

hydroOne



# POWERING FORWARD

2016 ANNUAL REPORT

ONE OF NORTH AMERICA'S LARGEST ELECTRIC UTILITIES (TSX: H)

Hydro One Limited is Canada's largest pure-play electric transmission and distribution utility with \$25 billion in assets and annual revenues of over \$6.5 billion. It transmits and distributes electricity safely and reliably across the Province of Ontario, home to 38 percent of the country's population.

Hydro One owns and operates a 30,000 circuit km high-voltage transmission network transmitting 98 percent of Ontario's electric capacity, and a 123,000 circuit km lower-voltage distribution network serving 75 percent of the geography of the province

and more than 1.3 million residential and business customers. Hydro One Limited became a public company coincident with its initial public offering in November 2015, and its common shares are listed on the Toronto Stock Exchange (TSX: H).

# HYDRO ONE'S BUSINESS

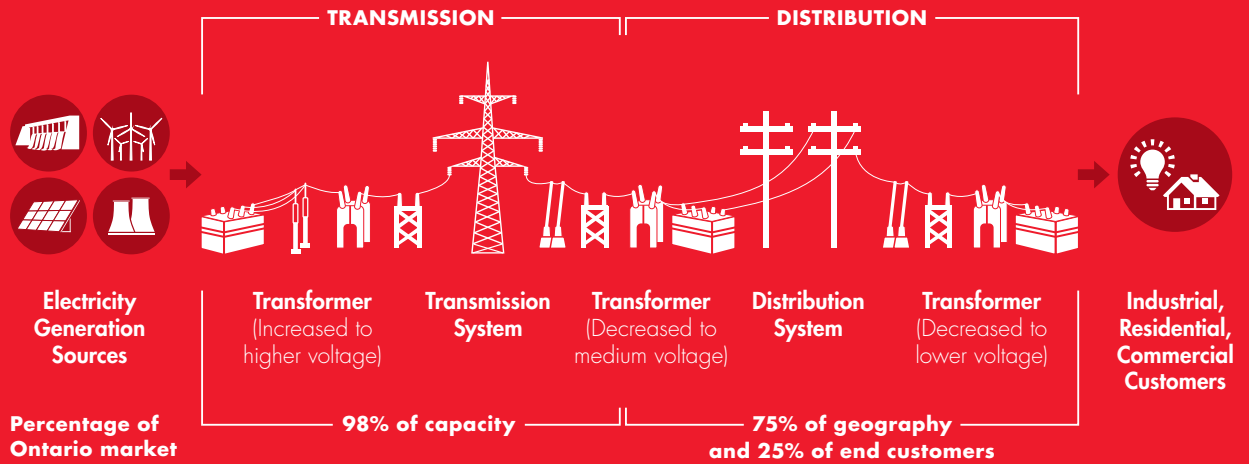
**YEAR ENDED DECEMBER 31,**  
(CAD \$ millions, except per share amounts)

	<b>2016</b>	<b>2015</b>
Revenues	\$ 6,552	\$ 6,538
Purchased power	3,427	3,450
<b>Revenues (net of purchased power)</b>	<b>3,125</b>	3,088
Operation, maintenance and administration	1,069	1,135
Depreciation and amortization	778	759
Income before financing charges and income tax expense	1,278	1,194
Financing charges	393	376
Income tax expense	139	105
<b>Net income attributable to common shareholders</b>	<b>721</b>	690
Diluted earnings per common share	1.21	1.39
Adjusted diluted earnings per common share <sup>1</sup>	1.21	1.16
Net cash from (used in) operating activities	1,656	(1,253)
Adjusted net cash from operating activities <sup>2</sup>	1,656	1,557
Capital investments	1,697	1,663
Transmission – average monthly Ontario 60-minute peak demand (MW)	20,690	20,344
Distribution – electricity distributed to Hydro One customers (GWh)	26,289	28,764

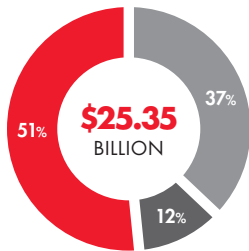
<sup>1</sup> 2015 Adjusted earnings per share (EPS) is calculated using the number of common shares outstanding at December 31, 2016

<sup>2</sup> 2015 amount excludes the \$2,810 million non-cash impact of IPO-related adjustments

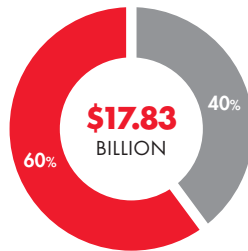
## HYDRO ONE'S ROLE IN THE ELECTRIC POWER SYSTEM



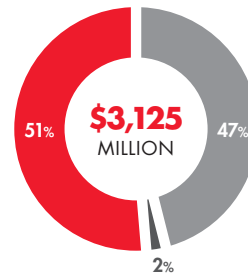
### TOTAL ASSETS



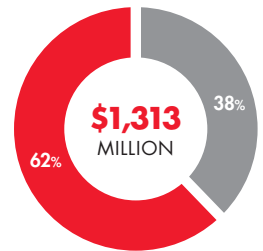
### RATE BASE



### REVENUES (NET OF PURCHASED POWER COSTS)



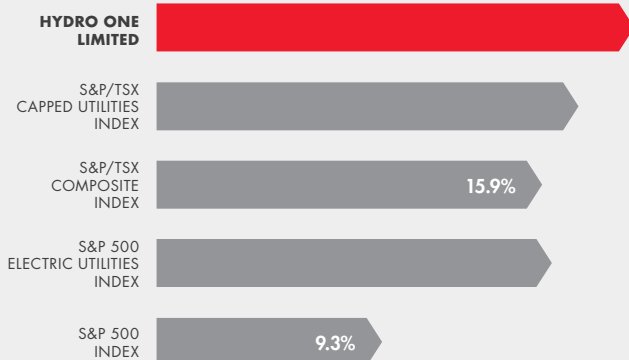
### REGULATED EARNINGS BEFORE FINANCING CHARGES AND INCOME TAXES



● Transmission    ● Distribution    ● Other

### TOTAL SHAREHOLDER RETURN\*

NOVEMBER 5, 2015 IPO TO DECEMBER 31, 2016



\*Source: Bloomberg and S&P

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**“Hydro One has achieved much over this past year while making significant progress in laying the foundation and building the organizational momentum to deliver increasing value for its customers and shareholders in the years to come.”**

## A MESSAGE FROM THE CHAIR OF THE BOARD

Dear fellow shareholders,

2016 was Hydro One’s first full year as a public company, and its evolution to a more broadly owned and customer-focused organization is well underway. The company has achieved much over this past year, including executing its 2016 financial and operating plans and generating total shareholder return of 19.7% since the November 2015 initial public offering. It has also made significant progress in laying the foundation to deliver increasing value for its customers and shareholders in the years to come.

One of President and Chief Executive Officer Mayo Schmidt’s key objectives over the past year was to significantly strengthen the company’s senior leadership team, and in that regard we now have new executives heading Hydro One’s operations, customer service, legal, and strategy functions. Each of these individuals has brought significant experience and capabilities to Hydro One, and the Board of Directors is very confident that we now have in place the depth and breadth of leadership expertise that will further accelerate the company’s evolution.

In April 2016, the Province of Ontario sold an additional 15% of its stake in Hydro One to the public in a very successful secondary offering. This followed the November 2015 initial public offering of the shares of Hydro One, and served to double the public float of the company to 30% of

shares outstanding while at the same time measurably increasing the trading volume and liquidity of the shares. This transaction was not dilutive to our existing public shareholders, and was another step by the Province towards its stated goal of reducing its ownership of Hydro One to 40%.

While the Province of Ontario remains a significant shareholder of Hydro One, the autonomy of the company and independence of our Board of Directors is enshrined in a governance agreement between Hydro One and the Province. This governance agreement was executed in advance of last year’s initial public offering and has operated as designed to ensure that the company is governed as an independent commercial entity with the Province’s role limited to that of a shareholder.

I would like to recognize my fellow Board members for their service over this busy period of change. Our Board is comprised of a diverse and accomplished group of proven leaders, each of whom is very committed to the success of Hydro One and the highest standards of corporate governance. The Board has been highly engaged with Mayo Schmidt and his leadership team in defining the strategy for the organization and charting the path forward over the course of the next few years.

I would also like to acknowledge the hard work and commitment of the more than 5,500 regular employees of Hydro One. This team of dedicated professionals works tirelessly -- often around the clock and in potentially hazardous weather and conditions -- to ensure that electric power is transmitted and distributed safely, reliably and cost-effectively to the millions of citizens of Ontario and the communities in which they live and work.

Thank you for your investment and continued support,

**DAVID F. DENISON, O.C.**

*Chair of the Board*  
Hydro One Limited



**“We have assembled a team of talented and deeply experienced leaders who are dedicated to transforming Hydro One into a more disciplined, customer-focused and commercially oriented electric transmission and distribution service provider.”**

## A MESSAGE FROM THE PRESIDENT AND CEO

Dear fellow shareholders,

This is a new era at Hydro One. 2016 was a transformative year as we embarked on our journey from good to great. In this first full year as a public company, we undertook a company-wide systematic review of our business. Through this intensive process, we identified a number of initiatives, metrics and targets that will enable us to drive greater efficiency and effectiveness across customer service, operations, procurement, network planning, capital deployment and administration.

Accordingly, we have assembled a team of talented and deeply experienced leaders who are dedicated to transforming Hydro One into a more disciplined, customer-focused and commercially oriented electric transmission and distribution service provider. We are becoming significantly more customer and performance driven by focusing on company-wide accountability, productivity, and efficiency while also engaging more proactively with our communities and First Nations and Métis partners.

Many Ontarians feel the pressure of increases to their electricity bills, so we are doing our part to keep Hydro One's portion of the bill as low as possible. We are also providing customers with meaningful conservation programs so they can take greater control of their consumption and manage their bills. Part of this move involves information technology investments that enable the shift from paper-based systems to increasingly mobile, online and paperless technologies.

Hydro One's employees have embraced our transformational journey to becoming a commercial enterprise, one focused on delivering value for customers and shareholders. This transformation is central to our actions and strategies, and is enshrined in all that we endeavour to achieve. As we move the organization forward and modernize Ontario's electrical grid, I believe that we have multiple opportunities to create increasing value for our customers and shareholders alike.

While we are fortunate to have a strong foundation for growth upon which to build, we are also aware that there are opportunities for us to enhance customer service and improve our execution capabilities across the business. We also appreciate the criticality of accelerating the pace of upgrading Ontario's aging electric power system and the significant infrastructure investment that is needed to build and maintain a strong, modern and reliable grid.

We made important progress this year on the regulatory front, where we now have a plan with a clear line of sight to the imminent transition from a cost of service-based regulatory model to a more dynamic performance-based, customer-focused regulatory model. We are fully engaged and gaining traction on this front in both segments of our regulated business. We expect to complete the transition to a performance-based regulatory framework in our distribution segment in early 2018 and in our transmission segment in early 2019.

In addition to the significant value we intend to create in improving the performance of our substantial existing operations, there is also value to be created in continuing to lead the consolidation of what is still a fragmented system of electric utility assets in Ontario. As such, during 2016 we significantly stepped up the rigour and capabilities around how we acquire and integrate other electric utilities. Our successful integration of the Haldimand and Woodstock municipal utilities is a good indicator of things to come. During the year, we also completed the acquisition of Great Lakes Power Transmission and announced the acquisition of Orillia Power Distribution, two regulated electric utilities in Ontario which further add to our leadership position.

My thanks go out to the thousands of Hydro One employees across Ontario for embracing this transformational journey and their unwavering commitment to our customers. I also extend my appreciation to our Board of Directors for its support and confidence in management.

The future is bright and we will continue to power forward,

**MAYO SCHMIDT**

*President and Chief Executive Officer*  
Hydro One Limited



**IN 2016, HYDRO ONE COMPLETED THE PURCHASE OF GREAT LAKES POWER TRANSMISSION, THE SECOND LARGEST ELECTRICITY TRANSMITTER IN ONTARIO. THIS ACQUISITION INCREASED HYDRO ONE'S TRANSMISSION CAPACITY IN ONTARIO TO 98%, WHILE IMPROVING THE COMPANY'S ABILITY TO CONNECT GENERATORS IN NORTHERN ONTARIO TO ELECTRICITY DEMAND IN SOUTHERN ONTARIO.**

## **ELECTRIC TRANSMISSION SEGMENT**

The scale of Hydro One's transmission operations increased during 2016 to approximately 30,000 circuit-kilometres of high-voltage lines. Hydro One transmits high-voltage electricity from nuclear, hydroelectric, natural gas, wind and solar generation sources to local distribution companies and to directly connected industrial customers across Ontario.

**Hydro One's transmission assets can be divided into three main categories:**

### **Transmission stations**

Used for the delivery of power, voltage transformation and switching, the stations serve as connection points for both customers and generators.

### **Transmission lines**

Bulk transmission lines deliver power from generating stations or connections to receiving terminal stations. Area supply lines take power from the network and transmit it to customer supply transmission stations at customer load centres.

### **Network operations**

The Ontario Grid Control Centre manages all of Hydro One's transmission and sub-transmission operations.

**During 2016, capital investments in Hydro One's transmission segment totaled \$988 million, including expenditures on the following projects:**

### **TORONTO MIDTOWN TRANSMISSION REINFORCEMENT PROJECT**

In 2016, Hydro One substantially completed work on the \$118 million Toronto Midtown Transmission Reinforcement Project which refurbished the existing transmission

infrastructure that serves midtown Toronto and areas to the west. This five-year project replaced 14,500 metres of transmission cables and provides 100 megawatts of additional capacity to serve the local distribution company and its customers.

### **GUELPH AREA TRANSMISSION REFRUBISHMENT PROJECT**

Hydro One substantially completed the \$87 million Guelph Area Transmission Refurbishment Project that will help meet the electricity needs of the growing southwestern Ontario region. The project included upgrading a five-kilometre section of existing transmission lines, and installing new transformer and switching equipment at the transformer station. More than 340 construction professionals were involved in the construction phase of the project.

### **COLLABORATION WITH LONDON HYDRO**

Hydro One entered into a collaborative investment with London Hydro to modernize the equipment in Hydro One's Nelson Transformer Station. Hydro One identified a need to replace aging equipment and London Hydro contributed financially for a voltage conversion of the station to be consistent with the other six local transformer stations, allowing the entire London Hydro system to be interconnected. The project will also increase the reliability of supply to an important station that serves much of downtown London.

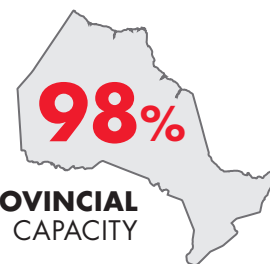
These projects together with many others underway ensure that Ontarians continue to receive a safe, reliable supply of electricity now, and for years to come.



**30,000**  
CIRCUIT KILOMETRES  
OF HIGH-VOLTAGE LINES



**306**  
TRANSMISSION  
STATIONS







**ONE OF NORTH  
AMERICA'S LARGEST  
ELECTRIC POWER  
TRANSMITTERS**

Photo courtesy of Brian Pieters Photography  
[www.pietersphoto.com](http://www.pietersphoto.com)



**HYDRO ONE'S 5,500 SKILLED AND DEDICATED EMPLOYEES SERVE 1.3 MILLION VALUED RESIDENTIAL AND BUSINESS CUSTOMERS ACROSS ONTARIO. HYDRO ONE IS THE PROVINCE'S LARGEST LOCAL ELECTRIC POWER DISTRIBUTION COMPANY WITH APPROXIMATELY 123,000 CIRCUIT KILOMETRES OF POWER LINES.**

## **ELECTRIC DISTRIBUTION SEGMENT**

Operating in rural, suburban and urban communities spread across the province of Ontario, home to 38 percent of the population of Canada, Hydro One possesses significant economies of scale and brings to bear a strong commitment to ensuring a modern and reliable local electricity system for its 1.3 million customers. This commitment also includes serving customers in 21 remote communities spread across the far reaches of northern Ontario that are not connected to the electricity transmission grid.

### **CUSTOMER CONSULTATION**

In mid-2016, Hydro One announced a province-wide consultation process to seek input from its customers on the development of a five-year rate plan that will help shape future investments in Hydro One's electric distribution system. The goal of the consultation was to better understand how Hydro One's customers' needs are being met by the current system, and the types of reliability and service improvements customers would value most. This included addressing aging electricity infrastructure, system repairs and responding to power outages, power quality and costs, as well as new products, services and web-enabled tools to make it easier for customers to do business with Hydro One.

The feedback influenced detailed plans that the company will submit to the Ontario Energy Board, who will ultimately determine the investments and rate plans for Hydro One's local distribution segment for the 2018 through 2022 period.

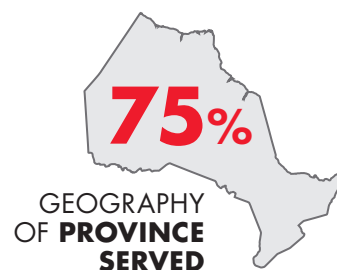
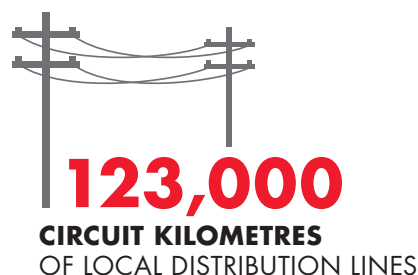
### **ACQUISITION OF ORILLIA POWER**

In August 2016, Hydro One announced that it reached a definitive agreement to acquire Orillia Power Distribution Corporation in a transaction valued at over \$41 million. Hydro One will integrate into its operations approximately 14,000 customers located in Simcoe County, home to a population of more than 30,000 and part of the Huronia region of Central Ontario.

Hydro One's current service territory includes the areas surrounding the City of Orillia and this acquisition enables Hydro One to realize operational synergies over time. After closing, Hydro One also intends to construct several grid control and operating facilities in Orillia. The acquisition is conditional upon the satisfaction of customary closing conditions and approval of the Ontario Energy Board.

### **SERVING MANITOULIN ISLAND**

In October 2016, Hydro One announced that a new distribution station will be built to serve customers on Manitoulin Island, located in northern Ontario on Lake Huron. The new distribution station will replace the Little Current Distribution Station, which was originally built in 1950, and will help improve reliability and increase capacity for the approximately 10,000 customers who live on Manitoulin Island.





