries (# of lost time injuries per 200,000 hours worked)	0.3	0.3
<b>Satisfying our Customers</b>	Customer Satisfaction (6 customer segments)	83	88
<b>Continuous Innovation</b>	Fully-Enabled Smart Meters	746,865	800,000
<b>Reliable Transmission and Distribution</b>	Transmission Frequency of Unplanned Customer Interruptions on 115/230KV Network System	0.28	0.26
	Transmission Duration of Unplanned Customer Interruptions on 115/230KV Network System	19.7	12.4
	Distribution Duration of Customer Interruptions	7.0	7.4
<b>Protecting Environment</b>	Oil Spills (% recovered from oil-filled electrical equipment spills)	97%	90%
	Greenhouse Gas Reductions (# Metric Tonnes of Greenhouse Gas Removed)	525	400
<b>Recruitment/ Knowledge Transfer</b>	Employee Survey	3.63	3.68
<b>Shareholder Value</b>	Net Income After Tax (\$M)	470	448
	Credit Rating (Long Term Debt Rating Category)	A	A
<b>Productivity</b>	Transmission Unit Cost (Capital and O&M per asset) %	10.1	10.6
	Distribution Unit Cost (Capital and O&M per km of line) \$’000s	6.2	6.1

The scorecard is intentionally not weighted. Each measure is key to driving corporate performance, and all of the measures are interrelated. In terms of assessing performance, the

HRPP Committee is required to exercise judgment in weighing the results for each measure and determining whether overall corporate performance, as reflected through scorecard performance, is met. If, on balance, scorecard performance is met or exceeded, the short term incentive fund may be funded to a percentage of the maximum short term incentive payout, from 0% to 100%, based on the recommendation of the HRPP Committee, but subject to the ultimate discretion of the Board of Directors. If, on balance, scorecard performance is not met, the HRPP Committee will determine and recommend a funding level, also subject to the ultimate discretion of the Board of Directors. For 2009, Hydro One's Board of Directors intended to take the same approach as in 2008 in which the funding level was set at 75% of the maximum short term incentive fund. This determination was based on the assumption that all scorecard performance targets for 2009 would be met and, in the event that targets were not met, the Board of Directors retained the discretion to reduce the short term incentive further. For 2009, while the majority of targets were met or exceeded, some were not met, and the funding level was determined, in the exercise of the Board's discretion, to be 65% of the maximum short term incentive fund; that is, approximately 13% less than it would have been if the targets had been met.

### *1. Safety*

With respect to safety, the potentially hazardous nature of Hydro One's business demands constant focus in this area. Safety is the primary value of the company and its first key strategic objective. The safety of our employees is paramount. For 2009, Hydro One measured the number of lost time incidents per 200,000 hours worked. This is a measure used throughout the industry and is benchmarked against comparable and leading companies. In 2009, Hydro One targeted a lost time injury frequency of 0.3 and met this target.

### *2. Customer Satisfaction*

Keeping customers satisfied is an integral part of Hydro One's business focus. Customer satisfaction measures the degree to which our customers are satisfied with the service they receive from our company. Additionally, corporate reputation is a key influencer in customer satisfaction. As a result, Hydro One focused on improving its reputation. Hydro One was honoured by Corporate Knights as the Top Corporate Citizen for 2009. Customer satisfaction is measured on the results of various customer surveys conducted on Hydro One's behalf by independent third parties. In 2009, we targeted a customer satisfaction rate of 88% and achieved 83%, thus not meeting the target. While the results of this measure were below target, overall performance has steadily improved since 2003 when customer satisfaction was at 61%.

### *3. Continuous Innovation*

We are committed to identifying and providing innovative solutions that will improve the reliability and efficiency of electricity delivery and allow our customers more capability to manage their power costs. Among our continuous innovation initiatives, the installation of smart meters was a priority in 2009. We installed 1,217,000 meters to date, of which 747,000 meters are communicating at a level capable of reliable meter reading. We fell short of our 2009 target of 800,000 meters enabled for meter reading due to the need to develop new technologies better suited for our rural environment.

#### *4. Reliability of Transmission and Distribution*

Hydro One aims to retain and build public confidence and trust in its operations, as stewards of Ontario's electricity grid. In 2009, Hydro One continued its focus on this strategic priority by investing in the key assets of the electricity delivery system and by operating the existing system for customers in a safe, reliable and efficient fashion. Transmission reliability measures the frequency and duration of unplanned customer interruptions and compares the results of Hydro One's performance with other large sized participants of the Canadian Electricity Association ("CEA"). Reliability is influenced by weather patterns and generation constraints and accordingly, to achieve results, Hydro One requires good performance from both its transmission and distribution systems. Distribution reliability measures the duration of customer interruptions. Hydro One is conscious that businesses of all sizes require a reliable service to allow them to deliver their products and services and that customers' expectations are for a reasonably limited duration of interruption.

With respect to transmission, in 2009, Hydro One targeted 0.26 interruptions per delivery point for its frequency of unplanned interruptions. In August 2009, severe thunderstorms and a number of tornado touchdowns in Southern Ontario caused numerous momentary outages to various 230kV circuits. The line terminal breakers associated with these circuits reached their duty cycle limits and the breakers were no longer available for service. This resulted in the load loss at a number of transformer stations lasting about 3.75 hours. The year-end frequency of unplanned customer interruptions was 0.28, which is higher than the year-end target of 0.26.

For duration of unplanned customer interruptions on the transmission side, the target was 12.4 minutes per delivery point. The duration of unplanned customer interruptions at year-end was 19.7 minutes, higher than the target. The long duration interruption at the Dufferin TS in January, along with additional events in March through June, and a Force Majeure event in August contributed to the results.

On the distribution side, the target for 2009 for the duration of customer interruptions was set at 7.4 hours per customer and Hydro One was able to do better than the target, achieving 7.0 hours per customer.