**ONTARIO'S  
LARGEST LOCAL  
ELECTRIC POWER  
DISTRIBUTION  
COMPANY**







hydro  
one

**SERVING  
CUSTOMERS AND  
COMMUNITIES  
RELIABLY AND  
SAFELY**

# SERVING CUSTOMERS & COMMUNITIES

CUSTOMER  
SERVICE

RELIABILITY

SAFETY

FIRST NATIONS  
PARTNERSHIPS

SUSTAINABILITY

DIVERSITY

Throughout 2016, Hydro One's skilled and dedicated employees responded 24 hours a day, seven days a week to quickly and safely restore power for customers through often extremely challenging weather, terrain and circumstances. Hydro One also continued to provide new and enhanced programs and services to further define the company's commitment to customer service and energy conservation.

## PROACTIVE OUTAGE ALERTS

In early 2016, Hydro One was the first utility in Canada to offer customers proactive outage alerts. Customers who register for this service receive personalized email or text alerts about outages that may affect their homes, cottages, farms or small businesses, as well as information on estimated times of restoration. Since launching the program, Hydro One has sent hundreds of thousands of proactive alerts to customers. This service is an extension of Hydro One's existing suite of outage communication tools, which includes online outage maps and smartphone apps.

## GET LOCAL IN FIRST NATIONS COMMUNITIES

Hydro One began to offer a new service model in First Nations and Métis communities which focuses on local, face-to-face interactions to ensure customers are informed of and have access to all of the conservation and assistance programs the company offers. Meeting with Chiefs and Councils, representatives from Hydro One's Customer Service team visit communities throughout the province and conduct information-sharing sessions with customers.

## FARM RAPID RESPONSE TEAM

Hydro One announced the launch of its Farm Rapid Response Team that assists the company's 13,000 farming customers to identify, assess and mitigate on-farm electrical issues. This new approach better serves the needs of Hydro One's farming customers and was developed in partnership with the Ontario Federation of Agriculture. This streamlined process also provides Hydro One's farming customers a single, specialized point of contact to better assist with their specific on-farm concerns.

## PAPERLESS BILLING AND HIGH USAGE ALERTS

In late 2016, Hydro One launched paperless billing notifications and high usage alerts to provide customers with more visibility and control over their accounts and energy use. With billing notifications, customers sign up to receive paperless billing together with personalized insights and program promotions, which also provide a new online self-service channel for customers as an alternative to contacting the call centre. With high usage alerts, customers receive emails or text messages if their usage during a billing period is trending higher than a predefined threshold. Customers also receive guidance on how they can adjust their energy use before the end of the billing period. Through the enhanced web portal, customers can also easily find more information about their energy use, as well as explore a wide range of energy tips and conservation programs provided by Hydro One.

## COMMUNITY INVESTMENT

Throughout 2016, Hydro One committed millions of dollars in donations and sponsorships to communities it serves across Ontario. The contributions supported community projects such as the Markstay outdoor ice rink roof-building project for the local municipality, benefiting the community's local youth. Other community initiatives include the company's partnership with Right to Play's Promoting Life-Skills in Aboriginal Youth program, a non-profit organization that aims to deliver safe, fun and educational programming to Aboriginal youth.



For further information on Hydro One's commitments to customers go to

► [HydroOne.com/Commitments](http://HydroOne.com/Commitments)





## TRANSMITTING AND DELIVERING SOME OF THE CLEANEST ELECTRIC POWER IN NORTH AMERICA



**AS A STEWARD OF THE GRID, HYDRO ONE IS FOCUSED ON TRANSMITTING AND DELIVERING SAFE, CLEAN AND SUSTAINABLE ENERGY. THIS YEAR THE COMPANY PRODUCED ITS FIRST CORPORATE SOCIAL RESPONSIBILITY REPORT, ONE WHICH ADHERES TO THE GUIDELINES FOR THE G4 GLOBAL REPORTING INITIATIVE AND IS PART OF A CONTINUED EFFORT BY THE COMPANY TO ENHANCE THE TRANSPARENCY, ACCOUNTABILITY AND LINE OF SIGHT TO ITS SUSTAINABLE OPERATIONS.**

## ENVIRONMENTAL SUSTAINABILITY

### HEBER DOWN CONSERVATION AREA

Hydro One's Forestry team partnered with the Central Lake Ontario Conservation Authority and neighbouring utilities to mitigate the spread of Phragmites, an invasive species, on 3,500 square metres of a right-of-way corridor in the Heber Down Conservation Area. Challenging and costly to remove, such invasive species threaten lakes, rivers and forests. Together with a local contractor and using a variety of control methods based on location, density and surrounding vegetation of each area, the company began work on eliminating the invasive species from its right-of-way. With thousands of kilometres of transmission line corridors crossing the province, the company has taken a leadership role in engaging with local stakeholders, taking a proactive approach to land management and pooling community resources to manage the spread of invasive species.

### VEGETATION MANAGEMENT

To ensure the continued safe operation of Hydro One's transmission and distribution lines, the company conducts province-wide vegetation management operations to maintain reliability across the system. As part of the company's ongoing commitment to local communities, Hydro One has consulted with conservation authorities and is working with local seed distributors to develop and test pollinator-friendly seed mixes. Pollinators include various forms of bees, wasps, ants, flies, moths, beetles, bats and birds. These species feed on nectar and pollen from plants and their populations in Ontario are generally in decline due to habitat loss, disease, pesticide use and climate change. To mitigate this, Hydro One is working to incorporate pollinator-friendly seed as part of its vegetation management work in appropriate areas as an alternative to grass seed. Locally, this work supports provincial initiatives like the Pollinator Health Action Plan developed by the Ontario Ministry of Agriculture, Food and Rural Affairs.

### CORPORATE KNIGHT'S BEST 50 CORPORATE CITIZENS

Hydro One was ranked as the top utility in the 15th annual ranking of the 2015 Corporate Knights Canada's Best 50 Corporate Citizens. The Best 50 Corporate Citizens in Canada ranking assesses a broad range of Canadian enterprises on a set of 12 sustainability metrics, including carbon, water and waste productivity, percent of taxes paid, leadership gender diversity, innovation, health and safety performance, and pension fund quality. Being recognized as one of Canada's Best 50 Corporate Citizens is a testament to Hydro One's core values and demonstrates that the company continues to develop a strong culture of sustainability and corporate responsibility. Customers, investors and citizens of Ontario should expect that Hydro One will power forward in its responsible leadership on Corporate Citizenship in Canada.



For further information on Hydro One's commitments to the environment, go to [HydroOne.com/OurCommitment](http://HydroOne.com/OurCommitment)

# CORPORATE GOVERNANCE OVERVIEW

★ CHAIR ● MEMBER

BOARD OF DIRECTORS AND COMMITTEES	AUDIT	NOMINATING, CORPORATE GOVERNANCE, PUBLIC POLICY AND REGULATORY	HUMAN RESOURCES	HEALTH, SAFETY, ENVIRONMENT AND FIRST NATIONS AND MÉTIS
David Denison – Chair				
Mayo Schmidt – President and CEO				
Ian Bourne		●	★	
Charles Brindamour	●		●	
Marc Caira		●	●	
Christie Clark		●	●	
George Cooke	●			●
Marianne Harris			●	★
James Hinds	●			●
Kathryn Jackson		●		●
Roberta Jamieson	●			●
Frances Lankin	●	●		
Philip Orsino	★	●		
Jane Peverett		★	●	
Gale Rubenstein			●	●

Hydro One and its independent Board of Directors recognize the importance of corporate governance to the effective management of the company. Independence, integrity and accountability are the foundation of the company's approach to corporate governance. It is in the long-term best interests of shareholders as well as customers and promotes and strengthens relationships with employees, the communities in which the company operates and other stakeholders of the company. The Board of Directors is firmly supported in these commitments by a governance agreement between Hydro One and the Province of Ontario, which was executed in advance of the November 2015 initial public offering of the company and assures that the Province's role is limited to that of a shareholder and not a manager of the business.

Hydro One's Board of Directors is composed of a diverse and accomplished group of independent, proven business leaders with deep corporate governance experience. The Board's primary role is overseeing corporate performance and the quality, depth and continuity of management required to meet the company's strategic objectives. Hydro One is committed to best practices of corporate governance, and regularly reviews the company's governance practices in response to changing governance expectations and regulations. The Company's practices are fully aligned with the rules and regulations issued by Canadian Securities Administrators and the Toronto Stock Exchange, including national corporate governance guidelines and related disclosure requirements.

## HYDRO ONE'S GOOD GOVERNANCE PRACTICES

FULLY INDEPENDENT BOARD (EXCLUDING CEO)	CODE OF BUSINESS CONDUCT AND WHISTLEBLOWER HOTLINE	ANNUAL REVIEWS OF BOARD AND COMMITTEE PERFORMANCE
BOARD EDUCATION SESSIONS	COMMITTEE AUTHORITY TO RETAIN INDEPENDENT ADVISORS	BOARD AND COMMITTEE IN-CAMERA DISCUSSIONS
TERM LIMITS FOR DIRECTORS	DIRECTOR SHARE OWNERSHIP GUIDELINES	COMMITMENT TO DIRECTOR DIVERSITY
SEPARATE BOARD CHAIR AND CEO	MAJORITY VOTING FOR DIRECTORS	GOVERNANCE AGREEMENT WITH PROVINCE

 For a complete description of Hydro One's corporate governance structure and practices and individual director biographical information, go to [HydroOne.com/Investors](https://www.hydroone.com/Investors)

# TEN REASONS TO INVEST IN HYDRO ONE

1

One of the largest pure play electric utilities in North America, with significant scale and a leadership position in Canada's most populated province

2

Unique combination of electric transmission and local distribution, with no material exposure to commodity prices

3

Business is 99 percent regulated and operates in a stable, transparent and collaborative rate-regulated environment

4

Consistent rate base growth expected under multi-year capital investment program to upgrade aging electric power system infrastructure

5

Strong governance structure and a fully independent Board allow company to operate autonomously, transform its culture and drive shareholder value creation on multiple fronts

6

Timing of operational transformation coincident with transition to Ontario's incentive based regulatory framework expected to create value for both customers and shareholders

7

Proven management team with demonstrated experience in transforming organizations, accelerating performance and creating significant shareholder value

8

Attractive dividend yield with 70 – 80 percent target payout ratio and opportunity for growth with rate base expansion, efficiency realization and continued consolidation

9

Strong 'A'-rated investment grade balance sheet with one of the highest-quality credit profiles in the North American utility sector

10

**A unique opportunity to participate in the transformation of a premium, large-scale utility**





## 2016 FINANCIAL REPORT

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# Management's Discussion and Analysis

For the years ended December 31, 2016 and 2015

The following Management's Discussion and Analysis (MD&A) of the financial condition and results of operations should be read together with the consolidated financial statements and accompanying notes (the Consolidated Financial Statements) of Hydro One Limited (Hydro One or the Company) for the year ended December 31, 2016. The Consolidated Financial Statements are presented in Canadian dollars and have been prepared in accordance with United States (US) Generally Accepted Accounting Principles (GAAP). All financial information in this MD&A is presented in Canadian dollars, unless otherwise indicated.

The Company has prepared this MD&A in accordance with National Instrument 51-102 – Continuous Disclosure Obligations of the Canadian Securities Administrators. This MD&A provides information for the year ended December 31, 2016, based on information available to management as of February 9, 2017.

The comparative information consists of the results of Hydro One Inc. up to October 31, 2015, and the consolidated results of Hydro One and Hydro One Inc. from November 1, 2015 to December 31, 2015. See further details in section "Other Developments – Change in Hydro One Ownership Structure".

## Consolidated Financial Highlights And Statistics

Year ended December 31

(millions of dollars, except as otherwise noted)

	2016	2015	Change
Revenues	6,552	6,538	0.2%
Purchased power	3,427	3,450	(0.7%)
Revenues, net of purchased power	3,125	3,088	1.2%
Operation, maintenance and administration costs	1,069	1,135	(5.8%)
Depreciation and amortization	778	759	2.5%
Financing charges	393	376	4.5%
Income tax expense	139	105	32.4%
<b>Net income attributable to common shareholders of Hydro One</b>	<b>721</b>	<b>690</b>	<b>4.5%</b>
Basic earnings per common share (EPS)	\$ 1.21	\$ 1.39	(12.9%)
Diluted EPS	\$ 1.21	\$ 1.39	(12.9%)
Basic pro forma adjusted non-GAAP EPS (Adjusted EPS) <sup>1</sup>	\$ 1.21	\$ 1.16	4.5%
Diluted Adjusted EPS <sup>1</sup>	\$ 1.21	\$ 1.16	4.5%
Net cash from (used in) operating activities	1,656	(1,248)	232.7%
Adjusted net cash from operating activities <sup>1</sup>	1,656	1,562	6.0%
Funds from (used in) operations (FFO) <sup>1</sup>	1,494	(1,479)	201.0%
Adjusted FFO <sup>1</sup>	1,494	1,331	12.2%
Capital investments	1,697	1,663	2.0%
Assets placed in-service	1,605	1,476	8.7%
Transmission: Average monthly Ontario 60-minute peak demand (MW)	20,690	20,344	1.7%
Distribution: Electricity distributed to Hydro One customers (GWh)	26,289	28,764	(8.6%)
<b>December 31</b>	<b>2016</b>	<b>2015</b>	
Debt to capitalization ratio <sup>2</sup>	52.6%	50.7%	

<sup>1</sup> See section "Non-GAAP Measures" for description and reconciliation of Adjusted EPS, adjusted net cash from operating activities, FFO and Adjusted FFO.

<sup>2</sup> Debt to capitalization ratio has been calculated as total debt (includes total long-term debt and short-term borrowings, net of cash and cash equivalents) divided by total debt plus total shareholders' equity, including preferred shares but excluding any amounts related to noncontrolling interest.

## Overview

Hydro One is the largest electricity transmission and distribution company in Ontario. Through its wholly owned subsidiary, Hydro One Inc., Hydro One owns and operates substantially all of Ontario's electricity transmission network, and an approximately 123,000 circuit km low-voltage distribution network. Hydro One has three business segments: (i) transmission; (ii) distribution; and (iii) other business.

## Transmission Segment

Hydro One's transmission business owns, operates and maintains Hydro One's transmission system, which accounts for approximately 98% of Ontario's transmission capacity based on revenue approved

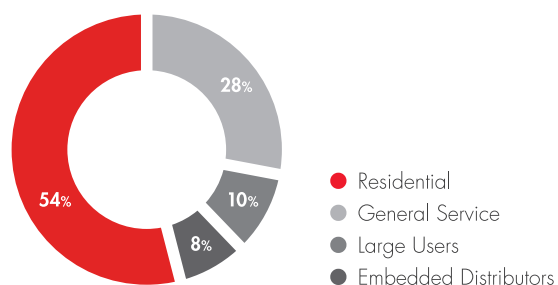
by the Ontario Energy Board (OEB). The Transmission Business consists of the transmission system operated by Hydro One Inc.'s subsidiaries, Hydro One Networks Inc. (Hydro One Networks) and Hydro One Sault Ste. Marie LP (formerly Great Lakes Power Transmission LP (Great Lakes Power)), as well as a 66% interest in B2M Limited Partnership (B2M LP), a limited partnership between Hydro One and the Saugeen Ojibway Nation in respect of the Bruce-to-Milton transmission line. The Company's transmission business is a rate-regulated business that earns revenues mainly from charging transmission rates that are approved by the OEB. The transmission business represented approximately 51% of the Company's total assets as at December 31, 2016, and approximately 51% of its 2016 revenues, net of purchased power.

	2016	2015
Electricity transmitted <sup>1</sup> (MWh)	136,989,747	137,011,780
Transmission lines spanning the province (circuit-kilometres)	30,259	29,355
Rate base (millions of dollars)	10,775	10,175
Capital investments (millions of dollars)	988	943
Assets placed in-service (millions of dollars)	937	696

<sup>1</sup> Electricity transmitted represents total electricity transmission in Ontario by all transmitters.

## Distribution Segment

Hydro One's distribution business is the largest in Ontario and consists of the distribution system operated by Hydro One Inc.'s subsidiaries Hydro One Networks and Hydro One Remote Communities Inc. The Company's distribution business is a rate-regulated business that earns revenues mainly by charging distribution rates that are approved by the OEB. The distribution business represented approximately 37% of the Company's total assets as at December 31, 2016, and approximately 47% of its 2016 revenues, net of purchased power.



	2016	2015
Electricity distributed to Hydro One customers (GWh)	26,289	28,764
Electricity distributed through Hydro One lines (GWh) <sup>1</sup>	37,394	40,721
Distribution lines spanning the province (circuit-kilometres)	122,599	123,425
Distribution customers (number of customers)	1,355,302	1,347,231
Rate base (millions of dollars)	7,056	6,739
Capital investments (millions of dollars)	703	711
Assets placed in-service (millions of dollars)	662	775

<sup>1</sup> Units distributed through Hydro One lines represent total distribution system requirements and include electricity distributed to consumers who purchased power directly from the Independent Electricity System Operator (IESO).

## Other Business Segment

Hydro One's other business segment consists of the Company's telecommunications business and certain corporate activities. The telecommunications business provides telecommunications support for the Company's transmission and distribution businesses, and also offers communications and IT solutions to organizations with broadband

network requirements utilizing Hydro One Telecom Inc.'s (Hydro One Telecom) fibre optic network to provide diverse, secure and highly reliable broadband connectivity. Hydro One's other business segment is not rate-regulated. This segment represented approximately 12% of Hydro One's total assets as at December 31, 2016, and approximately 2% of its 2016 revenues, net of purchased power.



## Primary Factors Affecting Results Of Operations

### Transmission Revenues

Transmission revenues primarily consist of the Company's transmission rates approved by the OEB which are charged based on the monthly peak electricity demand across Hydro One's high-voltage network. Transmission rates are designed to generate revenues necessary to construct, upgrade, extend and support a transmission system with sufficient capacity to accommodate maximum forecasted demand and a regulated return on the Company's investment. Peak electricity demand is primarily influenced by weather and economic conditions. Transmission revenues also include export revenues associated with transmitting electricity to markets outside of Ontario. Ancillary revenues include revenues from providing maintenance services to power generators and from third-party land use.

### Distribution Revenues

Distribution revenues include the distribution rates approved by the OEB and amounts to recover the cost of purchased power used by the customers of the distribution business. Distribution rates are designed to generate revenues necessary to construct and support the local distribution system with sufficient capacity to accommodate existing and new customer demand and a regulated return on the Company's investment. Accordingly, distribution revenues are influenced by distribution rates, the cost of purchased power, and the amount of electricity the Company distributes. Distribution revenues also include ancillary distribution service revenues, such as fees related to the joint use of Hydro One's distribution poles by the telecommunications and cable television industries, as well as miscellaneous revenues such as charges for late payments.

### Purchased Power Costs

Purchased power costs are incurred by the distribution business and represent the cost of the electricity purchased by the Company for delivery to customers within Hydro One's distribution service territory. These costs comprise the wholesale commodity cost of energy, in addition to wholesale market service and transmission charges levied by the IESO. Hydro One passes the cost of electricity that it delivers to its customers, and is therefore not exposed to wholesale electricity commodity price risk.

### Operation, Maintenance and Administration Costs

Operation, maintenance and administration (OM&A) costs are incurred to support the operation and maintenance of the transmission and distribution systems, and other costs such as property taxes related to transmission and distribution lines, stations and buildings. Transmission OM&A costs are incurred to sustain the Company's

high-voltage transmission stations, lines and rights-of-way, and include preventive and corrective maintenance costs related to power equipment, overhead transmission lines, transmission station sites, and forestry control to maintain safe distance between line spans and trees. Distribution OM&A costs are required to maintain the Company's low-voltage distribution system, and include costs related to distribution line clearing and forestry control to reduce power outages caused by trees, line maintenance and repair, as well as land assessment and remediation. Hydro One manages its costs through ongoing efficiency and productivity initiatives, while continuing to complete planned work programs associated with the development and maintenance of its transmission and distribution networks.

### Depreciation and Amortization

Depreciation and amortization costs relate primarily to depreciation of the Company's property, plant and equipment, and amortization of certain intangible assets and regulatory assets. Depreciation and amortization also includes the costs incurred to remove property, plant and equipment where no asset retirement obligations have been recorded on the balance sheet.

### Financing Charges

Financing charges relate to the Company's financing activities, and include interest expense on the Company's long-term debt and short-term borrowings, gains and losses on interest rate swap agreements, net of interest earned on short-term investments. A portion of financing charges incurred by the Company is capitalized to the cost of property, plant and equipment associated with the periods during which such assets are under construction before being placed in-service.

### Income Taxes

Hydro One and its subsidiaries were exempt from regular Canadian federal and Ontario income tax (Federal Tax Regime) and instead paid an equivalent amount referred to as payments in lieu of corporate income taxes (PILs) to the Ontario Electricity Financial Corporation (OEFC) under the *Electricity Act* (PILs Regime) until October 2015. Since then, Hydro One and its subsidiaries have been subject to the Federal Tax Regime.

## Results of Operations

### Net Income

Net income attributable to common shareholders for the year ended December 31, 2016 was \$721 million, an increase of 4.5% from the prior year. Earnings were positively affected by lower OM&A and higher revenues net of purchased power. These positive effects were partly offset by non-recurring items related to the Company's IPO in 2015, namely an increase in the effective tax rate primarily driven by IPO-related tax benefit of \$19 million recorded in 2015 and divestiture of Hydro One Brampton Inc. (Hydro One Brampton) in 2015. Excluding these IPO-related effects, net income increased by 10.9%.

### Basic EPS and Adjusted Basic EPS

Basic EPS was \$1.21 in 2016 (2015 – \$1.39). Basic EPS is significantly affected by the weighted average number of shares in issue being different from last year due to the effects of the IPO, and is the most significant reason for the lower EPS compared to last year.

Adjusted Basic EPS, which adjusts for the inconsistent number of shares in issue, was \$1.21 in 2016 (2015 – \$1.16), driven by increased net income compared to last year. See section "Non-GAAP Measures" for description of Adjusted EPS.

### Revenues

Year ended December 31

(millions of dollars, except as otherwise noted)

	2016	2015	Change
Transmission	1,584	1,536	3.1%
Distribution	4,915	4,949	(0.7%)
Other	53	53	–
	<b>6,552</b>	<b>6,538</b>	<b>0.2%</b>
Transmission volumes: Average monthly Ontario 60-minute peak demand (MW)	20,690	20,344	1.7%
Distribution volumes: Electricity distributed to Hydro One customers (GWh)	26,289	28,764	(8.6%)

### Transmission Revenues

Transmission revenues increased by 3.1% in 2016 primarily due to the following:

- prior year revenues were affected by a regulatory driven reduction of \$28 million related to differences between actual and forecast province-wide conservation and demand management savings during 2014, which did not recur in 2016;
- higher average monthly Ontario 60-minute peak demand mainly due to warmer weather in the second and third quarters of 2016, as well as the impact of several extremely cold days that more than offset the overall milder weather in the fourth quarter of 2016; and
- increased OEB-approved transmission rates for 2016.

### Distribution Revenues

Distribution revenues decreased by 0.7% in 2016 primarily due to the following:

- the divestiture of Hydro One Brampton in August 2015, which also caused the majority of the decrease in distribution volumes; and
- lower overall energy consumption resulting from milder weather in the first and fourth quarters of 2016; partially offset by
- higher power costs from generators that are passed on to customers, excluding the impact of divestiture of Hydro One Brampton;
- increased OEB-approved distribution rates for 2016; and
- increased revenues due to a rate order related to shared-use revenue.

### Operation, Maintenance and Administration Costs

Year ended December 31

(millions of dollars)

	2016	2015	Change
Transmission	382	414	(7.7%)
Distribution	608	633	(3.9%)
Other	79	88	(10.2%)
	<b>1,069</b>	<b>1,135</b>	<b>(5.8%)</b>

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Transmission OM&A Costs

Transmission OM&A decreased by 7.7% in 2016 primarily due to lower project cost and inventory write-downs coupled with lower activity related to transformer equipment refurbishments and stations maintenance.

### Distribution OM&A Costs

Distribution OM&A decreased by 3.9% in 2016 primarily due to the following:

- decrease in bad debt expense including the impact of revised estimates of uncollectible accounts;
- the divestiture of Hydro One Brampton in August 2015;
- lower support services costs; and
- lower costs associated with underground distribution cable locates; partially offset by
- higher volume of vegetation management activities.

### Other OM&A Costs

Other OM&A decreased by 10.2% in 2016 primarily due to lower costs relating to the integration of acquired local distribution companies and lower consulting costs.

### Depreciation and Amortization

The increase of \$19 million or 2.5% in depreciation and amortization costs for 2016 was mainly due to the growth in capital assets as the Company continues to place new assets in-service, consistent with its ongoing capital investment program.

### Financing Charges

The increase of \$17 million or 4.5% in financing charges for 2016 was mainly due to the following:

- an increase in interest expense on long-term debt mainly due to the increase in weighted average long-term debt balance outstanding during the year, partially offset by a decrease in the weighted average interest rate for long-term debt; and
- an increase in interest expense on short-term notes mainly due to the increase in weighted average short-term notes balance outstanding during the year, as well as an increase in the weighted average interest rate for short-term notes.

### Income Tax Expense

Income tax expense in 2016 increased by \$34 million compared to 2015, and the Company realized an effective tax rate of approximately 15.7% in 2016, compared to approximately 12.8% realized in 2015. The increase in the tax expense is primarily due to the effect of an IPO-related positive tax adjustment of \$19 million in 2015, coupled with higher income before taxes in 2016.

## Common Share Dividends

In 2016, the Company declared and paid cash dividends to common shareholders as follows:

Date Declared	Record Date	Payment Date	Amount per Share	Total Amount (millions of dollars)
February 11, 2016	March 17, 2016	March 31, 2016	\$0.34 <sup>1</sup>	202
May 5, 2016	June 14, 2016	June 30, 2016	\$0.21	125
August 11, 2016	September 14, 2016	September 30, 2016	\$0.21	125
November 10, 2016	December 14, 2016	December 30, 2016	\$0.21	125
				577

<sup>1</sup> This was the first common share dividend declared by the Company following the completion of its initial public offering in November 2015. The \$0.34 per share dividend included \$0.13 for the post-IPO period from November 5 to December 31, 2015, and \$0.21 for the quarter ended March 31, 2016.

Following the conclusion of the fourth quarter of 2016, the Company declared a cash dividend to common shareholders as follows:

Date Declared	Record Date	Payment Date	Amount per Share	Total Amount (millions of dollars)
February 9, 2017	March 14, 2016	March 31, 2017	\$0.21	125



## Divestiture of Hydro One Brampton

On August 31, 2015, a dividend was paid to the Province of Ontario (Province) by transferring to a company wholly owned by the Province all of the issued and outstanding shares of Hydro One Brampton and inter-company indebtedness owed to Hydro One Inc.

by Hydro One Brampton. Hydro One's 2015 consolidated results of operations include the results of Hydro One Brampton up to August 31, 2015. The following tables present quarterly results of Hydro One Brampton that were included in consolidated results of Hydro One for the year ended December 31, 2015.

<i>Quarter ended</i> <i>(millions of dollars)</i>	Mar. 31, 2015	Jun. 30, 2015	Sept. 30, 2015	Dec. 31, 2015	2015 Total
Revenues	125	129	100	–	354
Purchased power	107	111	88	–	306
OM&A	6	6	4	–	16
Depreciation and amortization	5	4	2	–	11
Income tax expense	–	1	(1)	–	–
Net income	7	7	7	–	21
Capital investments	9	11	8	–	28

## Selected Annual Financial Statistics

*Year ended December 31*

*(millions of dollars, except per share amounts)*

	2016	2015	2014
Total revenue	6,552	6,538	6,548
Net income attributable to common shareholders	721	690	731
Basic and diluted EPS	\$ 1.21	\$ 1.39	\$ 1.53
Basic and diluted Adjusted EPS	\$ 1.21	\$ 1.16	\$ 1.23
Dividends per common share declared	\$ 0.97 <sup>1</sup>	\$ 1.83	\$ 0.56
Dividends per preferred share declared	\$ 1.12	\$ 1.03	\$ 1.38

<sup>1</sup> The \$0.97 per share dividends declared in 2016 included \$0.13 for the post-IPO period from November 5 to December 31, 2015, and \$0.84 for the year ended December 31, 2016.

*December 31*

*(millions of dollars)*

	2016	2015	2014
Total assets	25,351	24,294	22,550
Total non-current financial liabilities	10,078	8,207	8,373

## Quarterly Results of Operations

<i>Quarter ended</i> <i>(millions of dollars, except EPS)</i>	Dec. 31, 2016	Sept. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
Revenues	1,614	1,706	1,546	1,686	1,522	1,645	1,563	1,808
Purchased power	858	870	803	896	786	856	838	970
Revenues, net of purchased power	756	836	743	790	736	789	725	838
Net income to common shareholders	128	233	152	208	143	188	131	228
Basic EPS	\$ 0.22	\$ 0.39	\$ 0.26	\$ 0.35	\$ 0.26	\$ 0.39	\$ 0.27	\$ 0.47
Diluted EPS	\$ 0.21	\$ 0.39	\$ 0.25	\$ 0.35	\$ 0.26	\$ 0.39	\$ 0.27	\$ 0.47
Basic Adjusted EPS	\$ 0.22	\$ 0.39	\$ 0.26	\$ 0.35	\$ 0.24	\$ 0.32	\$ 0.22	\$ 0.38
Diluted Adjusted EPS	\$ 0.21	\$ 0.39	\$ 0.25	\$ 0.35	\$ 0.24	\$ 0.32	\$ 0.22	\$ 0.38

Variations in revenues and net income over the quarters are primarily due to the impact of seasonal weather conditions on customer demand and market pricing.

## Capital Investments

The Company makes capital investments to maintain the safety, reliability and integrity of its transmission and distribution assets and to provide for the ongoing growth and modernization required to meet the expanding and evolving needs of its customers and the electricity market. This is achieved through a combination of sustaining capital

investments, which are required to support the continued operation of Hydro One's existing assets, and development capital investments, which involve both additions to existing assets and large scale projects such as new transmission lines and transmission stations.

The following table presents Hydro One's 2016 and 2015 capital investments:

Year ended December 31

(millions of dollars)

	2016	2015	Change
<b>Transmission</b>			
Sustaining	750	706	6.2%
Development	156	166	(6.0%)
Other	82	71	15.5%
	<b>988</b>	<b>943</b>	<b>4.8%</b>
<b>Distribution</b>			
Sustaining	384	398	(3.5%)
Development	217	220	(1.4%)
Other	102	93	9.7%
	<b>703</b>	<b>711</b>	<b>(1.1%)</b>
<b>Other</b>	<b>6</b>	<b>9</b>	<b>(33.3%)</b>
<b>Total capital investments</b>	<b>1,697</b>	<b>1,663</b>	<b>2.0%</b>

### Transmission Capital Investments

Transmission capital investments increased by \$45 million or 4.8% in 2016. Principal impacts on the levels of capital investments included:

- an increased volume of work on overhead line refurbishments and insulator replacements;
- an increased volume of integrated station component replacements to sustain certain aging assets at transmission stations;
- continued work on major local area supply network development projects, such as the Holland Transmission Station, the Hawthorne Transmission Station, and the Toronto Midtown Transmission Reinforcement; and
- increased investments relating to information technology infrastructure and customer programs, enhancement projects, including investments to integrate mobile technology with the Company's existing work management tools; partially offset by
- decreased investments in system enhancement projects, primarily due to completion of certain projects and a difference in timing of work on other projects; and
- completion of the Guelph Area Transmission Refurbishment project.

### Distribution Capital Investments

Distribution capital investments decreased by \$8 million or 1.1% in 2016. Principal impacts on the levels of capital investments included:

- reduced capital expenditures due to the divestiture of Hydro One Brampton in 2015; and
- a lower volume of work within station refurbishment programs and lower volume of spare transformer purchases; partially offset by
- increased investments related to information technology infrastructure and customer programs together with upgrade and enhancement projects, including investments to integrate mobile technology with the Company's existing work management tools; and
- investments in smart grid technology to mitigate power quality impacts of distributed generation and to improve outage response times.

## Major Transmission Capital Investment Projects

The following table summarizes the status of significant transmission projects as at December 31, 2016:

Project Name	Location	Type	Anticipated In-Service Date	Estimated Cost	Capital Cost To-Date
<b>Development Projects:</b>					
Guelph Area Transmission Refurbishment	Guelph area Southwestern Ontario	Transmission line upgrade	September 2016 <sup>1</sup>	\$87 million	\$86 million
Toronto Midtown Transmission Reinforcement	Toronto Southwestern Ontario	New transmission line	December 2016 <sup>2</sup>	\$118 million	\$113 million
Supply to Essex County Transmission Reinforcement	Windsor-Essex area Southwestern Ontario	New transmission line and station	2018	\$73 million	\$13 million
Clarington Transmission Station	Oshawa area Southwestern Ontario	New transmission station	2018	\$267 million	\$192 million
Northwest Bulk Transmission Line	Thunder Bay Northwestern Ontario	New transmission line	To be determined	To be determined	–
East-West Tie Station Expansion	Northern Ontario	Station expansion	2020	\$166 million	–
<b>Sustainment Projects:</b>					
Bruce A Transmission Station	Tiverton Southwestern Ontario	Station sustainment	2019	\$109 million	\$83 million
Richview Transmission Station Circuit Breaker Replacement	Toronto Southwestern Ontario	Station sustainment	2019	\$102 million	\$68 million
Lennox Transmission Station Circuit Breaker Replacement	Napanee Southeastern Ontario	Station sustainment	2020	\$95 million	\$15 million
Beck #2 Transmission Station Circuit Breaker Replacement	Niagara area Southwestern Ontario	Station sustainment	2021	\$93 million	\$28 million

<sup>1</sup> Major portions of the project were completed and placed in-service in September 2016. Work on certain minor portions of the project continues in the first quarter of 2017.

<sup>2</sup> Major portions of the project were completed and placed in-service in December 2016. Work on certain minor portions of the project continues in the first quarter of 2017.

## Future Capital Investments

Following is a summary of estimated capital investments by Hydro One over the next five years. The Company's estimates are based on management's expectations of the amount of capital expenditures that will be required to provide transmission and distribution services that are efficient, reliable, and provide value for customers, consistent with the OEB's Renewed Regulatory Framework. These estimates differ

from the prior year disclosures, reflecting annual increases of \$126 million for 2017, \$113 million for 2018, \$239 million for 2019, and \$360 million for 2020. These future capital investments reflect management's best estimates and, as applicable, projections included in rate filings currently in process. These projections and the timing of expenditures are in large part subject to approval by the OEB, and will be adjusted going forward as appropriate to reflect rate decisions by the OEB.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following table summarizes Hydro One's annual projected capital investments for 2017 to 2021, by business segment:

<i>(millions of dollars)</i>	2017	2018	2019	2020	2021
Transmission	1,086	1,132	1,217	1,278	1,486
Distribution	648	647	771	735	749
Other	12	9	8	6	8
<b>Total capital investments</b>	<b>1,746</b>	<b>1,788</b>	<b>1,996</b>	<b>2,019</b>	<b>2,243</b>

The following table summarizes Hydro One's annual projected capital investments for 2017 to 2021, by category:

<i>(millions of dollars)</i>	2017	2018	2019	2020	2021
Sustaining	1,107	1,165	1,219	1,327	1,546
Development	414	400	484	487	490
Other <sup>1</sup>	225	223	293	205	207
<b>Total capital investments</b>	<b>1,746</b>	<b>1,788</b>	<b>1,996</b>	<b>2,019</b>	<b>2,243</b>

<sup>1</sup> "Other" capital expenditures consist of special projects, such as those relating to information technology.

## Summary Of Sources And Uses Of Cash

Hydro One's primary sources of cash flows are funds generated from operations, capital market debt issuances and bank credit facilities that are used to satisfy Hydro One's capital resource requirements, including the Company's capital expenditures, servicing and repayment of debt, and dividend payments.

Year ended December 31

<i>(millions of dollars)</i>	2016	2015
Cash provided by (used in) operating activities	1,656	(1,248)
Cash provided by financing activities	161	2,954
Cash used in investing activities	(1,861)	(1,712)
<b>Decrease in cash and cash equivalents</b>	<b>(44)</b>	<b>(6)</b>

### Primary factors behind the increase in cash provided by operating activities

The increase in cash provided by operating activities is primarily due to a deferred tax recovery of \$2.8 billion recorded in 2015 that resulted as a consequence of leaving the PILs Regime and entering the Federal Tax Regime.

### Primary factors behind the decrease in cash provided by financing activities

#### Sources of cash

- The Company received \$2.3 billion proceeds from issuance of long-term debt in 2016, compared to \$350 million received last year.
- The Company received \$3,031 million proceeds from issuance of short-term notes in 2016, compared to \$2,891 million received last year.
- In 2015, the Company received \$2.6 billion proceeds from common shares issued to the Province prior to the completion of the initial public offering (IPO).

#### Uses of cash

- Dividends paid in 2016 were \$596 million, consisting of \$577 million common share dividends and \$19 million preferred share dividends, compared to \$888 million paid in 2015. 2015 dividends consisted of \$75 million common share dividends, \$13 million preferred share dividends, as well as an \$800 million special dividend paid to the Province prior to the completion of the IPO.
- The Company repaid \$4,053 million of short-term notes, compared to \$1,400 million repaid last year.
- The Company repaid \$502 million of long-term debt in 2016 compared to \$585 million repaid last year.