#### *5. Protecting the Environment*

A major part of Hydro One's initiatives is to assist customers in reducing their carbon footprint through the delivery of clean and renewable energy and through measures that allow our customers to manage and reduce their energy use. In the spirit of sustaining the environment, Hydro One developed two key measures related to (i) the recovery of oil spills and (ii) greenhouse gas reduction. Regarding oil spills, Hydro One targeted a 90% recovery rate from oil filled electrical equipment spills. Hydro One exceeded this target with a 97% recovery rate. With respect to greenhouse gas reduction, Hydro One established a target of 400 metric tons of greenhouse gas removed and was able to exceed this target through its initiatives related to its fleet (vehicle) program, achieving 525 metric tons of greenhouse gas removed. Hydro One's efforts to improve both fuel efficiency and environmental management of its fleet of service vehicles recently earned it the gold rating from Canada's Energy, Environment and Excellence group. This program recognizes companies and governments who increase fuel efficiency in their fleets and reduce their carbon footprint and who demonstrate leadership in fleet management excellence.

## *6. Recruitment/Knowledge Transfer*

Hydro One's greatest assets are its employees. As previously noted, Hydro One is addressing the issue of labour demographics and in particular the inevitable retirement of a significant number of employees within the near future. With such departures come challenges for the company, not only in the loss of knowledgeable and skilled employees but also on its ability to retain and attract talent and to drive productivity throughout the organization. Pursuing this goal, Hydro One focussed on increasing employee engagement throughout the company as an engaged workforce is one in which employees embrace the corporate values of safety, stewardship, excellence and innovation. Engagement is achieved through providing and receiving development, with knowledge transfer being a significant type of employee development which will occur over the foreseeable future given the company's demographics. The process of measuring and improving such engagement began in 2008 by means of an employee engagement survey and follow up action plans administered by an independent third party expert and the target is to improve the grand mean score year over year. While the response rate to the survey improved dramatically in 2009, and there was significant improvement from the 2008 grand mean score of 3.51, the target of improving the grand mean score to 3.68 in 2009 was not met and the actual score was 3.63.

## *7. Shareholder Value*

Achievement of strong financial performance is measured by our two performance measures of net income after tax and a strong credit rating. Our targets were \$448 million net income after tax and an "A" category credit rating. Net income for 2009 was \$470 million thereby exceeding the target of \$448 million. In relation to our credit rating, Hydro One's long term credit ratings provided by Standard & Poor's, Moody's and DBRS met the targeted "A" rating category. Maintaining an "A" category credit rating allows us to have access to long-term debt markets on a cost-effective basis, which is even more critical in the current financial market environment and given our capital requirements over the medium term.

## *8. Productivity*

In keeping with our vision to be the leading electricity delivery company, our strategic goal is to be productive through efficiency improvements and effective management of costs. To meet our productivity goals, Hydro One benchmarked itself against electricity industry wide measures of productivity. The two most comparable benchmark measures are (a) transmission unit cost (capital and O&M per asset) on a percentage basis (i.e. cost per asset value for the transmission business) and (b) distribution unit cost (capital and O&M per kilometre of line) (i.e. cost per line length for the distribution business) and these were set as our performance measures. Using these measures allowed us to benchmark our performance and monitor productivity year over year. Our transmission unit cost target was set at 10.6% and Hydro One was able to exceed this target at 10.1%. Regarding distribution unit cost, our target was set at \$6,100 per kilometre and Hydro One achieved unit costs of \$6,200 per kilometre, which was essentially on target.

## **Overall Performance for 2009**

For 2009, the HRPP Committee determined that of the 13 corporate targets, 8 were met or exceeded and 5 were not met. The HRPP Committee determined, by reason of a balanced scorecard assessment that this level of achievement supported the establishment of payout

funding at 65% of the maximum short term incentive, for the direct reports of the President and Chief Executive Officer, which include the NEOs other than the President and Chief Executive Officer, which is a 13% reduction from the maximum percentage payout for 2008 of 75%. The funding at 65% of the maximum short term incentive payout affected all management employees, including the NEOs. In particular, for the President and Chief Executive Officer and those NEOs whose total cash compensation was disclosed in 2008 and is disclosed in 2009, their short term incentive payment is at least 13% lower than paid in 2008, resulting in total cash compensation for 2009 being lower than in 2008. For the NEOs who had increased responsibilities and compensation in 2009, their short term incentive payment would be 13% lower than the potential maximum payable.

#### (b) Individual Performance

The second component of determining the amount of short term incentive payments to be made to NEOs pursuant to the Incentive Plan is their individual performance. Individual target performance criteria are outlined in individual performance agreements which include both broad corporate and individual specific targets. NEOs are expected to align their efforts with and advance the Corporate Performance Measures and Targets discussed above. In addition, the following leadership attributes are factored into individual performance targets: communicates vision and purpose, deals with ambiguity, builds customer and stakeholder support, lives the values, possesses business acumen, sets priorities, has managerial courage, drives for results, is a team player, and develops staff capability. Performance agreements are entered into annually between the President and Chief Executive Officer and her direct reports. The Board of Directors, in turn, annually approves the performance agreement entered into between the President and Chief Executive Officer and the Chair of the Board.

Potential awards for NEOs are expressed as a percentage of base salary as described above. Awards are granted on the basis of individual performance against the measures and targets in the performance agreements, individual performance relative to other senior executives and within the context, for 2009, of a 65% of maximum potential payout fund amongst the direct report population to the President and Chief Executive Officer.

In 2009, 50% of the 2009 Incentive Plan payout for each NEO was based on meeting specific targets related to the company's major information technology and business transformation initiative, a project referred to as Cornerstone. The following three Cornerstone specific measures had to be met for the NEOs to receive the 50% portion for Cornerstone. Otherwise, the payout for this portion would be zero.

- the project must be substantially on time and on budget at year end;
- all 2009 project milestones must be substantially achieved; and
- each NEO must remain committed to the successful completion of the project and work collegially to ensure its success.

Each of these targets was met by the NEOs in 2009.