## Primary factors behind the increase in cash used in investing activities

### Uses of cash

- Capital expenditures were \$29 million higher in 2016, primarily due to increased transmission capital investments consistent with the Company's ongoing capital investment program.
- In 2016, the Company paid \$226 million to acquire Great Lakes Power, compared to a total of \$90 million paid in 2015 to acquire Haldimand County Utilities Inc. (Haldimand Hydro) and Woodstock Hydro Holdings Inc. (Woodstock Hydro).
- In August 2015, an investment of \$53 million was made in Hydro One Brampton prior to its divestiture to the Province.

## Liquidity and Financing Strategy

Short-term liquidity is provided through funds from operations, Hydro One Inc.'s commercial paper program, and the Company's consolidated bank credit facilities. Under the commercial paper program, Hydro One Inc. is authorized to issue up to \$1.5 billion in short-term notes with a term to maturity of up to 365 days. At December 31, 2016, Hydro One Inc. had \$469 million in commercial paper borrowings outstanding, compared to \$1,491 million outstanding at December 31, 2015. In addition, the Company and Hydro One Inc. have revolving bank credit facilities totalling \$2,550 million maturing in 2021. The Company may use the credit facilities for working capital and general corporate purposes. The short-term liquidity under the commercial paper program, the credit facilities and anticipated levels of funds from operations are expected to be sufficient to fund the Company's normal operating requirements.

At December 31, 2016, the Company's long-term debt in the principal amount of \$10,671 million included \$10,523 million long-term debt issued under Hydro One Inc.'s Medium Term Note (MTN) Program and long-term debt in the principal amount of \$148 million held by Great Lakes Power. At December 31, 2016, the maximum authorized principal amount of notes issuable under the current MTN Program prospectus filed in December 2015 was \$3.5 billion, with \$1.2 billion remaining available for issuance until January 2018. The

long-term debt consists of notes and debentures that mature between 2017 and 2064, and at December 31, 2016, had an average term to maturity of approximately 15.9 years and a weighted average coupon of 4.3%.

On March 30, 2016, Hydro One filed a final universal short form base shelf prospectus (Universal Base Shelf Prospectus) with securities regulatory authorities in Canada. The Universal Base Shelf Prospectus allows Hydro One to offer, from time to time in one or more public offerings, up to \$8.0 billion of debt, equity or other securities, or any combination thereof, during the 25-month period ending on April 30, 2018. Hydro One filed the Universal Base Shelf Prospectus in part to facilitate the secondary offerings of outstanding shares of the Company by the Province, and to provide the Company with increased financing flexibility going forward. In 2016, Hydro One completed a secondary offering of a portion of its common shares previously owned by the Province. See section "Other Developments – Change in Hydro One Ownership Structure" for details of this transaction. Upon closing of the transaction, \$6,030 million remained available under the Universal Base Shelf Prospectus.

At December 31, 2016, the Company and Hydro One Inc. were in compliance with all financial covenants and limitations associated with the outstanding borrowings and credit facilities.

## Credit Ratings

At December 31, 2016, Hydro One's corporate credit ratings were as follows:

Rating Agency	Corporate Credit Rating
Standard & Poor's Rating Services (S&P)	A

Hydro One has not obtained a credit rating in respect of any of its securities. An issuer rating from S&P is a forward-looking opinion about an obligor's overall creditworthiness. This opinion focuses on the obligor's capacity and willingness to meet its financial commitments as they come due but it does not apply to any specific financial obligation. An obligor with a long-term credit rating of 'A' has strong capacity to meet its financial commitments but is somewhat

more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.

The rating above is not a recommendation to purchase, sell or hold any of Hydro One's securities and does not comment on the market price or suitability of any of the securities for a particular investor. There can be no assurance that the rating will remain in effect for any

## MANAGEMENT'S DISCUSSION AND ANALYSIS

given period of time or that the rating will not be revised or withdrawn entirely by S&P at any time in the future. Hydro One has made, and anticipates making, payments to S&P pursuant to

agreements entered into with S&P in respect of the rating assigned to Hydro One and expects to make payments to S&P in the future to the extent it obtains a rating specific to any of its securities.

At December 31, 2016, Hydro One Inc.'s long-term and short-term debt ratings were as follows:

Rating Agency	Short-term Debt	Long-term Debt
	Rating	Rating
DBRS Limited	R-1 (low)	A (high)
Moody's Investors Service	Prime-2	A3
S&P	A-1	A

### Effect of Interest Rates

The Company is exposed to fluctuations of interest rates as its regulated return on equity (ROE) is derived using a formulaic approach that takes into account changes in benchmark interest rates for Government of Canada debt and the A-rated utility corporate bond yield spread. See section "Risk Management and Risk Factors – Risks Relating to Hydro One's Business – Market, Financial Instrument and Credit Risk" for more details.

### Pension Plan

In 2016, Hydro One contributed approximately \$108 million to its pension plan, compared to contributions of approximately \$177 million in 2015, and incurred \$116 million in net periodic pension benefit costs, compared to \$163 million incurred in 2015.

In June 2016, Hydro One Inc. filed an actuarial valuation of its Pension Plan as at December 31, 2015. Based on this valuation and 2016 levels of pensionable earnings, the 2016 annual employer contributions have decreased by approximately \$72 million from \$180 million as estimated at December 31, 2015, primarily due to improvements in the funded status of the plan and future actuarial assumptions. The decrease also reflects the impact of changes implemented by management to improve the balance between

employee and Company contributions to the Pension Plan. The updated actuarial valuation resulted in a \$25 million decrease in 2016 revenue with a corresponding decrease in OM&A costs, as the lower pension contributions will be returned to customers through the pension cost variance deferral account in future rate applications. The Company estimates that total pension contributions for 2017 and 2018 will be approximately \$105 million and \$102 million, respectively.

The Company's pension benefits obligation is impacted by various assumptions and estimates, such as discount rate, rate of return on plan assets, rate of cost of living increase and mortality assumptions. A full discussion of the significant assumptions and estimates can be found in the section "Critical Accounting Estimates – Employee Future Benefits".

### Other Obligations

#### Off-Balance Sheet Arrangements

There are no off-balance sheet arrangements that have, or are reasonably likely to have, a material current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

## Summary of Contractual Obligations and Other Commercial Commitments

The following table presents a summary of Hydro One's debt and other major contractual obligations and commercial commitments:

<i>December 31, 2016</i> <i>(millions of dollars)</i>	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
<b>Contractual obligations (due by year)</b>					
Long-term debt – principal repayments	10,671	602	1,484	1,156	7,429
Long-term debt – interest payments	8,145	456	827	754	6,108
Short-term notes payable	469	469	–	–	–
Pension contributions <sup>1</sup>	207	105	102	–	–
Environmental and asset retirement obligations	243	27	51	65	100
Outsourcing agreements	374	165	196	4	9
Operating lease commitments	42	11	16	13	2
Long-term software/meter agreement	73	17	33	18	5
<b>Total contractual obligations</b>	<b>20,224</b>	<b>1,852</b>	<b>2,709</b>	<b>2,010</b>	<b>13,653</b>
<b>Other commercial commitments (by year of expiry)</b>					
Credit facilities <sup>2</sup>	2,550	–	–	2,550	–
Letters of credit <sup>3</sup>	174	174	–	–	–
Guarantees <sup>4</sup>	330	330	–	–	–
<b>Total other commercial commitments</b>	<b>3,054</b>	<b>504</b>	<b>–</b>	<b>2,550</b>	<b>–</b>

<sup>1</sup> Contributions to the Hydro One Pension Fund are generally made one month in arrears. The 2017 and 2018 minimum pension contributions are based on an actuarial valuation as at December 31, 2015 and projected levels of pensionable earnings.

<sup>2</sup> On August 15, 2016, Hydro One Inc. terminated its credit facilities totalling \$2.3 billion maturing in June 2020 and October 2018, and entered into a new \$2.3 billion credit facility maturing in June 2021. On November 7, 2016, the maturity date of Hydro One's \$250 million credit facility was extended from November 2020 to November 2021.

<sup>3</sup> Letters of credit consist of a \$150 million letter of credit related to retirement compensation arrangements, and letters of credit totalling \$24 million provided as prudential support.

<sup>4</sup> Guarantees consist of prudential support provided to the IESO by Hydro One Inc. on behalf of its subsidiaries.

## Regulation

The OEB approves both the revenue requirements of and the rates charged by Hydro One's regulated transmission and distribution businesses. The rates are designed to permit the Company's transmission and distribution businesses to recover the allowed costs

and to earn a formula-based annual rate of return on its equity invested in the regulated businesses. This is done by applying a specified equity risk premium to forecasted interest rates on long-term bonds. In addition, the OEB approves rate riders to allow for the recovery or disposition of specific regulatory deferral accounts over specified time frames.

The following table summarizes the status of Hydro One's major regulatory proceedings:

Application	Year(s)	Type	Status
<b>Electricity Rates</b>			
Hydro One Networks	2015-2016	Transmission – Cost-of-service	OEB decision received
Hydro One Networks	2017-2018	Transmission – Cost-of-service	OEB decision pending
Hydro One Networks	2015-2017	Distribution – Custom	OEB decision received
B2M LP	2015-2019	Transmission – Cost-of-service	OEB decision received
Great Lakes Power	2017	Transmission – Cost-of-service	OEB decision pending
<b>Mergers Acquisitions Amalgamations and Divestitures</b>			
Great Lakes Power	n/a	Acquisition	OEB decision received
Orillia Power	n/a	Acquisition	OEB decision pending
<b>Leave to Construct</b>			
Supply to Essex County Transmission Reinforcement Project	n/a	Section 92	OEB decision received

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Hydro One has obtained revenue requirement approvals from the OEB, subject to certain annual adjustments, for Hydro One Networks' transmission business through 2016, for B2M LP through

2019, and for Hydro One Networks' distribution business to the end of 2017. The following table summarizes the key elements and status of Hydro One's electricity rate applications:

Application	Year	ROE Allowed (A) or Forecast (F)	Rate Base	Rate Application Status	Rate Order Status
<b>Transmission</b>					
Hydro One Networks	2016	9.19% (A)	\$10,040 million	Approved in January 2015	Approved in January 2016
	2017	8.78% (A)	\$10,554 million	Filed in May 2016	To be filed in 2017 Q1
	2018	8.78% (F)	\$11,226 million	Filed in May 2016	To be filed in 2017 Q4
B2M LP	2016	9.19% (A)	\$516 million	Approved in December 2015	Approved in January 2016
	2017	8.78% (A)	\$509 million	Approved in December 2015	Filed in December 2016
	2018	8.78% (F)	\$502 million	Approved in December 2015	To be filed in 2017 Q4
	2019	8.78% (F)	\$496 million	Approved in December 2015	To be filed in 2018 Q4
Great Lakes Power	2017	9.19% (F)	\$218 million	Filed in December 2016	Filed in December 2016
<b>Distribution</b>					
Hydro One Networks	2016	9.19% (A)	\$6,863 million	Approved in March 2015	Approved in April 2015
	2017	8.78% (A)	\$7,190 million	Approved in March 2015	Approved in December 2016

### Hydro One Networks

On May 31, 2016, Hydro One Networks filed a cost-of-service application with the OEB for 2017 and 2018 transmission rates. The application seeks approval of rate base of \$10,554 million for 2017 and \$11,226 million for 2018. In October 2016, the OEB issued updated cost of capital parameters for rates effective in 2017, including an updated 2017 allowed ROE of 8.78%. The application also lays out a planned transmission capital investment program for the five-year period ending on December 31, 2021, with investments in capital spending primarily to address reliability, safety and customer needs, in a cost-effective manner. Management expects that a decision will be received in the first half of 2017, and that new rates will be retroactive to January 1, 2017. Future transmission rate applications are anticipated to be filed under the OEB's incentive-based regulatory framework.

Hydro One Networks plans to submit an application for 2018-2022 distribution rates under the OEB's incentive-based regulatory framework in the first quarter of 2017.

### B2M LP

On January 14, 2016, the OEB issued its Decision and Rate Order approving the B2M LP revenue requirement recovery through the 2016 Uniform Transmission Rates. On December 1, 2016, B2M LP filed a Draft Rate Order with a revised 2017 revenue requirement of \$34 million, reflecting updated 2017 cost of capital parameters issued by the OEB in October 2016.

### Other Regulatory Developments

#### OEB Pension and Other Post-Employment Benefits (OPEB) Generic Hearing

In 2015, the OEB began a consultation process to examine pensions and OPEBs in rate-regulated utilities, with the objectives of developing standard principles to guide its review of pension and OPEB related costs in the future, and to establish specific requirements for applications and appropriate and consistent regulatory mechanisms for cost recovery. Hydro One and other stakeholders filed written submissions with respect to initial OEB questions intended to solicit views on the key issues of interest to the OEB. Following a stakeholder forum in July 2016, updated written submissions were filed with the OEB in September 2016. It is anticipated that subsequent to the OEB's review of the updated written submissions, the OEB will outline principles to guide its review of pension and OPEB related costs in the future, and provide further guidance on application requirements and regulatory mechanisms for cost recovery.

### Other Developments

#### Change in Hydro One Ownership Structure

In November 2015, Hydro One and the Province completed an IPO on the Toronto Stock Exchange of approximately 89.3 million common shares of Hydro One, representing 1.5% of the Province's ownership position. Prior to the completion of the IPO, Hydro One and its subsidiary, Hydro One Inc., completed a series of transactions (Pre-IPO Transactions) that resulted in, among other things, the acquisition by Hydro One of all of the issued and

outstanding shares of Hydro One Inc. from the Province and the issuance of new common shares and preferred shares of Hydro One to the Province. Both Hydro One and Hydro One Inc. are reporting issuers. In April 2016, the Province completed a secondary offering of 83.3 million common shares of Hydro One on the Toronto Stock Exchange. Hydro One did not receive any of the proceeds from either of the sales of common shares by the Province. At December 31, 2016, the Province directly holds approximately 70.1% of Hydro One's total issued and outstanding common shares.

### Class Action Lawsuit

Hydro One Inc., Hydro One Networks, Hydro One Remote Communities Inc., and Norfolk Power Distribution Inc. are defendants in a class action suit in which the representative plaintiff is seeking up to \$125 million in damages related to allegations of improper billing practices. A certification motion in the class action is pending. Due to the preliminary stage of legal proceedings, an estimate of a possible loss related to this claim cannot be made.

### Acquisitions

#### Integration of Haldimand Hydro and Woodstock Hydro

In 2015, the Company acquired Haldimand Hydro and Woodstock Hydro, two Ontario-based local distribution companies. In September 2016, the Company successfully completed the integration of both entities, including the integration of employees, customer and billing information, business processes, and operations.

#### Acquisition of Great Lakes Power

On October 31, 2016, following receipt of regulatory approval of the transaction by the OEB, Hydro One completed the acquisition of Great Lakes Power, an Ontario regulated electricity

transmission business operating along the eastern shore of Lake Superior, north and east of Sault Ste. Marie, Ontario. The total purchase price for Great Lakes Power was approximately \$376 million, including the assumption of approximately \$150 million in outstanding indebtedness. On January 16, 2017, Great Lakes Power's name was changed to Hydro One Sault Ste. Marie LP.

On December 23, 2016, Great Lakes Power filed an application for 2017 rates, requesting an increase to the approved 2016 revenue requirement of 1.9%, resulting in an updated revenue requirement of \$41 million.

#### Acquisition of Orillia Power

In August 2016, the Company reached an agreement to acquire Orillia Power Distribution Corporation (Orillia Power), an electricity distribution company located in Simcoe County, Ontario, for approximately \$41 million, including the assumption of approximately \$15 million in outstanding indebtedness and regulatory liabilities, subject to closing adjustments. The acquisition is subject to regulatory approval by the OEB.

### Hydro One Work Force

Hydro One has a skilled and flexible work force of approximately 5,500 regular employees and over 2,000 non-regular employees province-wide, comprising a mix of skilled trades, engineering, professional, managerial and executive personnel. Hydro One's regular employees are supplemented primarily by accessing a large external labour force available through arrangements with the Company's trade unions for variable workers, sometimes referred to as "hiring halls", and also by access to contract personnel. The hiring halls offer Hydro One the ability to flexibly utilize highly trained and appropriately skilled workers on a project-by-project and seasonal basis.

The following table sets out the number of Hydro One employees as at December 31, 2016.

	Regular Employees	Non-Regular Employees	Total
Power Workers' Union (PWU)	3,470	698 <sup>1</sup>	4,168
The Society of Energy Professionals (Society)	1,365	44	1,409
Canadian Union of Skilled Workers (CUSW) and construction building trade unions <sup>2</sup>	–	1,275	1,275
Total employees represented by unions	4,835	2,017	6,852
Management and non-represented employees	659	28	687
Total employees	5,494	2,045	7,539

<sup>1</sup> Includes 528 non-regular "hiring hall" employees covered by the PWU agreement.

<sup>2</sup> Employees are jointly represented by both unions. The construction building trade unions have collective agreements with the Electrical Power Systems Construction Association (EPSCA).



## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Share-based Compensation

During 2016, the Company granted awards under its Long-term Incentive Plan, consisting of Performance Stock Units (PSUs) and Restricted Stock Units (RSUs), all of which are equity settled. At December 31, 2016, 230,600 PSUs and 254,150 RSUs were outstanding. No long-term incentive awards were granted during 2015.

### Non-GAAP Measures

#### Funds from Operations (FFO) and Adjusted FFO

FFO is defined as net cash from operating activities, adjusted for (i) changes in non-cash balances related to operations, (ii) dividends

paid on preferred shares, and (iii) distributions to noncontrolling interest. Adjusted FFO is defined as FFO, adjusted for the impact of the deferred income tax asset that resulted as a consequence of leaving the PILs Regime and entering the Federal Tax Regime. Management believes that FFO and Adjusted FFO are helpful as supplemental measures of the Company's operating cash flows as they exclude timing-related fluctuations in non-cash operating working capital and cash flows not attributable to common shareholders, and, in the case of Adjusted FFO, the impact of the IPO-related deferred income tax asset. As such, these measures provide consistent measures of the cash generating performance of the Company's assets.