The remainder of the potential award for each NEO was based on his or her relative achievement of specific individual performance targets. As noted earlier, these targets may be objective, numeric-based targets or more subjective targets. These targets are linked to some or all of the corporate performance measures and the NEO's business unit and were designed to enable our

company to promote and achieve its strategic plan. The evaluation of performance against the targets is important. Hydro One does not take a mechanistic approach to assessment. Each NEO is assessed objectively against his/her specific individual targets. Once this assessment has been completed, a second assessment comparing relative achievement across the NEOs is also conducted. This approach requires judgment on the part of the President and Chief Executive Officer (with respect to the NEOs other than the President and Chief Executive Officer) and the HRPP Committee (with respect to the President and Chief Executive Officer), but provides a better assessment of performance since it considers both absolute performance (against a set of targets) and relative performance against the other NEOs (other than the President and Chief Executive Officer). Using this approach means an NEO could meet all of his/her targets but receive significantly less than his/her incentive maximum if other NEOs performed better against their targets.

Ms. Formusa's targets were both quantitative (weighted) and qualitative. The quantitative factors were financial (40%), transmission reliability and customer satisfaction (20%), safety and the environment (20%), and continuous innovation and productivity (20%). With respect to these quantitative targets, they were the same as and tied to the corporate performance measures and targets described above. The safety and environment target also included the employee component of the scorecard with the objective of improving the employee engagement grand mean score from 3.51 to 3.68. Finally, qualitative factors were identified, including leadership, company culture, Board and stakeholder relationships, employee focus and stability, the development of successors for the Chief Executive Officer position and compliance with continuous improvement of corporate policies.

Mr. Struthers' targets had a number of finance components including maintaining an "A" category credit rating and successfully completing the 2009 debt program in light of the current economic situation. Additionally, Mr. Struthers' targets aimed at completing staffing and succession plans for finance to address the growth in the company's work program and to account for the demographic challenges, overseeing the pension fund to aid the Audit and Finance Committee and the Board in their roles in monitoring the fund, supporting and enabling the 2009 rate filing, addressing the issues of productivity and continuous improvement and continuing the implementation of International Financial Reporting Standards.

Mr. D'Arcey's targets were focused on the areas of safety, customer satisfaction, distribution reliability and improved reliability and efficiency in particular through deployment of the smart meter program and incorporation of distributed generation, succession planning, achieving productivity performance in the customer operations business unit, and delivery of the 2009 Hydro One Remote Communities Inc. goals. Regarding safety, the focus of the target is an injury free workplace and the components include the lost time injuries metric in the corporate scorecard, improving safety culture, maintaining high public safety standards, training and development of staff, monitoring compliance and enhancing the internal responsibility system. The customer satisfaction target also mirrors the corporate scorecard metric of 88% in relation to distribution related customers through a variety of initiatives, such as improved call center standards, increased community presence and improved customer communication. The reliability target reflects the goal of completing work programs that affect the system and includes the smart metering program, time of use billing, demand monitoring, and efficient incorporation of distributed generation onto the system. Mr. D'Arcey was also to identify or secure succession candidates for his own position and for the management employees in the business lines

reporting to him and create development plans for key positions expected to be vacated within the foreseeable future. Regarding the smart meter program, Mr. D'Arcey's goal was to achieve the target in the corporate scorecard of 800,000 meters installed and deployed. With respect to productivity as set out in scorecard of the Customer Operations group, the goal was to achieve improvement in the net bad debt ratio and non-energy accounts receivable. In his role as President and Chief Executive Officer of Hydro One Remote Communities Inc., Mr. D'Arcey delivered upon the 2009 Remote Communities scorecard in the areas of health and safety, financial strength, environmental stewardship, customer relations, system reliability, operational efficiency and workforce engagement.

Mr. Goldie's targets included a number of initiatives with respect to the human resources function, including implementing the employee engagement survey, implementing Hydro One diversity programs, finalizing the implementation of the candidate assessment program for apprenticeship hiring, increasing the implementation of Organization Alignment (change management) initiatives in Hydro One, providing strategic labour advice on key corporate initiatives, and providing service to and being the lead executive responsible for the HRPP Committee. In keeping with his role in human resources, Mr. Goldie, on behalf of Hydro One, successfully chaired the Human Resources Committee of Canadian Electricity Association. For other business units reporting to Mr. Goldie, his targeted goal was to achieve 100% compliance of the NERC Cyber Security Standards, successfully integrate the enablement unit of the Cornerstone project into the Chief Information Officer's organization and complete the fencing security enhancements for identified transformer and distributions stations as part of the prevention of theft of copper initiative.

Mr. Marcello retained oversight over a number of significant corporate projects and assumed the role of Senior Vice President Asset Management in 2009. Two projects which were under the guidance of Mr. Marcello were the Cornerstone project and the enhanced distribution solution initiative. With respect to the Cornerstone project, Mr. Marcello effectively led and supported the successful the implementation of Phase 2 of the program, related to supporting the Pay, Human Resources and Finance functions, to be on time and within the approved budget and supported the regulatory filing for the project as well. Regarding the enhanced distribution solution initiative, Mr. Marcello was responsible for seeking the approval of the mandate for this project from the Business Transformation Committee of the Board as well as establishing the governance structure, work program and ensuring the company's objectives would be realized. Distributed Generation is part of the Province's goals in the Green Energy Act, and in this regard Mr. Marcello focused on improving the company's goal of improving connections and setting up a governance structure, developing a work program and ensuring the objectives were achieved. In his role as Asset Manager, Mr. Marcello's targets were to improve Hydro One's ability to streamline work planning and the release of work to the operating business units, establish processes and clarify accountabilities to enable the earlier release of executable work, improve the movement of work from planning to execution and establish a process that enables multi-year releases of appropriate work. Additionally, as Asset Manager, his targets related to the transmission and distribution systems to ensure that sustaining capital and OM&A plans and programs were developed to meet customer needs and regulatory compliance. His Health and Safety goals included the fulfillment of all of his accountabilities and responsibilities under the company's Health and Safety Management System. In relation to other responsibilities, Mr. Marcello undertook to lead the company's due diligence responsibilities for emergency

preparedness and business continuity as well as to represent Hydro One in external business related forums.

In 2009, all NEOs substantially met all of their specific individual performance targets based on a subjective assessment of relative performance compared to other executives in their performance against their respective targets.

Stewardship is a key corporate value of Hydro One. As such, it is important that the NEOs demonstrate compliance with Hydro One's policies and procedures. To demonstrate stewardship on prudent financial responsibility, and as a term of their performance agreements, credit card transactions within the organization controlled by the NEO and submitted to and approved by the NEO had to meet a compliance target of 95% measured against three targets:

- signed approval of the credit card statement within 60 days of the statement date;
- attachment of itemized receipts; and
- documentation of business purpose.

If these compliance targets were not achieved, the NEO's Incentive Plan award would be reduced by 25%. Each of the NEOs achieved these targets.

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

### **(3) Benefits**

In addition to the Base Salary and Performance Based Compensation, as part of their compensation package, the NEOs also participate in the Hydro One registered pension plan and supplementary pension plan and participate in a flexible benefits plan, which is available to all other management employees. The flexible benefits plan provides various benefits, including life insurance, long term disability benefits, accident insurance, vacation and extended health care benefits. Hydro One provides to each executive and management employee certain core benefits, which include basic life insurance, accidental insurance, extended health benefits, out of country medical, dental, sick leave and long term disability, pension and basic vacation. Additionally, senior management has the option of receiving a third-party medical assessment. The flexible benefit plan provides for credits calculated each plan year on the individual's base annual earnings in effect at the time of enrolment in the plan. Those flexible benefit plan credits may then be allocated by each executive and management employee to additional life insurance, additional vacation (where applicable), a health care and/or general benefits account. Unallocated credits are paid out at year end, subject to withholding tax, to the employee.

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



Name and Principal Position	Year	Salary (\$)	Share-based awards (\$)	Option-based awards (\$)	Non-equity incentive plan compensation (\$)		Total Direct Compensation (\$)	Pension Value <sup>5</sup> (\$)	All Other Compensation (\$)	Total Compensation (\$)
					Annual incentive plans <sup>1</sup>	Long-term incentive plans				
President, Corporate Services	2009	\$325,815	\$0	\$0	\$125,666	\$0	\$451,481	\$24,000	\$0	\$475,481
	2008	\$321,000	\$0	\$0	\$145,000	\$0	\$466,000	\$83,000	\$0	\$549,000
C. Marcello <sup>4</sup> Senior Vice President Asset Management and Corporate Projects	2009	\$291,022	\$0	\$0	\$156,000	\$0	\$447,022	\$232,000	\$0	\$679,022
	2008	\$242,499	\$0	\$0	\$97,000	\$0	\$339,499	\$216,000	\$0	\$555,499

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

<sup>2</sup> Ms. Summers was CFO of the company for the year 2009 from January 1 to February 11, 2009. Ms. Summers submitted her letter of resignation on January 31, 2009; her last day of employment was February 13, 2009. As a result of her resignation, she was not entitled to any Annual Incentive payment for 2009.

<sup>3</sup> Mr. Struthers was CIO of the company in 2008 and from January 1 to February 11, 2009 after which he became the CFO effective February 12, 2009.

<sup>4</sup> Mr. Marcello was Vice President – Corporate Projects in 2008 and continued in that role until March 9, 2009 at which date he was given additional responsibilities and appointed Senior Vice President – Asset Management.

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

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

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

## **Pension Plan Benefits**

### **Defined Benefit Pension Plan**

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

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

The approximate projected credited years of service that each NEO will have if he or she works until the age of 65 is as follows: Ms. Formusa – 35 years at age 65; Mr. Struthers – 24 years at age 65; Mr. D'Arcey – 35 years at age 65; Mr. Goldie – 35 years at age 65; and Mr. Marcello 35 years at age 65.

This pension is reduced by 0.625% of the member's average base annual earnings up to the year's maximum pensionable earnings during the 36 consecutive months (60 consecutive months for management employees hired after January 1, 2004 and for employees represented by the Society of Energy Professionals who were hired after November 17, 2005) when his or her base earnings were highest (the reduction is 0.500% for employees represented by the Society of Energy Professionals who were hired prior to November 17, 2005 and for all employees represented by the Power Workers' Union). The reduction is intended to offset Canada Pension Plan ("CPP") benefits.

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

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

life of the member, and continuing after the member's death to his or her spouse at the rate of 66 2/3% of the amount the member was receiving.

Benefits payable under Hydro One's registered pension plan, similar to other entities, are restricted by the *Income Tax Act (Canada)*. This limit on benefits affects members whose average annual earnings exceed approximately \$136,000 in 2009. Participants whose pensions would otherwise be restricted by the *Income Tax Act (Canada)* participate in an unregistered supplementary pension plan that provides benefits equal to the difference between the *Income Tax Act (Canada)* maximum pension benefits and the benefits determined in accordance with the formula set out in Hydro One's registered pension plan. The supplementary pension plan is unfunded and the additional retirement income is paid from general revenues. Hydro One's obligations to participants under the supplementary pension plan are secured by a letter of credit.

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

- Years of credited service as at December 31, 2009 and as at the normal retirement age of 65;
- Estimated annual benefit accrued, or earned, for service up to December 31, 2009 and up to the normal retirement age of 65; and
- A reconciliation of the accrued obligation from December 31, 2008 to December 31, 2009. The accrued obligations reflect the impact of the annual bonus earned in the year even though it is paid in the following year.