The following table presents the reconciliation of net cash from operating activities to FFO and Adjusted FFO:

<i>Year ended December 31</i> <i>(millions of dollars)</i>	2016	2015
Net cash from (used in) operating activities	1,656	(1,248)
Changes in non-cash balances related to operations	(134)	(213)
Preferred share dividends	(19)	(13)
Distributions to noncontrolling interest	(9)	(5)
<b>FFO</b>	<b>1,494</b>	<b>(1,479)</b>
Less: Deferred income tax asset <sup>1</sup>	–	(2,810)
<b>Adjusted FFO</b>	<b>1,494</b>	<b>1,331</b>

<sup>1</sup> Impact of deferred income tax asset that resulted as a consequence of leaving the PILs Regime and entering the Federal Tax Regime.

### Adjusted EPS

The following basic and diluted Adjusted EPS has been prepared by management on a supplementary basis which assumes that the total number of common shares outstanding was 595,000,000 in each of the years ended December 31, 2016 and 2015. The supplementary pro forma disclosure is used internally by management subsequent to the IPO of the Company's common shares in November 2015 to assess the Company's performance and is

considered useful because it eliminates the impact of a different and non-comparable number of shares outstanding and held by the Province prior to the IPO. Adjusted EPS is considered an important measure and management believes that presenting it consistently for all periods based on the number of outstanding shares on, and subsequent to, the IPO provides users with a comparative basis to evaluate the operations of the Company.

<i>Year ended December 31</i>	2016	2015
Net income attributable to common shareholders <i>(millions of dollars)</i>	721	690
Pro forma weighted average number of common shares		
Basic	595,000,000	595,000,000
Effect of dilutive stock-based compensation plans	1,700,823	94,691
Diluted	596,700,823	595,094,691
Adjusted EPS		
Basic	\$ 1.21	\$ 1.16
Diluted	\$ 1.21	\$ 1.16

## Adjusted Net Cash from Operating Activities

Adjusted net cash from operating activities is defined as net cash from operating activities, adjusted for the impact of the deferred income tax asset that resulted as a consequence of leaving the PILs Regime and entering the Federal Tax Regime. Management believes that this

measure is helpful as a supplemental measure of the Company's net cash from operating activities as it excludes the impact of the IPO-related deferred income tax asset. As such, adjusted net cash from operating activities provides a consistent measure of the Company's cash from operating activities compared to prior periods.

The following table presents the reconciliation of net cash from operating activities to adjusted net cash from operating activities:

<i>Year ended December 31</i> <i>(millions of dollars)</i>	2016	2015
Net cash from (used in) operating activities	1,656	(1,248)
Less: Deferred income tax asset <sup>1</sup>	–	(2,810)
<b>Adjusted net cash from operating activities</b>	<b>1,656</b>	<b>1,562</b>

<sup>1</sup> Impact of deferred income tax asset that resulted as a consequence of leaving the PILs Regime and entering the Federal Tax Regime.

To the extent that adjusted net income is used in future continuous disclosure documents of Hydro One, it will be defined as net income, adjusted for certain items, including non-recurring items and other one-time items that management does not consider to be reflective of the operating performance of the Company. No such adjustments to net income are presented in this MD&A. Management believes that this measure will be helpful in assessing the Company's financial and operating performance in the future.

FFO, adjusted FFO, adjusted basic and diluted EPS, adjusted net cash from operating activities, and adjusted net income are not recognized measures under US GAAP and do not have a standardized meaning prescribed by US GAAP. They are therefore unlikely to be directly comparable to similar measures presented by other companies. They should not be considered in isolation nor as a substitute for analysis of the Company's financial information reported under US GAAP.

## Related Party Transactions

The Province is the majority shareholder of Hydro One. The IESO, Ontario Power Generation Inc. (OPG), OEFC, OEB, and Hydro One Brampton are related parties to Hydro One because they are controlled or significantly influenced by the Province. The following is a summary of the Company's related party transactions during the year ended December 31, 2016:

Related Party	Transaction	Year ended December 31	
		2016	2015
		<i>(millions of dollars)</i>	
Province <sup>1</sup>	Dividends paid	451	888
	Common shares issued <sup>2</sup>	–	2,600
	IPO costs subsequently reimbursed by the Province <sup>3</sup>	–	7
IESO	Power purchased	2,096	2,318
	Revenues for transmission services	1,549	1,548
	Distribution revenues related to rural rate protection	125	127
	Distribution revenues related to the supply of electricity to remote northern communities	32	32
	Funding received related to Conservation and Demand Management programs	63	70
OPG	Power purchased	6	11
	Revenues related to provision of construction and equipment maintenance services	5	7
	Costs expensed related to the purchase of services	1	1
OEFC	Payments in lieu of corporate income taxes <sup>4</sup>	–	2,933
	Power purchased from power contracts administered by the OEFC	1	6
	Indemnification fee paid (terminated effective October 31, 2015)	–	8
OEB	OEB fees	11	12
Hydro One Brampton <sup>1</sup>	Revenues from management, administrative and smart meter network services	3	1

<sup>1</sup> On August 31, 2015, Hydro One Inc. completed the spin-off of its subsidiary, Hydro One Brampton, to the Province.

<sup>2</sup> On November 4, 2015, Hydro One issued common shares to the Province for proceeds of \$2.6 billion.

<sup>3</sup> In 2015, Hydro One incurred certain IPO related expenses totalling \$7 million, which were subsequently reimbursed to the Company by the Province.

<sup>4</sup> In 2015, Hydro One made PILs to the OEFC totalling \$2.9 billion, including departure tax of \$2.6 billion.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

At December 31, 2016, the amounts due from and due to related parties as a result of the transactions described above were \$158 million and \$147 million, compared to \$191 million and \$138 million at December 31, 2015, respectively. At December 31, 2016, included in amounts due to related parties were amounts owing to the IESO in respect of power purchases of \$143 million, compared to \$134 million at December 31, 2015.

### Risk Management and Risk Factors

#### Risks Relating to Hydro One's Business

#### Regulatory Risks and Risks Relating to Hydro One's Revenues

##### *Risks Relating to Obtaining Rate Orders*

The Company is subject to the risk that the OEB will not approve the Company's transmission and distribution revenue requirements requested in outstanding or future applications for rates. Rate applications for revenue requirements are subject to the OEB's review process, usually involving participation from intervenors and a public hearing process. There can be no assurance that resulting decisions or rate orders issued by the OEB will permit Hydro One to recover all costs actually incurred, costs of debt and income taxes, or to earn a particular ROE. A failure to obtain acceptable rate orders, or approvals of appropriate returns on equity and costs actually incurred, may materially adversely affect: Hydro One's transmission or distribution businesses, the undertaking or timing of capital expenditures, ratings assigned by credit rating agencies, the cost and issuance of long-term debt, and other matters, any of which may in turn have a material adverse effect on the Company. In addition, there is no assurance that the Company will receive regulatory decisions in a timely manner and, therefore, costs may be incurred prior to having an approved revenue requirement.

##### *Risks Relating to Actual Performance Against Forecasts*

The Company's ability to recover the actual costs of providing service and earn the allowed ROE depends on the Company achieving its forecasts established and approved in the rate-setting process. Actual costs could exceed the approved forecasts if, for example, the Company incurs operations, maintenance, administration, capital and financing costs above those included in the Company's approved revenue requirement. The inability to obtain acceptable rate decisions or to recover any significant difference between forecast and actual expenses could materially adversely affect the Company's financial condition and results of operations.

Further, the OEB approves the Company's transmission and distribution rates based on projected electricity load and consumption levels, among other factors. If actual load or consumption materially

falls below projected levels, the Company's revenue and net income for either, or both, of these businesses could be materially adversely affected. Also, the Company's current revenue requirements for these businesses are based on cost and other 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 the Company's costs.

The Company is subject to risk of revenue loss from other factors, such as economic trends and weather conditions that influence the demand for electricity. The Company's overall operating results may fluctuate substantially on a seasonal and year-to-year basis based on these trends and weather conditions. For instance, a cooler than normal summer or warmer than normal winter may reduce demand for electricity below that forecast by the Company, causing a decrease in the Company's revenues from the same period of the previous year. The Company's load could also be negatively affected by successful Conservation and Demand Management programs whose results exceed forecasted expectations.

##### *Risks Relating to Rate-Setting Models for Transmission and Distribution*

The OEB approves and periodically changes the ROE for transmission and distribution businesses. The OEB may in the future decide to reduce the allowed ROE for either of these businesses, modify the formula or methodology it uses to determine the ROE, or reduce the weighting of the equity component of the deemed capital structure. Any such reduction could reduce the net income of the Company.

The OEB's recent Custom Incentive Rate-setting model requires that the term of a custom rate application be a minimum five-year period. There are risks associated with forecasting key inputs such as revenues, operating expenses and capital, over such a long period. For instance, if unanticipated capital expenditures arise that were not contemplated in the Company's most recent rate decision, the Company may be required to incur costs that may not be recoverable until a future period or not recoverable at all in future rates. This could have a material adverse effect on the Company.

After rates are set as part of a part of a Custom Incentive Rate application, the OEB expects there to be no further rate applications for annual updates within the five-year term, unless there are exceptional circumstances, with the exception of the clearance of established deferral and variance accounts. For example, the OEB does not expect to address annual rate applications for updates for cost of capital (including ROE), working capital allowance or sales volumes. If there were an increase in interest rates over the period of a rate decision and no corresponding changes were permitted to the

Company's allowed cost of capital (including ROE), then the result could be a decrease in the Company's financial performance.

To the extent that the OEB approves an In-Service Variance Account for the transmission and/or distribution businesses, and should the Company fail to meet the threshold levels of in-service capital, the OEB may reclaim a corresponding portion of the Company's revenues.

### *Risks Relating to Capital Expenditures*

In order to be recoverable, capital expenditures require the approval of the OEB, either through the approval of capital expenditure plans, rate base or revenue requirements for the purposes of setting transmission and distribution rates, which include the impact of capital expenditures on rate base or cost of service. There can be no assurance that all capital expenditures incurred by Hydro One will be approved by the OEB. Capital cost overruns may not be recoverable in transmission or distribution rates. The Company could incur unexpected capital expenditures in maintaining or improving its assets, particularly given that new technology may be required to support renewable generation and unforeseen technical issues may be identified through implementation of projects. There is risk that the OEB may not allow full recovery of such expenditures in the future. To the extent possible, Hydro One aims 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.

Any future regulatory decision by the OEB to disallow or limit the recovery of any capital expenditures would lead to a lower than expected approved revenue requirement or rate base, potential asset impairment or charges to the Company's results of operations, any of which could have a material adverse effect on the Company.

### *Risks Relating to Deferred Tax Asset*

As a result of leaving the PLs Regime and entering the Federal Tax Regime in connection with the IPO of the Company, Hydro One recorded a deferred tax asset due to the revaluation of the tax basis of Hydro One's fixed assets at their fair market value and recognition of eligible capital expenditures. Management believes this will result in annual net cash savings over at least the next five years due to the reduction of cash income taxes payable by Hydro One associated primarily with a higher capital cost allowance. There is a risk that, in current or future rate applications, the OEB will reduce the Company's revenue requirement by all or a portion of those net cash savings. If the OEB were to reduce the Company's revenue requirement in this manner, it could have a material adverse effect on the Company.

### *Risks Relating to Other Applications to the OEB*

The Company is also subject to the risk that it will not obtain required regulatory approvals for other matters, such as leave to construct applications, applications for mergers, acquisitions, amalgamations and divestitures, and environmental approvals. Decisions to acquire or divest other regulated businesses licensed by the OEB are subject to OEB approval. Accordingly, there is the risk that such matters may not be approved or that unfavourable conditions will be imposed by the OEB.

### **First Nations and Métis Claims Risk**

Some of the Company's current and proposed transmission and distribution assets are or may be located on reserve (as defined in the *Indian Act* (Canada); Reserve) lands, and lands over which First Nations and Métis have Aboriginal, treaty, or other legal claims. Some First Nations and Métis leaders, communities, and their members have made assertions related to sovereignty and jurisdiction over Reserve lands and traditional territories and are increasingly willing to assert their claims through the courts, tribunals, or by direct action. These claims and/or settlement of these claims could have a material adverse effect on the Company or otherwise materially adversely impact the Company's operations, including the development of current and future projects.

The Company's operations and activities may give rise to the Crown's duty to consult and potentially accommodate First Nations and Métis communities. Procedural aspects of the duty to consult may be delegated to the Company by the Province or the federal government. A perceived failure by the Crown to sufficiently consult a First Nations or Métis community, or a perceived failure by the Company in relation to delegated consultation obligations, could result in legal challenges against the Crown or the Company, including judicial review or injunction proceedings, or could potentially result in direct action against the Company by a community or its citizens. If this occurs, it could disrupt or delay the Company's operations and activities, including current and future projects, and have a material adverse effect on the Company.

### **Risk from Transfer of Assets Located on Reserves**

The transfer orders by which the Company acquired certain of Ontario Hydro's businesses as of April 1, 1999 did not transfer title to assets located on Reserves. The transfer of title to these assets did not occur because authorizations originally granted by the federal government for the construction and operation of these assets on Reserves could not be transferred without required consent. In several cases, the authorizations had either expired or had never been issued.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Currently, the Ontario Electricity Financial Corporation holds legal title to these assets and it is expected that the Company will manage them until it has obtained permits to complete the title transfer. To occupy Reserves, the Company must have valid permits issued by Her Majesty the Queen in the Right of Canada. For each permit, the Company must negotiate an agreement (in the form of a memorandum of understanding) with the First Nation, the Ontario Electricity Financial Corporation and any members of the First Nation who have occupancy rights. The agreement includes provisions whereby the First Nation consents to the federal government (presently Indigenous Affairs and Northern Development Canada) issuing a permit. For transmission assets, the Company must negotiate terms of payment. It is difficult to predict the aggregate amount that the Company may have to pay, either on an annual or one-time basis, to obtain the required agreements from First Nations. If the Company cannot reach satisfactory agreements with the relevant First Nation to obtain federal permits, it may have to relocate these assets to other locations and restore the lands at a cost that could be substantial. In a limited number of cases, it may be necessary to abandon a line and replace it with diesel generation facilities. In either case, the costs relating to these assets could have a material adverse effect on the Company if the costs are not recoverable in future rate orders.

### Compliance with Laws and Regulations

Hydro One must comply with numerous laws and regulations affecting its business, including requirements relating to transmission and distribution companies, environmental laws, employment laws and health and safety laws. The failure of the Company to comply with these laws could have a material adverse effect on the Company's business. See also "– Health, Safety and Environmental Risk".

For example, Hydro One's licensed transmission and distribution businesses are required to comply with the terms of their licences, with codes and rules issued by the OEB, and with other regulatory requirements, including regulations of the National Energy Board. In Ontario, the Market Rules issued by the IESO require the Company to, among other things, comply with the reliability standards established by the North American Electric Reliability Corporation (NERC) and Northeast Power Coordinating Council, Inc. (NPCC). The incremental costs associated with compliance with these reliability standards are expected to be recovered through rates, but there can be no assurance that the OEB will approve the recovery of all of such incremental costs. Failure to obtain such approvals could have a material adverse effect on the Company.

There is the risk that new legislation, regulations, requirements or policies will be introduced in the future. These may require Hydro One to incur additional costs, which may or may not be recovered in future transmission and distribution rates.

### Risk of Natural and Other Unexpected Occurrences

The Company's facilities are exposed to the effects of severe weather conditions, natural disasters, man-made events including but not limited to cyber and physical terrorist type attacks, events which originate from third-party connected systems, or any other potentially catastrophic events. The Company's facilities may not withstand occurrences of this type in all circumstances. The Company does not have insurance for damage to its transmission and distribution wires, poles and towers located outside its transmission and distribution stations resulting from these or other events. Where insurance is available for other assets, such insurance coverage may have deductibles, limits and/or exclusions. Losses from lost revenues and repair costs could be substantial, especially for many of the Company's facilities that are located in remote areas. The Company could also be subject to claims for damages caused by its failure to transmit or distribute electricity.

### Risk Associated with Information Technology Infrastructure and Data Security

The Company's ability to operate effectively in the Ontario electricity market is, in part, dependent upon it developing, maintaining and managing complex information technology systems which are employed to operate and monitor its transmission and distribution facilities, financial and billing systems and other business systems. The Company's increasing reliance on information systems and expanding data networks increases its exposure to information security threats. The Company's transmission business is required to comply with various rules and standards for transmission reliability, including mandatory standards established by the NERC and the NPCC. These include standards relating to cyber-security and information technology, which only apply to certain of the Company's assets (generally being those whose failure could impact the functioning of the bulk electricity system). The Company may maintain different or lower levels of information technology security for its assets that are not subject to these mandatory standards. The Company must also comply with legislative and licence requirements relating to the collection, use and disclosure of personal information and information regarding consumers, wholesalers, generators and retailers.

Cyber-attacks or unauthorized access to corporate and information technology systems could result in service disruptions and system failures, which could have a material adverse effect on the Company, including as a result of a failure to provide electricity to customers. Due to operating critical infrastructure, Hydro One may be at greater risk of cyber-attacks from third parties (including state run or controlled parties) that could impair or incapacitate its assets. In addition, in the normal course of its operations, the Company collects, uses, processes and stores information, which could be



exposed in the event of a cyber-security incident or other unauthorized access, such as information about customers, suppliers, counterparties and employees.

Security and system disaster recovery controls are in place; however, there can be no assurance that there will not be system failures or security breaches or that such threats would be detected or mitigated on a timely basis. Upon occurrence and detection, the focus would shift from prevention to isolation, remediation and recovery until the incident has been fully addressed. Any such system failures or security breaches could have a material adverse effect on the Company.

### Work Force Demographic Risk

By the end of 2016, approximately 22% of the Company's employees who are members of the Company's defined benefit pension plan were eligible for retirement under that plan, and by the end of 2017, up to approximately 23% could be eligible. These percentages are not evenly spread across the Company's work force, but tend to be most significant in the most senior levels of the Company's staff and especially among management staff. During each of 2016 and 2015, approximately 3% of the Company's work force elected to retire. Accordingly, the Company's continued success will be tied to its ability to continue to attract and retain sufficient qualified staff to replace the capability lost through retirements and to meet the demands of the Company's work programs.

In addition, the Company expects the skilled labour market for its industry to be highly competitive in the future. Many of the Company's current employees and many of the potential employees it would seek in the future possess skills and experience that would also be highly sought after by other organizations inside and outside the electricity sector. The failure to attract and retain qualified personnel for Hydro One's business could have a material adverse effect on the Company.