Name	Number of years credited service at year end (#)	Annual benefits payable (\$)		Accrued obligation at start of year <sup>1</sup> (\$)	Compensatory change (\$)		Non-compensatory change <sup>4</sup> (\$)	Accrued obligation at year end <sup>5</sup> (\$)
		At year end	At age 65		Service Cost <sup>2</sup>	Other <sup>3</sup>		
L. Formusa	28.9 yrs	\$382,700	\$463,200	\$5,206,000	\$167,000	(\$92,000)	\$1,133,000	\$6,414,000
B. Summers	7.8 yrs	\$67,000	\$67,000	\$456,000	\$5,000	\$16,000	(\$145,000)	\$332,000
S. Struthers	9.9 yrs	\$53,700	\$130,000	398,000	\$45,000	\$150,000	162,000	755,000
M. D'Arcey	31.2 yrs	\$245,800	\$276,100	\$3,005,000	\$81,000	(\$45,000)	\$634,000	\$3,675,000
T. Goldie	31.9 yrs	\$240,300	\$263,500	\$3,067,000	\$81,000	(\$57,000)	\$460,000	\$3,551,000
C. Marcello	22.1 yrs	\$120,700	\$191,300	\$1,227,000	\$51,000	\$181,000	\$376,000	\$1,835,000

<sup>1</sup>The accrued obligation is the value of the projected pension earned for service to December 31, 2008. The values have been determined using the same actuarial assumptions used for determining the pension plan obligations at December 31, 2008 as disclosed in the notes to the 2008 consolidated financial statements, based on the actual earnings for 2008 and adjusted to reflect expected increases in pensionable earnings.

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

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

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

<sup>5</sup> The accrued obligation is the value of the projected pension earned for service to December 31, 2009. The values have been determined using the same actuarial assumptions used for determining the pension plan obligations at December 31, 2009 as disclosed in the notes to the 2009 consolidated financial statements, based on the actual earnings for 2009 and adjusted to reflect expected increases in pensionable earnings.

Notes:

- All members are currently vested in their pension entitlements earned to December 31, 2009.
- In accordance with Canadian generally accepted accounting principles, the amounts above make no allowance for the different tax treatment of the portion of pension not paid from the registered or qualified pension plans.
- All amounts shown above are estimated based on assumptions and represent contractual entitlements that may change over time.
- The method and assumptions used to determine estimated amounts will not be identical to the method and assumptions used by other issuers and, as a result, the figures may not be directly comparable to other issuers.

**Termination and Change of Control Benefits**

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

D'Arcey and Mr. Goldie were terminated on December 31, 2009 is summarized in the following table.

<b>Name</b>	<b>Base Salary (24 Months)</b>	<b>3 year average Incentive Payment (24 Months)</b>	<b>Total Payment</b>
<b>L. Formusa</b>	\$1,471,750	\$293,050	<b>\$1,764,800</b>
<b>S. Struthers</b>	\$650,000	\$149,333	<b>\$799,333</b>
<b>M. D'Arcey</b>	\$678,018	\$306,666	<b>\$984,684</b>
<b>T. Goldie</b>	<b>\$651,630</b>	<b>\$283,333</b>	<b>\$934,963</b>

In addition to the above, each of Ms. Formusa, Mr. Struthers, Mr. D'Arcey and Mr. Goldie would continue to earn credited service under the Hydro One Pension Plan during such 24-month period. The following information summarizes the amount by which each NEO's annual pension would increase due to inclusion of such 24-months of additional credited service and any corresponding increase in average annual earnings calculated at the end of such 24-month period.

Ms. Formusa's annual pension accrued at December 31, 2009 would be expected to increase by \$111,700.

Mr. Struthers's annual pension accrued at December 31, 2009 would be expected to increase by \$29,700.

Mr. D'Arcey's annual pension accrued at December 31, 2009 would be expected to increase by \$17,800.

Mr. Goldie's annual pension accrued at December 31, 2009 would be expected to increase by \$17,200.

Ms. Summers resigned on January 31, 2009 and her last day of employment was February 13, 2009. She was paid her base salary for the period January 1, 2009 to February 13, 2009 as noted in the Summary Compensation Table. She was not entitled to and did not receive any incentive payment for 2009.

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

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

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

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

## Director Compensation

The by-laws of Hydro One provide that directors may receive reasonable remuneration for their services, commensurate with their duties, together with reimbursement for all reasonable expenses incurred in fulfilment of their duties, including travel expenses. The amount of such remuneration is determined by the Board of Directors from time to time. The following remuneration is currently paid to directors:

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

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

Mr. James Arnett was appointed Chair of the Board of Directors on March 31, 2008. He resigned from the Board for an interim period following his appointment as special advisor to the Premier of Ontario on the automobile industry from December 8, 2008 until his re-appointment as Chair of the Board of Directors effective February 17, 2009. Mr. Douglas Speers was appointed interim Chair of the Board of Directors from December 8, 2008 until February 17, 2009. The Chair receives annual remuneration of \$150,000 per annum and does not receive any additional fees for serving as a director.

The following table summarizes the compensation paid in 2009 to the directors of Hydro One.

### **DIRECTOR COMPENSATION TABLE**

<b>Name</b>	<b>Fees Earned</b>	<b>All other compensation<sup>1</sup></b>	<b>Total</b>
<b>James Arnett Chair February 17 to December 31, 2009</b>	\$130,625.00		<b>\$130,625.00</b>
<b>Douglas Speers Chair January 1 to February 16, 2009 Director February 17 to December 31, 2009</b>	\$67,092.81	\$6,300.00	<b>\$73,392.81</b>
<b>Sami Bébawi</b>	\$45,100.00	\$4,500.00	<b>\$49,600.00</b>
<b>Kathryn Bouey</b>	\$48,400.00	\$900.00	<b>\$49,300.00</b>
<b>Murray Elston</b>	\$25,856.17	\$3,600.00	<b>\$29,456.17</b>

<b>Name</b>	<b>Fees Earned</b>	<b>All other compensation<sup>1</sup></b>	<b>Total</b>
<b>Director January 1 to July 27, 2009 (resigned on July 28, 2009)</b>			
<b>Don MacKinnon</b>	\$44,200.00	\$900.00	<b>\$45,100.00</b>
<b>Michael Mueller</b>	\$56,800.00	\$7,200.00	<b>\$64,000.00</b>
<b>Walter Murray</b>	\$53,200.00	\$7,200.00	<b>\$60,400.00</b>
<b>Robert Pace</b>	\$45,700.00	\$5,400.00	<b>\$51,100.00</b>
<b>Gale Rubenstein</b>	<b>\$45,108.21</b>	<b>\$900.00</b>	<b>\$46,008.21</b>

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

## **APPOINTMENT OF AUDITOR**

On December 13, 2007, the board of directors recommended to our sole shareholder that KPMG LLP be appointed as the auditor of our company for the fiscal year ended December 31, 2008. This appointment was confirmed by our sole shareholder on December 19, 2007. In 2009, KPMG LLP was re-appointed as the auditor of our company for the fiscal year ended December 31, 2009.

## **AUDIT AND FINANCE COMMITTEE INFORMATION**

### **The Audit and Finance Committee's Charter**

Our Audit and Finance Committee's mandate is attached hereto as Appendix "A", which Appendix is hereby incorporated by reference. The Audit and Finance Committee mandate was last reviewed on February 10, 2010.

### **Composition of the Audit and Finance Committee**

As at December 31, 2009, the members of our Audit and Finance Committee were Walter Murray, James Arnett, Michael Mueller and Robert Pace. All members are independent, with the exception of Mr. Arnett, and all members are financially literate as such terms are defined under applicable Canadian securities legislation.

On August 7, 2009, Mr. Arnett was appointed, on an interim basis, as a member of the Audit and Finance Committee after the resignation of Mr. Murray Elston, who resigned from the Board of Directors and the Committee on July 28, 2009. At that time, the Board of Directors accepted and concurred with the determination of the Corporate Governance Committee that Mr. Arnett, as a non-independent member of the Audit and Finance Committee, was able to exercise the impartial judgment necessary for him to fulfill his responsibilities as a member of the Audit and Finance Committee and that his appointment would not materially adversely affect the ability of the Audit and Finance Committee to act independently and to satisfy the other requirements of National Instrument 52-110-*Audit Committees* ("NI 52-110"). In connection with Mr. Arnett's appointment to the Audit and Finance Committee, the company relied on the exemption provided

by Section 3.5 of NI 52-110 to the requirement to have an audit committee comprised entirely of members who are independent. On February 11, 2010, the company replaced Mr. Arnett on the Audit and Finance Committee with George L. Cooke, who is independent.

### **Relevant Education and Experience**

In addition to each member's general business experience, the education and experience of each Audit and Finance Committee member who was serving as a member of the Audit and Finance Committee on December 31, 2009 that is relevant to the performance of his or her responsibilities as an Audit and Finance Committee member is described below.

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

Mr. Arnett was appointed Chair of Hydro One Inc. on March 31, 2008. His distinguished career as a senior executive, corporate director and lawyer also includes special assignments with the Government of Ontario. He was Counsel to Fraser Milner Casgrain LLP until retiring as of January 31<sup>st</sup>, 2010. Mr. Arnett chaired the Province of Ontario's 2007 Agency Review Panel that reviewed the way compensation is set for senior executives in Ontario's electricity sector agencies, and how those agencies can work together more efficiently. He was special advisor to the Premier of Ontario on the steel industry from 2004-2006 and on the automobile industry from 2008-2009. Mr. Arnett is a former president and CEO of Molson Inc. and between 1997 and 2000, he led Molson's transformation from a diversified holding company to a focused brewing company. Prior to that, he was a senior partner in a major Canadian law firm as the Toronto Corporate/Commercial Head and as resident partner in the firm's Washington, D.C. office. He is a Past Chair of the Toronto East General Hospital and a former member of the Directors Advisory Group of the Canadian Institute of Chartered Accountants. Mr. Arnett holds a Bachelor of Arts degree and an LL.B from the University of Manitoba and an LL.M from Harvard Law School.

Mr. Mueller is a former Global Leader of PricewaterhouseCoopers' (PwC) Private Company Services/Middle Market Practice and a former member of PwC's Global Audit Leadership Team, Global Advisory Leadership Team and the Global Markets Council. Mr. Mueller is a Chartered Accountant, and a Chartered Business Valuator. Until 2009, he was a Certified Insolvency Practitioner.

Mr. Pace is President and Chief Executive Officer, The Pace Group Ltd., which owns and operates a number of companies across Atlantic Canada. He serves on the Board of Directors of Canadian National Railway Company and is the former chair of its audit committee. He also serves on the audit committee of High Liner Foods Incorporated and Overland Realty Limited. Mr. Pace holds both a Bachelor of Laws and a Masters in Business Administration degree from

Dalhousie University. He has completed a corporate director education program at Harvard Business School relating to compensation committees, and a corporate director education course at the Chicago Business School, Stanford Law School and The Wharton School of the University of Pennsylvania (Joint Offering) relating to corporate governance.

### **Audit and Finance Committee Oversight**

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

### **Pre-Approval Policies and Procedures**

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

### **External Auditor Service Fees**

(a) *Audit Fees*

The audit fees to be billed by KPMG LLP for fiscal 2009 are estimated to be \$1,206,800.00. The audit fees billed by KPMG LLP for fiscal 2008 were \$873,600.00.

(b) *Audit-Related Fees*

The total audit-related fees billed by KPMG LLP for fiscal 2009 are estimated to be \$142,300.00. The total audit related fees billed by KPMG LLP for fiscal 2008 were \$140,000.00. The nature of services rendered in both years were: audit of the Hydro One Pension Plan, French translations and executive expense reviews.

(c) *Tax Fees*

There were no tax fees billed by KPMG LLP for fiscal 2008 or fiscal 2009 as KPMG LLP did not provide any professional services in respect of tax compliance, tax advice or tax planning.

(d) *All Other Fees*

No other fees are expected to be billed by KPMG LLP for fiscal 2009. For fiscal 2008, all other fees billed by KPMG LLP were \$30,000.00 for ancillary services.