### Labour Relations Risk

The substantial majority of the Company's employees are represented by either the PWU or the Society. Over the past several years, significant effort has been expended to increase Hydro One's flexibility to conduct operations in a more cost-efficient manner. Although the Company has achieved improved flexibility in its collective agreements, the Company may not be able to achieve further improvements. The Company reached an agreement with the PWU for a renewal collective agreement with a three-year term, covering the period from April 1, 2015 to March 31, 2018 and an early renewal collective agreement with the Society with a three-year term, covering the period from April 1, 2016 to March 31, 2019. The Company also reached a renewal collective agreement with the Canadian Union of Skilled Workers for a three-year term, covering

the period from May 1, 2014 to April 30, 2017. Additionally, the EPSCA and a number of construction unions have reached renewal agreements, to which Hydro One is bound, for a five-year term, covering the period from May 1, 2015 to April 30, 2020. Future negotiations with unions present the risk of a labour disruption and the ability to sustain the continued supply of energy to customers. The Company also faces financial risks related to its ability to negotiate collective agreements consistent with its rate orders. In addition, in the event of a labour dispute, the Company could face operational risk related to continued compliance with its requirements of providing service to customers. Any of these could have a material adverse effect on the Company.

### Risk Associated with Arranging Debt Financing

The Company expects to borrow to repay its existing indebtedness and to fund a portion of capital expenditures. Hydro One Inc. has substantial debt principal repayments, including \$602 million in 2017, \$753 million in 2018, and \$731 million in 2019. In addition, from time to time, the Company may draw on its syndicated bank lines and or issue short-term debt under Hydro One Inc.'s \$1.5 billion commercial paper program which would mature within approximately one year of issuance. The Company also plans to incur continued material capital expenditures for each of 2017 and 2018. Cash generated from operations, after the payment of expected dividends, will not be sufficient to fund the repayment of the Company's existing indebtedness and capital expenditures. The Company's ability to arrange sufficient and cost-effective debt financing could be materially adversely affected by numerous factors, including the regulatory environment in Ontario, the Company's results of operations and financial position, market conditions, the ratings assigned to its debt securities by credit rating agencies, an inability of the Corporation to comply with its debt covenants, and general economic conditions. A downgrade in the Company's credit ratings could restrict the Company's ability to access debt capital markets and increase the Company's cost of debt. Any failure or inability on the Company's part to borrow the required amounts of debt on satisfactory terms could impair its 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 the Company.

### Market, Financial Instrument and Credit Risk

Market risk refers primarily to the risk of loss that results from changes in costs, foreign exchange rates and interest rates. The Company is exposed to fluctuations in interest rates as its regulated ROE is derived using a formulaic approach that takes into account anticipated interest rates, but is not currently exposed to material commodity price risk or material foreign exchange risk.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The OEB-approved adjustment formula for calculating ROE in a deemed regulatory capital structure of 60% debt and 40% equity provides for increases and decreases depending on changes in benchmark interest rates for Government of Canada debt and the A-rated utility corporate bond yield spread. The Company estimates that a decrease of 100 basis points in the combination of the forecasted long-term Government of Canada bond yield and the A-rated utility corporate bond yield spread used in determining its rate of return would reduce the Company's transmission business' 2018 net income by approximately \$23 million and its distribution business' 2018 net income by approximately \$15 million. The Company periodically utilizes interest rate swap agreements to mitigate elements of interest rate risk.

Financial assets create a risk that a counterparty 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 counterparty default. Hydro One monitors and minimizes credit risk through various techniques, including dealing with highly rated counterparties, limiting total exposure levels with individual counterparties, entering into agreements which enable net settlement, and by monitoring the financial condition of counterparties. The Company does not trade in any energy derivatives. The Company is required to procure electricity on behalf of competitive retailers and certain local distribution companies 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 the Company's service agreements with these retailers in accordance with the OEB's Retail Settlement Code.

The failure to properly manage these risks could have a material adverse effect on the Company.

### Risks Relating to Asset Condition and Capital Projects

The Company continually incurs sustainment and development capital expenditures and monitors the condition of its transmission assets to manage the risk of equipment failures and to determine the need for and timing of major refurbishments and replacements of its transmission and distribution infrastructure. However the lack of real time monitoring of distribution assets increases the risk of distribution equipment failure. The connection of large numbers of generation facilities to the distribution network has resulted in greater than expected usage of some of the Company's equipment. This increases maintenance requirements and may accelerate the aging of the Company's assets.

Execution of the Company's capital expenditure programs, particularly for development capital expenditures, is partially dependent on external factors, such as environmental approvals,

municipal permits, equipment outage schedules that accommodate the IESO, generators and transmission-connected customers, and supply chain availability for equipment suppliers and consulting services. There may also be a need for, among other things, *Environmental Assessment Act* (Ontario) approvals, approvals which require public meetings, appropriate engagement with First Nations and Métis communities, OEB approvals of expropriation or early access to property, and other activities. Obtaining approvals and carrying out these processes may also be impacted by opposition to the proposed site of the capital investments. Delays in obtaining required approvals or failure to complete capital projects on a timely basis could materially adversely affect transmission reliability or customers' service quality or increase maintenance costs which could have a material adverse effect on the Company. External factors are considered in the Company's planning process. If the Company is unable to carry out capital expenditure plans in a timely manner, equipment performance may degrade, which may reduce network capacity, result in customer interruptions, compromise the reliability of the Company's networks or increase the costs of operating and maintaining these assets. Any of these consequences could have a material adverse effect on the Company.

Increased competition for the development of large transmission projects and legislative changes relating to the selection of transmitters could impact the Company's ability to expand its existing transmission system, which may have an adverse effect on the Company. To the extent that other parties are selected to construct, own and operate new transmission assets, the Company's share of Ontario's transmission network would be reduced.

### Health, Safety and Environmental Risk

The Company is subject to provincial health and safety legislation. Findings of a failure to comply with this legislation could result in penalties and reputational risk, which could negatively impact the Company.

The Company is subject to extensive Canadian federal, provincial and municipal environmental regulation. Failure to comply could subject the Company to fines or other penalties. In addition, the presence or release of hazardous or other harmful substances could lead to claims by third parties or governmental orders requiring the Company to take specific actions such as investigating, controlling and remediating the effects of these substances. Contamination of the Company's properties could limit its ability to sell or lease these assets in the future.

In addition, actual future environmental expenditures may vary materially from the estimates used in the calculation of the environmental liabilities on the Company's balance sheet. The Company does not have insurance coverage for these environmental expenditures.

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

Hydro One emits certain greenhouse gases, including sulphur hexafluoride or "SF6". There are increasing regulatory requirements and costs, along with attendant risks, associated with the release of such greenhouse gases, all of which could impose additional material costs on Hydro One.

Any future regulatory decision to disallow or limit the recovery of such costs could have a material adverse effect on the Company.

### Pension Plan Risk

Hydro One has the Hydro One Defined Benefit Pension Plan in place for the majority of its employees. Contributions to the pension plan are established by actuarial valuations which are required to be filed with the Financial Services Commission of Ontario on a triennial basis. The most recently filed valuation was prepared as at December 31, 2015, and was filed in June 2016, covering a three year period from 2016 to 2018. Hydro One's contributions to its pension plan satisfy, and are expected to satisfy, minimum funding requirements. Contributions beyond 2018 will depend on the funded position of the plan, which is determined by investment returns, interest rates and changes in benefits and actuarial assumptions at that time. A determination by the OEB that some of the Company's pension expenditures are not recoverable through rates could have a material adverse effect on the Company, and this risk may be exacerbated if the amount of required pension contributions increases.

The OEB has begun a consultation process that will examine pensions and other post-employment benefits in regulated utilities. See "– Other Post-Employment and Post-Retirement Benefits Risks". The outcome of this consultation process is uncertain and the Company is unable to assess the impact of the potential changes stemming from the review at this time.

### Risk of Recoverability of Total Compensation Costs

The Company manages all of its total compensation costs, including pension and other post-employment and postretirement benefits, subject to restrictions and requirements imposed by the collective bargaining process. Should any element of total compensation costs be disallowed in whole or part by the OEB and not be recoverable from customers in rates, the costs could be material and could decrease net income, which could have a material adverse effect on the Company.

### Other Post-Employment and Post-Retirement Benefits Risks

The Company provides other post-employment and post-retirement benefits, including workers compensation benefits and long-term disability benefits to qualifying employees. The OEB has begun a consultation process that will examine pensions and other post-employment benefits in regulated utilities. The objectives of the consultation are to develop standard principles to guide the OEB's review of pension and other post-employment and post-retirement benefits costs in the future, to establish specific information requirements for application and to establish appropriate regulatory mechanisms for cost recovery which can be applied consistently across the gas and electricity sectors for rate-regulated utilities. The outcome of this consultation process is uncertain and the Company is unable to assess the impact of the potential changes stemming from the review at this time. A determination that some of the Company's post-employment and post-retirement benefit costs are not recoverable could have a material adverse effect on the Company.

### Risk Associated with Outsourcing Arrangements

Consistent with Hydro One's strategy of reducing operating costs, it has entered into an outsourcing arrangement with a third party for the provision of back office services and call centre services. If the outsourcing arrangement or statements of work thereunder are terminated for any reason or expire before a new supplier is selected and fully transitioned, the Company could be required to incur significant expenses to transfer to another service provider or insource, which could have a material adverse effect on the Company's business, operating results, financial condition or prospects.

### Risk from Provincial Ownership of Transmission Corridors

The Province owns some of the corridor lands underlying the Company's transmission system. Although the Company has the statutory right to use these transmission corridors, the Company may be limited in its options to expand or operate its systems. Also, other uses of the transmission corridors by third parties in conjunction with the operation of the Company's systems may increase safety or environmental risks, which could have a material adverse effect on the Company.

### Litigation Risks

In the normal course of the Company's operations, it becomes involved in, is named as a party to and is the subject of, various legal proceedings, including regulatory proceedings, tax proceedings and legal actions, relating to actual or alleged violations of law, common law damages claims, personal injuries, property damage, property taxes, land rights, the environment and contract

## MANAGEMENT'S DISCUSSION AND ANALYSIS

disputes. The outcome of outstanding, pending or future proceedings cannot be predicted with certainty and may be determined adversely to the Company, which could have a material adverse effect on the Company. Even if the Company prevails in any such legal proceeding, the proceedings could be costly and time-consuming and would divert the attention of management and key personnel from the Company's business operations, which could adversely affect the Company. See also "Other Developments – Class Action Lawsuit".

### Transmission Assets on Third-Party Lands Risk

Some of the lands on which the Company's transmission assets are located are owned by third parties, including the Province and federal Crown, and are or may become subject to land claims by First Nations. The Company requires valid occupation rights to occupy such lands (which may take the form of land use permits, easements or otherwise). If the Company does not have valid occupational rights on third-party owned lands or has occupational rights that are subject to expiry, it may incur material costs to obtain or renew such occupational rights, or if such occupational rights cannot be renewed or obtained it may incur material costs to remove and relocate its assets and restore the subject land. If the Company does not have valid occupational rights and must incur costs as a result, this could have a material adverse effect on the Company or otherwise materially adversely impact the Company's operations.

### Reputational and Public Opinion Risk

Reputation risk is the risk of a negative impact to the Company's business, operations or financial condition that could result from a deterioration of Hydro One's reputation. The Company's reputation could be negatively impacted by changes in public opinion, attitudes towards the Company's privatization, failure to deliver on its customer promises and other external forces. Adverse reputational events could have negative impacts on the Company's business and prospects including, but not limited to, delays or denials of requisite approvals and accommodations for the Company's planned projects, escalated costs, legal or regulatory action, and damage to stakeholder relationships.

### Risks Relating to the Company's Relationship with the Province

#### Ownership and Continued Influence by the Province and Voting Power; Share Ownership Restrictions

The Province currently owns approximately 70.1% of the outstanding common shares of Hydro One. The *Electricity Act* restricts the Province from selling voting securities of Hydro One (including

common shares) of any class or series if it would own less than 40% of the outstanding number of voting securities of that class or series after the sale and in certain circumstances also requires the Province to take steps to maintain that level of ownership. Accordingly, the Province is expected to continue to maintain a significant ownership interest in voting securities of Hydro One for an indefinite period.

As a result of its significant ownership of the common shares of Hydro One, the Province has, and is expected indefinitely to have, the ability to determine or significantly influence the outcome of shareholder votes, subject to the restrictions in the governance agreement entered into between Hydro One and the Province dated November 5, 2015 (Governance Agreement; available on SEDAR at [www.sedar.com](http://www.sedar.com)). Despite the terms of the Governance Agreement in which the Province has agreed to engage in the business and affairs of the Company as an investor and not as a manager, there is a risk that the Province's engagement in the business and affairs of the Company as an investor will be informed by its policy objectives and may influence the conduct of the business and affairs of the Company in ways that may not be aligned with the interests of other shareholders.

The share ownership restrictions in the *Electricity Act* (Share Ownership Restrictions) and the Province's significant ownership of common shares of Hydro One together effectively prohibit one or more persons acting together from acquiring control of Hydro One. They also may limit or discourage transactions involving other fundamental changes to Hydro One and the ability of other shareholders to successfully contest the election of the directors proposed for election pursuant to the Governance Agreement. The Share Ownership Restrictions may also discourage trading in, and may limit the market for, the common shares and other voting securities.

#### Nomination of Directors and Confirmation of Chief Executive Officer and Chair

Although director nominees are required to be independent of both the Company and the Province pursuant to the Governance Agreement, there is a risk that the Province will nominate or confirm individuals who satisfy the independence requirements but who it considers are disposed to support and advance its policy objectives and give disproportionate weight to the Province's interests in exercising their business judgment and balancing the interests of the stakeholders of Hydro One. This, combined with the fact certain matters require a two-thirds vote of the Board of Directors, could allow the Province to unduly influence certain Board actions such as confirmation of the Chair and confirmation of the Chief Executive Officer.

## Board Removal Rights

Under the Governance Agreement, the Province has the right to withhold from voting in favour of all director nominees and has the right to seek to remove and replace the entire Board of Directors, including in each case its own director nominees but excluding the Chief Executive Officer and, at the Province's discretion, the Chair. In exercising these rights in any particular circumstance, the Province is entitled to vote in its sole interest, which may not be aligned with the interests of other shareholders.

## More Extensive Regulation

Although under the Governance Agreement, the Province has agreed to engage in the business and affairs of Hydro One as an investor and not as a manager and has stated that its intention is to achieve its policy objectives through legislation and regulation as it would with respect to any other utility operating in Ontario, there is a risk that the Province will exercise its legislative and regulatory power to achieve policy objectives in a manner that has a material adverse effect on the Company.

## Prohibitions on Selling the Company's Transmission or Distribution Business

The *Electricity Act* prohibits the Company from selling all or substantially all of the business, property or assets related to its transmission system or distribution system that is regulated by the OEB. There is a risk that these prohibitions may limit the ability of the Company to engage in sale transactions involving a substantial portion of either system, even where such a transaction may otherwise be considered to provide substantial benefits to the Company and the holders of the common shares.

## Future Sales of Common Shares by the Province

The Province has indicated that it currently intends to sell further common shares of Hydro One over time, until it holds approximately 40% of the common shares, subject to the selling restrictions agreed with the Underwriters. The registration rights agreement between Hydro One and the Province dated November 5, 2015 (available on SEDAR at [www.sedar.com](http://www.sedar.com)) also grants the Province the right to request that Hydro One file one or more prospectuses and take other procedural steps to facilitate secondary offerings by the Province of the common shares of Hydro One. Future sales of common shares of Hydro One by the Province, or the perception that such sales could occur, may materially adversely affect market prices for these common shares and impede Hydro One's ability to raise capital through the issuance of additional common shares, including the number of common shares that Hydro One may be able to sell at a particular time or the total proceeds that may be realized.

## Limitations on Enforcing the Governance Agreement

The Governance Agreement includes commitments by the Province restricting the exercise of its rights as a holder of voting securities, including with respect to the maximum number of directors that the Province may nominate and on how the Province will vote with respect to other director nominees. Hydro One's ability to obtain an effective remedy against the Province, if the Province were not to comply with these commitments, is limited as a result of the *Proceedings Against the Crown Act* (Ontario). This legislation provides that the remedies of injunction and specific performance are not available against the Province, although a court may make an order declaratory of the rights of the parties, which may influence the Province's actions. A remedy of damages would be available to Hydro One, but damages may not be an effective remedy, depending on the nature of the Province's non-compliance with the Governance Agreement.

## Critical Accounting Estimates and Judgments

The preparation of Hydro One Consolidated Financial Statements requires the Company to make key estimates and critical judgments that affect the reported amounts of assets, liabilities, revenues and costs, and related disclosures of contingencies. Hydro One bases its estimates and judgments on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities, as well as identifying and assessing the Company's accounting treatment with respect to commitments and contingencies. Actual results may differ from these estimates and judgments. Hydro One has identified the following critical accounting estimates used in the preparation of its Consolidated Financial Statements:

### Revenues

Distribution revenues attributable to the delivery of electricity are based on OEB-approved distribution rates and are recognized on an accrual basis and include billed and unbilled revenues. Billed revenues are based on electricity delivered as measured from customer meters. At the end of each month, electricity delivered to customers since the date of the last billed meter reading is estimated, and the corresponding unbilled revenue is recorded. The unbilled revenue estimate is affected by energy consumption, weather, and changes in the composition of customer classes.



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### Accounts Receivable and Allowance for Doubtful Accounts

The allowance for doubtful accounts reflects the Company's best estimate of losses on billed accounts receivable balances. The Company estimates the allowance for doubtful accounts on customer receivables by applying internally developed loss rates to the outstanding receivable balances by aging category. Loss rates applied to the accounts receivable balances are based on historical overdue balances, customer payments and write-offs.

### Regulatory Assets and Liabilities

Hydro One's regulatory assets represent certain amounts receivable from future electricity customers and costs that have been deferred for accounting purposes because it is probable that they will be recovered in future rates. The regulatory assets mainly include costs related to the pension benefit liability, deferred income tax liabilities, post-retirement and post-employment benefit liability, share-based compensation costs, and environmental liabilities. The Company's regulatory liabilities represent certain amounts that are refundable to future electricity customers, and pertain primarily to OEB deferral and variance accounts. The regulatory assets and liabilities can be recognized for rate-setting and financial reporting purposes only if the amounts have been approved for inclusion in the electricity rates by the OEB, or if such approval is judged to be probable by management. If management judges that it is no longer probable that the OEB will allow the inclusion of a regulatory asset or liability in future electricity rates, the applicable carrying amount of the regulatory asset or liability will be reflected in results of operations in the period that the judgment is made by management.

### Environmental Liabilities

Hydro One records a liability for the estimated future expenditures associated with the removal and destruction of PCB-contaminated insulating oils and related electrical equipment, and for the assessment and remediation of chemically contaminated lands. There are uncertainties in estimating future environmental costs due to potential external events such as changes in legislation or regulations and advances in remediation technologies. In determining the amounts to be recorded as environmental liabilities, the Company estimates the current cost of completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. All factors used in estimating the Company's environmental liabilities represent management's best estimates of the present value of costs required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company's current assumptions. Environmental liabilities are

reviewed annually or more frequently if significant changes in regulations or other relevant factors occur. Estimate changes are accounted for prospectively.