## **CORPORATE GOVERNANCE DISCLOSURE**

### **Board of Directors**

The Board of Directors of our company (the “Board”) has undertaken an independence assessment and determined that, except as noted below, all of Hydro One’s current directors are “independent” within the meaning of the rules adopted by the Canadian Securities Administrators (the “CSA”). Ms. Laura Formusa, who is the President and Chief Executive

Officer of our company and a member of the Board of Directors, is not independent as she is an executive officer of our company. In addition, Mr. James Arnett, the Chair of our Board of Directors, is also not considered independent as he acts as our Chair and accordingly is considered an executive officer of our company.

The Board has separated the roles of Chair and Chief Executive Officer. Mr. James Arnett was re-appointed Chair of the Board on February 17, 2009. The prime responsibility of the Chair of the Board of Directors is to provide leadership to the Board and to enhance Board effectiveness. The Chair, as the presiding member of the Board, also ensures that the relationships between the Board, management, the shareholder and other stakeholders are effective, efficient and further the best interests of our company. The Chair also encourages input and significant participation of independent directors in the leadership of our company.

Directors hold regularly scheduled meetings at which members of management are not in attendance. During 2009, seven such sessions without management were held. As well, the Audit and Finance Committee regularly holds such sessions with the external auditors and with the internal auditor. The Chair of the Audit and Finance Committee meets four times a year with the internal auditor. These sessions encourage open and candid discussion among the directors including amongst independent directors.

### **Summary of Attendance of Directors**

The following table summarises the attendance of individual directors at meetings of the Board of Directors held for the 12-month period ending December 31, 2009.

<b>Director</b>	<b>Board Meetings Attended</b>
James Arnett <sup>1</sup>	8 of 8
Sami Bébawi	6 of 9
Kathryn Bouey	9 of 9
Murray J. Elston <sup>2</sup>	4 of 4
Laura Formusa	9 of 9
Don MacKinnon	9 of 9
Michael Mueller	9 of 9
Walter Murray	9 of 9
Robert Pace	9 of 9
Gale Rubenstein	9 of 9
Douglas Speers	9 of 9

- (1) Mr. James Arnett was appointed Chair of the Board of Directors of Hydro One Inc. on March 31, 2008. He resigned on December 8, 2008 when he was appointed as Special Advisor to the Premier of Ontario on the automobile industry restructuring and was re-appointed as Chair of the Board of Directors of Hydro One Inc. on February 17, 2009. There were eight (8) meetings of the Board of Directors in 2009 after his re-appointment.

- (2) Mr. Murray Elston resigned as a Director of the Board of Directors of Hydro One Inc. on July 28, 2009. There were four (4) meetings of the Board of Directors in 2009 prior to his resignation.

### **Directors' Board Memberships in Other Reporting Issuers**

<b>Director</b>	<b>Reporting Issuer</b>
Robert Pace	Canadian National Railway Company, Overland Realty Limited, High Liner Foods Incorporated.

### **Board Mandate**

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

### **Position Descriptions**

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

### **Committees of the Board of Directors**

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

The five standing committees of the Board are the Audit and Finance Committee, the Corporate Governance Committee, the Human Resources and Public Policy Committee, the Regulatory and Environment Committee and the Health and Safety Committee. The ad hoc advisory committee of the Board is the Business Transformation Committee. The roles and responsibilities of each Committee are set out in formal written mandates. These mandates are reviewed at least annually to ensure that they reflect best practices as well as applicable regulatory requirements. A brief summary of each of the Committees' responsibilities follows.

#### *Audit and Finance Committee*

The Audit and Finance Committee is composed entirely of independent directors or directors who are exempt from such independence requirements as required by the CSA rules (for more information, see the mandate of the Audit and Finance Committee which is attached and the

discussion concerning the composition of the Audit and Finance Committee above). The Audit and Finance Committee oversees the integrity of accounting policies and financial reporting, internal controls, internal audit, significant corporate risk exposures, financial compliance and ethics policies.

#### *Corporate Governance Committee*

The Corporate Governance Committee is composed entirely of independent directors with the exception of Mr. Arnett. The Corporate Governance Committee acts as the nominating committee of the Board and recommends director candidates, committee assignments, director compensation, and corporate governance policy for committees and the board as a whole. The Corporate Governance Committee reviews the general and specific criteria applicable to candidates to be considered for nomination to the Board. The objective of this review is to maintain the composition of the Board in a way that provides the best mix of skills and experience to guide the long-term strategy and ongoing business operations of our company. In 2009, Caldwell Partners International was retained to assist the Corporate Governance Committee in its search for additional qualified directors. Use of an external search firm was meant to ensure that individuals with the necessary skills and experience are objectively identified as potential directors of Hydro One. In addition, the Corporate Governance Committee leads an annual evaluation of the Board and makes recommendations on modifications of the evaluation process.

#### *Human Resources and Public Policy Committee*

The Human Resources and Public Policy Committee (the “HRPP Committee”) is composed entirely of independent directors. The HRPP Committee recommends compensation policy for senior managers, leads the performance review of the President and Chief Executive Officer, recommends bargaining strategy with respect to the unions, and advises the Board on public policy matters and corporate social responsibility issues. In this regard, the Committee also reviews succession planning and the recommendations for the appointment of persons to senior executive positions. In 2009, the Hay Group reviewed and provided advice on management compensation. The HRPP Committee also engaged Hugessen Consulting Inc. to advise the Committee and the Board on the competitiveness and effectiveness of the company’s compensation programs. For additional information relating to the compensation of our company’s senior executives, see “Statement of Executive Compensation.”

#### *Regulatory and Environment Committee*

The Regulatory and Environment Committee monitors our company’s compliance with regulatory and environmental requirements and related risk, reviews related policies and generally oversees processes and procedures related to regulatory and environmental compliance at our company.

#### *Health and Safety Committee*

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

### *Business Transformation Committee*

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

The Enterprise Application Systems Replacement Strategy is a strategy to replace our existing customized business applications with commercially available software system applications to simplify our information technology infrastructure and improve the functionality of our business processes.