### Employee Future Benefits

Hydro One's employee future benefits consist of pension and post-retirement and post-employment plans, and include pension, group life insurance, health care, and long-term disability benefits provided to the Company's current and retired employees. Employee future benefits costs are included in Hydro One's labour costs that are either charged to results of operations or capitalized as part of the cost of property, plant and equipment and intangible assets. Changes in assumptions affect the benefit obligation of the employee future benefits and the amounts that will be charged to results of operations or capitalized in future years. The following significant assumptions and estimates are used to determine employee future benefit costs and obligations:

### Weighted Average Discount Rate

The weighted average discount rate used to calculate the employee future benefits obligation is determined at each year end by referring to the most recently available market interest rates based on "AA"-rated corporate bond yields reflecting the duration of the applicable employee future benefit plan. The discount rate at December 31, 2016 decreased to 3.90% (from 4.00% at December 31, 2015) for pension benefits and decreased to 3.90% (from 4.10% used at December 31, 2015) for the post-retirement and post-employment plans. The decrease in the discount rate has resulted in a corresponding increase in employee future benefits liabilities for the pension, post-retirement and post-employment plans for accounting purposes. The liabilities are determined by independent actuaries using the projected benefit method prorated on service and based on assumptions that reflect management's best estimates.

### Expected Rate of Return on Plan Assets

The expected rate of return on pension plan assets is based on expectations of long-term rates of return at the beginning of the year and reflects a pension asset mix consistent with the pension plan's current investment policy.

Rates of return on the respective portfolios are determined with reference to respective published market indices. The expected rate of return on pension plan assets reflects the Company's long-term expectations. The Company believes that this assumption is reasonable because, with the pension plan's balanced investment approach, the higher volatility of equity investment returns is intended to be offset by the greater stability of fixed-income and short-term investment returns. The net result, on a long-term basis, is a lower return than might be expected by investing in equities alone. In the short term, the pension plan can experience fluctuations in actual rates of return.

## Rate of Cost of Living Increase

The rate of cost of living increase is determined by considering differences between long-term Government of Canada nominal bonds and real return bonds, which increased from 1.50% per annum as at December 31, 2015 to approximately 1.80% per annum as at December 31, 2016. Given the Bank of Canada's commitment to keep long-term inflation between 1.00% and 3.00%, management believes that the current rate is reasonable to use as a long-term assumption and as such, has used a 2.0% per annum inflation rate for employee future benefits liability valuation purposes as at December 31, 2016.

## Mortality Assumptions

The Company's employee future benefits liability is also impacted by changes in life expectancies used in mortality assumptions. Increases in life expectancies of plan members result in increases in the employee future benefits liability. The mortality assumption used at December 31, 2016 is 95% of 2014 Canadian Pensioners Mortality Private Sector table projected generationally using improvement Scale B (compared to 100% of 2014 Canadian Pensioners Mortality Public Sector table projected generationally using improvement Scale B used at December 31, 2015). The mortality table was updated based on a review of the historical mortality experience of the pension plan members.

## Rate of Increase in Health Care Cost Trends

The costs of post-retirement and post-employment benefits are determined at the beginning of the year and are based on assumptions for expected claims experience and future health care cost inflation. A 1% increase in the health care cost trends would result in a \$23 million increase in 2016 interest cost plus service cost, and a \$289 million increase in the benefit liability at December 31, 2016.

## Business Combinations

Management's judgment is required to estimate the purchase price, to identify and to determine fair value of all assets and liabilities acquired. The determination of the fair value of assets and liabilities acquired is based upon management's estimates and certain assumptions.

## Taxes

Hydro One assesses the likelihood that deferred tax assets will be recovered from future taxable income. To the extent management considers it is more likely than not that some portion or all of the deferred tax assets will not be realized, a valuation allowance is recognized.

## Asset Impairment

Within Hydro One's regulated businesses, the carrying costs of most of the long-lived assets are included in the rate base where they earn an OEB-approved rate of return. Asset carrying values and the related return are recovered through OEB-approved rates. As a result, such assets are only tested for impairment in the event that the OEB disallows recovery, in whole or in part, or if such a disallowance is judged to be probable. The Company regularly monitors the assets of its unregulated Hydro One Telecom subsidiary for indications of impairment. As at December 31, 2016, no asset impairment had been recorded for assets within Hydro One's regulated or unregulated businesses.

Goodwill is evaluated for impairment on an annual basis, or more frequently if circumstances require. Hydro One has concluded that goodwill was not impaired at December 31, 2016. Goodwill represents the cost of acquired distribution and transmission companies that is in excess of the fair value of the net identifiable assets acquired at the acquisition date.

## Disclosure Controls And Internal Controls Over Financial Reporting

Internal controls have been documented and tested for adequacy and effectiveness, and continue to be refined over all business processes.

In compliance with the requirements of National Instrument 52-109, the Company's Certifying Officers have reviewed and certified the Consolidated Financial Statements for the year ended December 31, 2016, together with other financial information included in the Company's securities filings. The Certifying Officers have also certified that disclosure controls and procedures (DC&P) have been designed to provide reasonable assurance that material information relating to the Company is made known within the Company. Further, the Certifying Officers have certified that internal controls over financial reporting (ICFR) have been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Consolidated Financial Statements. Based on the evaluation of the design and operating effectiveness of the Company's DC&P and ICFR, the Certifying Officers concluded that the Company's DC&P and ICFR were effective as at December 31, 2016.

## New Accounting Pronouncements

The following tables present Accounting Standards Updates (ASUs) issued by the Financial Accounting Standards Board that are applicable to Hydro One.

### Recently Adopted Accounting Guidance

ASU	Date issued	Description	Effective date	Impact on Hydro One
2014-16	November 2014	This update clarifies that all relevant terms and features should be considered in evaluating the nature of a host contract for hybrid financial instruments issued in the form of a share. The nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument.	January 1, 2016	No material impact upon adoption
2015-01	January 2015	Extraordinary items are no longer required to be presented separately in the income statement.	January 1, 2016	No material impact upon adoption
2015-02	February 2015	Guidance on analysis to be performed to determine whether certain types of legal entities should be consolidated.	January 1, 2016	No material impact upon adoption
2015-03	April 2015	Debt issuance costs are required to be presented on the balance sheet as a direct deduction from the carrying amount of the related debt liability consistent with debt discounts or premiums.	January 1, 2016	Reclassification of deferred debt issuance costs and net unamortized debt premiums as an offset to long-term debt. Applied retrospectively.
2015-05	April 2015	Cloud computing arrangements that have been assessed to contain a software licence should be accounted for as internal-use software.	January 1, 2016	No material impact upon adoption
2015-16	September 2015	Adjustments to provisional amounts that are identified during the measurement period of a business combination in the reporting period in which the adjustment amount is determined are required to be recognized. The amount recorded in current period earnings are required to be presented separately on the face of the income statement or disclosed in the notes by line item.	January 1, 2016	No material impact upon adoption
2015-17	November 2015	All deferred tax assets and liabilities are required to be classified as noncurrent on the balance sheet.	January 1, 2017	This ASU was early adopted as of April 1, 2016 and was applied prospectively. As a result, the current portions of the Company's deferred income tax assets are reclassified as noncurrent assets on the consolidated Balance Sheet. Prior periods were not retrospectively adjusted.
2016-09	March 2016	Several aspects of the accounting for share-based payment transactions were simplified, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows.	January 1, 2017	This ASU was early adopted as of October 1, 2016 and was applied retrospectively. As a result, the Company accounts for forfeitures as they occur. There were no other material impacts upon adoption.

## Recently Issued Accounting Guidance Not Yet Adopted

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2014-09 2015-14 2016-08 2016-10 2016-12 2016-20	May 2014 – December 2016	ASU 2014-09 was issued in May 2014 and provides guidance on revenue recognition relating to the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. ASU 2015-14 deferred the effective date of ASU 2014-09 by one year. Additional ASUs were issued in 2016 that simplify transition and provide clarity on certain aspects of the new standard.	January 1, 2018	Hydro One has completed its initial assessment and has identified relevant revenue streams. No quantitative determination has been made as a detailed assessment is now underway and will continue through to the third quarter of 2017, with the end result being a determination of the financial impact of this standard. The Company is on track for implementation of this standard by the effective date.
2016-01	January 2016	This update requires equity investments to be measured at fair value with changes in fair value recognized in net income, and requires enhanced disclosures and presentation of financial assets and liabilities in the financial statements. This ASU also simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment.	January 1, 2018	Under assessment
2016-02	February 2016	Lessees are required to recognize the rights and obligations resulting from operating leases as assets (right to use the underlying asset for the term of the lease) and liabilities (obligation to make future lease payments) on the balance sheet.	January 1, 2019	An initial assessment is currently underway encompassing a review of all existing leases, which will be followed by a detailed review of relevant contracts. No quantitative determination has been made at this time. The Company is on track for implementation of this standard by the effective date.
2016-05	March 2016	The amendments clarify that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require de-designation of that hedging relationship provided that all other hedge accounting criteria continue to be met.	January 1, 2018	Under assessment
2016-06	March 2016	Contingent call (put) options that are assessed to accelerate the payment of principal on debt instruments need to meet the criteria of being "clearly and closely related" to their debt hosts.	January 1, 2017	No material impact
2016-07	March 2016	The requirement to retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in the level of ownership or degree of influence has been eliminated.	January 1, 2017	No material impact
2016-11	May 2016	This amendment covers the SEC Staff's rescinding of certain SEC Staff observer comments that are codified in Topic 605 and Topic 932, effective upon the adoption of Topic 606 and Topic 815, effective to coincide with the effective date of Update 2014-16.	January 1, 2019	No material impact

## MANAGEMENT'S DISCUSSION AND ANALYSIS

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2016-13	June 2016	The amendment provides users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date.	January 1, 2019	Under assessment
2016-15	August 2016	The amendments provide guidance for eight specific cash flow issues with the objective of reducing the existing diversity in practice.	January 1, 2018	Under assessment
2016-16	October 2016	The amendment eliminates the prohibition of recognizing current and deferred income taxes for an intra-entity asset transfer, other than inventory, until the asset has been sold to an outside party. The amendment will permit income tax consequences of such transfers to be recognized when the transfer occurs.	January 1, 2018	Under assessment
2016-18	November 2016	The amendment requires that restricted cash or restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning and end-of-period balances in the statement of cash flows.	January 1, 2018	Under assessment
2017-01	January 2017	The amendment clarifies the definition of a business and provides additional guidance on evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses.	January 1, 2018	Under assessment

## Summary of Fourth Quarter Results of Operations

Three months ended December 31

(millions of dollars, except EPS)

	2016	2015	Change
<b>Revenues</b>			
Distribution	1,228	1,148	7.0%
Transmission	373	361	3.3%
Other	13	13	–
	1,614	1,522	6.0%
<b>Costs</b>			
Purchased power	858	786	9.2%
OM&A			
Distribution	163	146	11.6%
Transmission	98	126	(22.2%)
Other	26	29	(10.3%)
	287	301	(4.7%)
Depreciation and amortization	204	193	5.7%
	1,349	1,280	5.4%
<b>Income before financing charges and income taxes</b>	265	242	9.5%
Financing charges	101	94	7.4%
<b>Income before income taxes</b>	164	148	10.8%
Income tax expense	29	1	100.0%
<b>Net income</b>	135	147	(8.2%)
<b>Net income attributable to common shareholders of Hydro One</b>	128	143	(10.5%)
Basic EPS	\$ 0.22	\$ 0.26	(15.4%)
Diluted EPS	\$ 0.21	\$ 0.26	(19.2%)
<b>Capital investments</b>			
Distribution	201	198	1.5%
Transmission	274	251	9.2%
Other	2	2	–
	477	451	5.8%

### Net Income

Net income attributable to common shareholders for the quarter ended December 31, 2016 of \$128 million is a decrease of \$15 million or 10.5% from the prior year. Excluding the effect of an IPO-related positive tax adjustment of \$19 million in the fourth quarter of 2015, net income for the quarter increased by 3.2%.

### Revenues

The quarterly increase of \$12 million or 3.3% in transmission revenues was primarily due to higher average monthly Ontario

60-minute peak demand as several extremely cold days during the quarter increased peak transmission demand and OEB-approved transmission rate increases.

The quarterly increase of \$80 million or 7.0% in distribution revenues was primarily due to higher power costs from generators that are passed on to customers and increased OEB-approved distribution rates for 2016, partially offset by lower energy consumption resulting from milder weather.



## MANAGEMENT'S DISCUSSION AND ANALYSIS

### OM&A Costs

The quarterly decrease of \$28 million or 22.2% in transmission OM&A costs was primarily due to lower project cost and inventory write-downs and lower expenditures related to forestry control and line clearing on the Company's transmission rights-of-way.

The quarterly increase of \$17 million or 11.6% in distribution OM&A costs was primarily due to higher volume of vegetation management activities, partially offset by lower costs related to restoring power services and storm response.

### Depreciation and Amortization

The increase of \$11 million or 5.7% in depreciation and amortization costs for the fourth quarter of 2016 was mainly due to the growth in capital assets as the Company continues to place new assets in-service, consistent with its ongoing capital investment program.

### Financing Charges

The quarterly increase of \$7 million or 7.4% in financing charges was primarily due to an increase in interest expense on long-term debt resulting from the increase in weighted average long-term debt outstanding during the quarter.

### Income Tax Expense

Income tax expense for the fourth quarter of 2016 increased by \$28 million compared to 2015, and the Company realized an effective tax rate of approximately 17.7% in the fourth quarter of 2016 compared to approximately 0.7% in 2015. The increase in tax expense is primarily due to the following:

- the effect of an IPO-related positive tax adjustment of \$19 million in the fourth quarter of 2015;
- higher income before taxes in the fourth quarter of 2016; and
- a decrease in deductible temporary differences such as capitalized pension deducted for tax purposes.

### Capital Investments

The increase in transmission capital investments during the fourth quarter was primarily due to

- an increased volume of work on insulator replacements;
- an increased volume of integrated station component replacements to replace deteriorated assets at transmission stations; and
- higher volume of demand work associated with equipment failures and spare transformer equipment purchases; partially offset by
- reduced work on the Clarington Transmission Station as the project nears completion.

The increase in distribution capital investments during the fourth quarter was primarily due to

- increased investments related to information technology infrastructure and customer programs together with upgrade and enhancement projects, including investments to integrate mobile technology with the Company's existing work management tools;
- higher volume of facility upgrades and construction of new operation centres; and
- higher volumes of work associated with further enabling certain of Hydro One's assets to be jointly used by the telecommunications and cable television industries, as well as relocation of poles, conductors and other equipment as required by municipal and provincial road authorities; partially offset by
- higher storm restoration work in the prior year primarily as a result of two significant wind storms during the fourth quarter of 2015.

## Forward-looking Statements And Information

The Company's oral and written public communications, including this document, often contain forward-looking statements that are based on current expectations, estimates, forecasts and projections about the Company's business and the industry, regulatory and economic environments in which it operates, and include beliefs and assumptions made by the management of the Company. Such statements include, but are not limited to: statements regarding the Company's transmission and distribution rates resulting from rate applications; statements regarding the Company's liquidity and capital resources and operational requirements; statements about the standby credit facilities; expectations regarding the Company's financing activities; statements regarding the Company's maturing debt; statements related to credit ratings; statements regarding ongoing and planned projects and/or initiatives, including expected results and completion dates; statements regarding expected future capital and development investments, the timing of these expenditures and the Company's investment plans; statements regarding contractual obligations and other commercial commitments; statements related to the OEB; statements regarding future pension contributions, the pension plan and valuations; expectations related to work force demographics; statements about collective agreements; statements related to dividends; statements related to claims; expectations regarding taxes; statements related to occupational rights; statements about non-GAAP measures; statements related to critical accounting estimates, including expectations regarding employee future benefits, environmental liabilities, and regulatory assets and liabilities; expectations related to the effect of interest rates; statements about the Company's reputation; statements regarding cyber and data security; statements related to future sales of shares of Hydro One; statements related to the Company's

relationship with the Province; statements regarding recent accounting-related guidance; expectations related to tax impacts; statements related to the Universal Base Shelf Prospectus; and statements related to the Company's acquisitions, including statements about Great Lakes Power and Orillia Power. Words such as "expect", "anticipate", "intend", "attempt", "may", "plan", "will", "believe", "seek", "estimate", "goal", "aim", "target", 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 it 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, the following: 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 and future rate and other applications; no unexpected delays in obtaining the required approvals; no unforeseen changes in rate orders or rate setting methodologies for the Company's distribution and transmission businesses; continued use of US GAAP; a stable regulatory environment; no unfavourable changes in environmental regulation; and no significant event occurring outside the ordinary course of business. These assumptions are based on information currently available to the Company, including information obtained 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, the Company's business, results of operations, financial condition and 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:

- risks associated with the Province's share ownership of Hydro One and other relationships with the Province, including potential conflicts of interest that may arise between Hydro One, the Province and related parties;
- regulatory risks and risks relating to Hydro One's revenues, including risks relating to rate orders, actual performance against forecasts and capital expenditures;
- the risk that the Company may be unable to comply with regulatory and legislative requirements or that the Company may incur additional costs for compliance that are not recoverable through rates;
- the risk of exposure of the Company's facilities to the effects of severe weather conditions, natural disasters or other unexpected

occurrences for which the Company is uninsured or for which the Company could be subject to claims for damage;

- public opposition to and delays or denials of the requisite approvals and accommodations for the Company's planned projects;
- the risk that Hydro One may incur significant costs associated with transferring assets located on Reserves (as defined in the *Indian Act* (Canada));
- the risks associated with information system security and maintaining a complex information technology system infrastructure;
- the risks related to the Company's work force demographic and its potential inability to attract and retain qualified personnel;
- the risk of labour disputes and inability to negotiate appropriate collective agreements on acceptable terms consistent with the Company's rate decisions;
- risk that the Company is not able to arrange sufficient cost-effective financing to repay maturing debt and to fund capital expenditures;
- risks associated with fluctuations in interest rates and failure to manage exposure to credit risk;
- the risk that the Company may not be able to execute plans for capital projects necessary to maintain the performance of the Company's assets or to carry out projects in a timely manner;
- the risk of non-compliance with environmental regulations or failure to mitigate significant health and safety risks and inability to recover environmental expenditures in rate applications;
- the risk that assumptions that form the basis of the Company's recorded environmental liabilities and related regulatory assets may change;
- the risk of not being able to recover the Company's pension expenditures in future rates and uncertainty regarding the future regulatory treatment of pension, other post-employment benefits and post-retirement benefits costs;
- the potential that Hydro One may incur significant expenses to replace functions currently outsourced if agreements are terminated or expire before a new service provider is selected;
- the risks associated with economic uncertainty and financial market volatility;
- the inability to prepare financial statements using US GAAP; and
- the impact of the ownership by the Province of lands underlying the Company's transmission system.