In May 2009, the Committee's mandate was amended to include oversight responsibility for all matters related to the Smart Grid and Continuous Innovation Strategy. Smart Grid and Continuous Innovation Strategy provides a focus on building and maintaining reliable, cost effective transmission and distribution systems and protecting and sustaining the environment for future generations.

### **Orientation and Continuing Education**

In 2008, Hydro One's Director Education Program was formalized in a written document, "The Director Orientation and Continuing Education Program", which was established in accordance with the principles set out in the *Business Corporations Act* (Ontario), National Policy 58-201: *Corporate Governance Guidelines*, the mandate of the Board and the mandates of the Corporate Governance and Audit and Finance Committees. The Director Orientation and Continuing Education Program consists of two elements: the New Director Orientation Program and the Continuing Director Education Program. The New Director Orientation Program consists of a Hydro One Directors' Guide, which is given to all new directors upon joining the Board to provide them with an overview of the key organizational, financial, regulatory, and operational aspects of our company. The Directors Guide also contains information on the structure of the Board and its committees, committee mandates and general information on a director's obligations. In addition, new directors receive orientation sessions with the Chair, the President and Chief Executive Officer and members of the senior management team as well as tours of our company's facilities. The orientation sessions familiarize directors with Hydro One's strategic plans, its significant financial, accounting and risk management issues, its compliance programs, its Pension Plan and the directors' obligations as plan fiduciaries, and its Code of Business Conduct.

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

## **Ethical Business Conduct**

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

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

In 2008, the Code was updated to reflect changes in Hydro One’s organizational structure, corporate accountabilities, and the Company’s business strategy. The revised Code reflects current best governance and ethics practices, including the introduction of a third-party hotline for the anonymous reporting of any accounting, internal accounting controls or auditing matters.

## **Board, Committee and Director Assessments and Management’s Assessment of the Board**

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

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

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

Management’s Assessment of the Board consists of one questionnaire completed annually by members of senior management. This Assessment provides the board with meaningful and constructive feedback on its performance from senior management members.

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

## APPENDIX “A”

### AUDIT AND FINANCE COMMITTEE MANDATE

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

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

The Committee shall:

- (1) in connection with its advisory functions:
  - (a) review the internal audit procedures of the Corporation and advise the Board on its auditing practices and procedures and obtain adequate assurance that internal controls are adequate;
  - (b) meet separately with the external auditors and internal auditors;
  - (c) review the recommendations of the officers of the Corporation as to the reappointment or appointment of external auditors and make recommendations to the Board with respect to the nomination and remuneration of external auditors to be appointed at each annual meeting

of the Shareholder. If a change in external auditors is proposed, the Committee will inquire as to the reasons for the change, including the response of the incumbent auditors, and inquire as to the qualifications of the newly proposed auditors before making its recommendation to the Board;

- (d) review periodically, reports on the nature and extent of compliance with requirements regarding statutory deductions and remittances, including deductions and remittances under the Income Tax Act (Canada), the Excise Tax Act (Canada) and the Unemployment Insurance Act (Canada), the nature and extent of non-compliance together with the reasons therefore and the plan and timetable to correct deficiencies and report to the Board on the status of such matters;
- (e) review and reassess the Committee's mandate at least annually and report to the Board results of the review, including any recommended changes to the mandate;
- (f) the Committee shall meet with management to review and assess the process and systems in place for the review of public disclosure documents that contain audited and unaudited financial information and their effectiveness;
- (g) describe in the annual information form all information about the Committee as required by applicable securities regulatory authorities; and
- (h) review and assess with management and recommend to the Board for approval any material transaction, contract or other matter involving the Corporation and a shareholder, or other person, which owns directly or indirectly voting securities of the Corporation. For this purpose, "material" means any transaction, contract or matter that significantly affects, or would reasonably be expected to have a significant effect on, the financial position of the Corporation or the market price or value of its securities.

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

- (a) review and recommend to the Board for approval:
  - (i) the audited annual financial statements of the Corporation, the annual management discussion and analysis ("MD&A") and any required annual MD&A supplement and related press releases before the Corporation publicly discloses this information;
  - (ii) the Corporation's interim (quarterly) financial statements, interim MD&A and any required interim MD&A supplement and related press releases before the Corporation publicly discloses this information, unless the Board delegates to the Committee such approval authority as provided in paragraph (b) below;

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

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

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

thought to bear on independence, including non-audit related services and fees and their impact;

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

reports detailing the asset mix status and performance of the pension fund and any further pension-related reports or policies to be submitted to the Board, including those resulting from the Terms of Reference of the Pension Committee, the Pension Plan Terms of Reference of the Board of Directors, or the Terms of Reference of the Pension Investments Unit.

- (6) In instances where members of the Committee believe that in order to properly discharge their fiduciary obligations to the Corporation it is necessary to obtain the advice of independent counsel and other expert advisers, the Committee shall have authority to engage and compensate the appropriate experts. The Board shall be kept apprised of both the selection of the experts and the expert's findings through the Committee's regular reports to the Board.

## APPENDIX “B”

### HYDRO ONE INC. BOARD OF DIRECTORS MANDATE

#### DUTIES OF THE BOARD OF DIRECTORS

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

#### ACCOUNTABILITIES AND RESPONSIBILITIES

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

##### 1. **Corporate Governance**

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

##### 2. **Strategic Planning**

The Board is responsible for:

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

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

**3. Risk Management**

The Board is responsible for:

- a. identifying the principal risks of the Corporation's business and ensuring the implementation of appropriate systems to effectively monitor and manage such risks with a view to the long-term viability of the Corporation;
- b. overseeing the integrity of the Corporation's internal control and management information systems;
- c. approving, and monitoring compliance with, all significant policies and procedures by which the Corporation is operated; and
- d. approving policies and procedures designed to ensure that the Corporation operates at all times within applicable laws and regulations.

**4. Human Resources Management**

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

**5. Communications and Reporting**

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

**6. Board Meetings and Materials**

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

**7. Committees of the Board**

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

**DIRECTOR DEVELOPMENT AND EVALUATION**

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