Hydro One cautions the reader that the above list of factors is not exhaustive. Some of these and other factors are discussed in more detail in the section "Risk Management and Risk Factors" in this MD&A.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

In addition, Hydro One cautions the reader that information provided in this MD&A regarding the Company's outlook on certain matters, including potential future investments, is provided in order to give context to the nature of some of the Company's future plans and may not be appropriate for other purposes.

Additional information about Hydro One, including the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com) and the Company's website at [www.HydroOne.com/Investors](http://www.HydroOne.com/Investors).

# Management's Report

The Consolidated Financial Statements, Management's Discussion and Analysis (MD&A) and related financial information have been prepared by the management of Hydro One Limited (Hydro One or the Company). Management is responsible for the integrity, consistency and reliability of all such information presented. The Consolidated Financial Statements have been prepared in accordance with United States Generally Accepted Accounting Principles and applicable securities legislation. The MD&A has been prepared in accordance with National Instrument 51-102.

The preparation of the Consolidated Financial Statements and information in the MD&A involves the use of estimates and assumptions based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. Estimates and assumptions are based on historical experience, current conditions and various other assumptions believed to be reasonable in the circumstances, with critical analysis of the significant accounting policies followed by the Company as described in Note 2 to the Consolidated Financial Statements. The preparation of the Consolidated Financial Statements and the MD&A includes information regarding the estimated impact of future events and transactions. The MD&A also includes information regarding sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from the present assessment of this information because future events and circumstances may not occur as expected. The Consolidated Financial Statements and MD&A have been properly prepared within reasonable limits of materiality and in light of information up to February 9, 2017.

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. In meeting its responsibility for the reliability of financial information, management maintains and relies on a comprehensive system of internal control and internal audit. The system of internal control includes a written corporate conduct policy; implementation of a risk management framework; effective segregation of duties and delegation of authorities; and sound accounting policies that are regularly reviewed. This structure is designed to provide reasonable assurance that assets are safeguarded and that reliable information is available on a timely basis. In addition, management has assessed the design and operating effectiveness of the Company's internal

control over financial reporting in accordance with the criteria set forth in Internal Control – Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that the Company maintained effective internal control over financial reporting as of December 31, 2016. The effectiveness of these internal controls is reported to the Audit Committee of the Hydro One Board of Directors, as required.

The Consolidated Financial Statements have been audited by KPMG LLP, independent external auditors appointed by the shareholders of the Company. The external auditors' responsibility is to express their opinion on whether the Consolidated Financial Statements are fairly presented in accordance with United States Generally Accepted Accounting Principles. The Independent Auditors' Report outlines the scope of their examination and their opinion.

The Hydro One Board of Directors, through its Audit Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Audit Committee of Hydro One met periodically with management, the internal auditors and the external auditors to satisfy itself that each group had properly discharged its respective responsibility and to review the Consolidated Financial Statements before recommending approval by the Board of Directors. The external auditors had direct and full access to the Audit Committee, with and without the presence of management, to discuss their audit findings.

The President and Chief Executive Officer and the Chief Financial Officer have certified Hydro One's annual Consolidated Financial Statements and annual MD&A, related disclosure controls and procedures and the design and effectiveness of related internal controls over financial reporting.

On behalf of Hydro One's management:



Mayo Schmidt  
President and Chief  
Executive Officer



Michael Vels  
Chief Financial Officer

# Independent Auditors' Report

*To the Shareholders of Hydro One Limited*

We have audited the accompanying Consolidated Financial Statements of Hydro One Limited, which comprise the consolidated balance sheets as at December 31, 2016 and December 31, 2015, the consolidated statements of operations and comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

## *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these Consolidated Financial Statements in accordance with United States Generally Accepted Accounting Principles, and for such internal control as management determines is necessary to enable the preparation of Consolidated Financial Statements that are free from material misstatement, whether due to fraud or error.

## *Auditors' Responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Consolidated Financial Statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the

Consolidated Financial Statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the Consolidated Financial Statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Consolidated Financial Statements.

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

## *Opinion*

In our opinion, the Consolidated Financial Statements present fairly, in all material respects, the consolidated financial position of Hydro One Limited as at December 31, 2016 and December 31, 2015, and its consolidated results of operations and its consolidated cash flows for the years then ended in accordance with United States Generally Accepted Accounting Principles.



Chartered Professional Accountants, Licensed Public Accountants

Toronto, Canada  
February 9, 2017

# Consolidated Statements of Operations and Comprehensive Income

For the years ended December 31, 2016 and 2015

Year ended December 31 (millions of Canadian dollars, except per share amounts)

	2016	2015
<b>Revenues</b>		
Distribution (includes \$160 related party revenues; 2015 – \$159) (Note 26)	4,915	4,949
Transmission (includes \$1,553 related party revenues; 2015 – \$1,554) (Note 26)	1,584	1,536
Other	53	53
	<b>6,552</b>	<b>6,538</b>
<b>Costs</b>		
Purchased power (includes \$2,103 related party costs; 2015 – \$2,335) (Note 26)	3,427	3,450
Operation, maintenance and administration (Note 26)	1,069	1,135
Depreciation and amortization (Note 5)	778	759
	<b>5,274</b>	<b>5,344</b>
<b>Income before financing charges and income taxes</b>	<b>1,278</b>	<b>1,194</b>
Financing charges (Note 6)	393	376
<b>Income before income taxes</b>	<b>885</b>	<b>818</b>
Income taxes (Notes 7, 26)	139	105
<b>Net income</b>	<b>746</b>	<b>713</b>
Other comprehensive income	–	1
<b>Comprehensive income</b>	<b>746</b>	<b>714</b>
<b>Net income attributable to:</b>		
Noncontrolling interest (Note 25)	6	10
Preferred shareholders	19	13
Common shareholders	721	690
	<b>746</b>	<b>713</b>
<b>Comprehensive income attributable to:</b>		
Noncontrolling interest (Note 25)	6	10
Preferred shareholders	19	13
Common shareholders	721	691
	<b>746</b>	<b>714</b>
<b>Earnings per common share (Note 23)</b>		
Basic	\$ 1.21	\$ 1.39
Diluted	\$ 1.21	\$ 1.39
<b>Dividends per common share declared (Note 22)</b>	<b>\$ 0.97</b>	<b>\$ 1.83</b>

See accompanying notes to Consolidated Financial Statements.



# Consolidated Balance Sheets

At December 31, 2016 and 2015

December 31 (millions of Canadian dollars)

	2016	2015
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	50	94
Accounts receivable (Note 8)	838	776
Due from related parties (Note 26)	158	191
Other current assets (Note 9)	102	105
	<b>1,148</b>	<b>1,166</b>
Property, plant and equipment (Note 10)	19,140	17,968
Other long-term assets:		
Regulatory assets (Note 12)	3,145	3,015
Deferred income tax assets (Note 7)	1,235	1,636
Intangible assets (Note 11)	349	336
Goodwill (Note 4)	327	163
Other assets	7	10
	<b>5,063</b>	<b>5,160</b>
<b>Total assets</b>	<b>25,351</b>	<b>24,294</b>
<b>Liabilities</b>		
Current liabilities:		
Short-term notes payable (Note 15)	469	1,491
Long-term debt payable within one year (Note 15)	602	500
Accounts payable and other current liabilities (Note 13)	945	868
Due to related parties (Note 26)	147	138
	<b>2,163</b>	<b>2,997</b>
Long-term liabilities:		
Long-term debt (includes \$548 measured at fair value; 2015 – \$51) (Notes 15, 16)	10,078	8,207
Regulatory liabilities (Note 12)	209	236
Deferred income tax liabilities (Note 7)	60	207
Other long-term liabilities (Note 14)	2,752	2,723
	<b>13,099</b>	<b>11,373</b>
<b>Total liabilities</b>	<b>15,262</b>	<b>14,370</b>
Contingencies and Commitments (Notes 28, 29)		
Subsequent Events (Note 31)		
Noncontrolling interest subject to redemption (Note 25)	22	23
<b>Equity</b>		
Common shares (Notes 21, 22)	5,623	5,623
Preferred shares (Notes 21, 22)	418	418
Additional paid-in capital (Note 24)	34	10
Retained earnings	3,950	3,806
Accumulated other comprehensive loss	(8)	(8)
Hydro One shareholders' equity	10,017	9,849
Noncontrolling interest (Note 25)	50	52
<b>Total equity</b>	<b>10,067</b>	<b>9,901</b>
	<b>25,351</b>	<b>24,294</b>

See accompanying notes to Consolidated Financial Statements.

On behalf of the Board of Directors:



David Denison  
Chair



Philip Orsino  
Chair, Audit Committee

# Consolidated Statements of Changes in Equity

For the years ended December 31, 2016 and 2015

Year ended December 31, 2016 (millions of Canadian dollars)	Common Shares	Preferred Shares	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Hydro One Shareholders' Equity	Non- controlling Interest (Note 25)	Total Equity
January 1, 2016	5,623	418	10	3,806	(8)	9,849	52	9,901
Net income	-	-	-	740	-	740	4	744
Other comprehensive income	-	-	-	-	-	-	-	-
Distributions to noncontrolling interest	-	-	-	-	-	-	(6)	(6)
Dividends on preferred shares	-	-	-	(19)	-	(19)	-	(19)
Dividends on common shares	-	-	-	(577)	-	(577)	-	(577)
Stock-based compensation (Note 24)	-	-	24	-	-	24	-	24
<b>December 31, 2016</b>	<b>5,623</b>	<b>418</b>	<b>34</b>	<b>3,950</b>	<b>(8)</b>	<b>10,017</b>	<b>50</b>	<b>10,067</b>

Year ended December 31, 2015 (millions of Canadian dollars)	Common Shares	Preferred Shares	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Hydro One Shareholders' Equity	Non- controlling Interest (Note 25)	Total Equity
January 1, 2015	3,314	-	-	4,249	(9)	7,554	49	7,603
Net income	-	-	-	703	-	703	7	710
Other comprehensive income	-	-	-	-	1	1	-	1
Distributions to noncontrolling interest	-	-	-	-	-	-	(4)	(4)
Dividends on preferred shares	-	-	-	(13)	-	(13)	-	(13)
Dividends on common shares	-	-	-	(875)	-	(875)	-	(875)
Hydro One Brampton spin-off (Note 4)	(196)	-	-	(258)	-	(454)	-	(454)
Pre-IPO Transactions (Note 21)	2,505	418	-	-	-	2,923	-	2,923
Stock-based compensation (Note 24)	-	-	10	-	-	10	-	10
<b>December 31, 2015</b>	<b>5,623</b>	<b>418</b>	<b>10</b>	<b>3,806</b>	<b>(8)</b>	<b>9,849</b>	<b>52</b>	<b>9,901</b>

See accompanying notes to Consolidated Financial Statements.

# Consolidated Statements of Cash Flows

For the years ended December 31, 2016 and 2015

Year ended December 31 (millions of Canadian dollars)

	2016	2015
<b>Operating activities</b>		
Net income	746	713
Environmental expenditures	(20)	(19)
Adjustments for non-cash items:		
Depreciation and amortization (excluding removal costs)	688	668
Regulatory assets and liabilities	(16)	(3)
Deferred income taxes (Note 7)	114	(2,844)
Other	10	24
Changes in non-cash balances related to operations (Note 27)	134	213
<b>Net cash from (used in) operating activities</b>	<b>1,656</b>	<b>(1,248)</b>
<b>Financing activities</b>		
Long-term debt issued	2,300	350
Long-term debt repaid	(502)	(585)
Short-term notes issued	3,031	2,891
Short-term notes repaid	(4,053)	(1,400)
Common shares issued	–	2,600
Dividends paid	(596)	(888)
Distributions paid to noncontrolling interest	(9)	(5)
Change in bank indebtedness	–	(2)
Other	(10)	(7)
<b>Net cash from financing activities</b>	<b>161</b>	<b>2,954</b>
<b>Investing activities</b>		
Capital expenditures (Note 27)		
Property, plant and equipment	(1,600)	(1,595)
Intangible assets	(61)	(37)
Capital contributions received (Note 27)	21	57
Acquisitions (Note 4)	(224)	(90)
Investment in Hydro One Brampton (Note 4)	–	(53)
Other	3	6
<b>Net cash used in investing activities</b>	<b>(1,861)</b>	<b>(1,712)</b>
<b>Net change in cash and cash equivalents</b>	<b>(44)</b>	<b>(6)</b>
Cash and cash equivalents, beginning of year	94	100
<b>Cash and cash equivalents, end of year</b>	<b>50</b>	<b>94</b>

See accompanying notes to Consolidated Financial Statements.

# Notes to Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

## 1. Description of The Business

Hydro One Limited (Hydro One or the Company) was incorporated on August 31, 2015, under the *Business Corporations Act* (Ontario). On October 31, 2015, the Company acquired Hydro One Inc., a company previously wholly owned by the Province of Ontario (Province). The acquisition of Hydro One Inc. by Hydro One was accounted for as a common control transaction and Hydro One is a continuation of business operations of Hydro One Inc. At December 31, 2016, the Province holds approximately 70.1% (2015 – 84%) of the common shares of Hydro One. See note 21 for further details regarding the reorganization of Hydro One.

The principal businesses of Hydro One are the transmission and distribution of electricity to customers within Ontario.

## 2. Significant Accounting Policies

### Basis of Consolidation and Preparation

These Consolidated Financial Statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances have been eliminated.

The comparative information to these Consolidated Financial Statements has been presented in a manner similar to the pooling-of-interests method. The comparative information consists of the results of operations of Hydro One Inc. prior to October 31, 2015, and the consolidated results of operations of Hydro One from the date of incorporation on August 31, 2015 to December 31, 2015, which include the results of Hydro One Inc. subsequent to its acquisition on October 31, 2015. The comparative information has been combined using historical amounts. In addition, Hydro One's issued and outstanding common shares prior to October 31, 2015 have been retroactively adjusted for the purposes of presentation to reflect the effects of the acquisition of Hydro One Inc. using the exchange ratio established for the acquisition. The Consolidated Financial Statements are referred to as "consolidated" for all periods presented.

On August 31, 2015, Hydro One Inc. completed the spin-off of its subsidiary, Hydro One Brampton Networks Inc. (Hydro One Brampton) to the Province (see note 4). The comparative information to these Consolidated Financial Statements includes the results of Hydro One Brampton up to August 31, 2015.

### Basis of Accounting

These Consolidated Financial Statements are prepared and presented in accordance with United States (US) Generally Accepted Accounting Principles (GAAP) and in Canadian dollars.

### Use of Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains and losses during the reporting periods. Management evaluates these estimates on an ongoing basis based upon historical experience, current conditions, and assumptions believed to be reasonable at the time the assumptions are made, with any adjustments being recognized in results of operations in the period they arise. Significant estimates relate to regulatory assets and regulatory liabilities, environmental liabilities, pension benefits, post-retirement and post-employment benefits, asset retirement obligations, goodwill and asset impairments, contingencies, unbilled revenues, allowance for doubtful accounts, derivative instruments, and deferred income tax assets and liabilities. Actual results may differ significantly from these estimates.

### Rate Setting

The Company's Transmission Business consists of the transmission business of Hydro One Inc., which includes the transmission business of Hydro One Networks Inc. (Hydro One Networks), Hydro One Sault Ste. Marie LP (previously Great Lakes Power Transmission LP (Great Lakes Power)), and its 66% interest in B2M Limited Partnership (B2M LP). The Company's Distribution Business consists of the distribution business of Hydro One Inc., which includes the distribution businesses of Hydro One Networks, as well as Hydro One Remote Communities Inc. (Hydro One Remote Communities).

### Transmission

In November 2015, the OEB approved Hydro One Networks' 2016 transmission rates revenue requirement of \$1,480 million.

In December 2015, the OEB approved B2M LP's 2015-2019 rates revenue requirements of \$39 million, \$36 million, \$37 million, \$38 million and \$37 million for the respective years. On January 14, 2016, the OEB approved the B2M LP revenue requirement recovery through the 2016 Uniform Transmission Rates, and the establishment of a deferral account to capture costs of Tax Rate and Rule changes.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Distribution

In March 2015, the OEB approved Hydro One Networks' distribution revenue requirements of \$1,326 million for 2015, \$1,430 million for 2016 and \$1,486 million for 2017. The OEB has subsequently approved updated revenue requirements of \$1,410 million for 2016 and \$1,415 million for 2017.

On March 17, 2016, the OEB approved an increase of 2.10% to Hydro One Remote Communities' basic rates for the distribution and generation of electricity, with an effective date of May 1, 2016.

### Regulatory Accounting

The OEB has the general power to include or exclude revenues, costs, gains or losses in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have been applied in an unregulated company. Such change in timing involves the application of rate-regulated accounting, giving rise to the recognition of regulatory assets and liabilities. The Company's regulatory assets represent certain amounts receivable from future customers and costs that have been deferred for accounting purposes because it is probable that they will be recovered in future rates. In addition, the Company has recorded regulatory liabilities that generally represent amounts that are refundable to future customers. The Company continually assesses the likelihood of recovery of each of its regulatory assets and continues to believe that it is probable that the OEB will include its regulatory assets and liabilities in setting of future rates. If, at some future date, the Company judges that it is no longer probable that the OEB will include a regulatory asset or liability in setting future rates, the appropriate carrying amount would be reflected in results of operations in the period that the assessment is made.

### Cash and Cash Equivalents

Cash and cash equivalents include cash and short-term investments with an original maturity of three months or less.

### Revenue Recognition

Transmission revenues are collected through OEB-approved rates, which are based on an approved revenue requirement that includes a rate of return. Such revenue is recognized as electricity is transmitted and delivered to customers.

Distribution revenues attributable to the delivery of electricity are based on OEB-approved distribution rates and are recognized on an accrual basis and include billed and unbilled revenues. Billed revenues are based on electricity delivered as measured from customer meters. At the end of each month, electricity delivered to customers since the date of the last billed meter reading is estimated,

and the corresponding unbilled revenue is recorded. The unbilled revenue estimate is affected by energy consumption, weather, and changes in the composition of customer classes.

Distribution revenue also includes an amount relating to rate protection for rural, residential, and remote customers, which is received from the Independent Electricity System Operator (IESO) based on a standardized customer rate that is approved by the OEB.

Revenues also include amounts related to sales of other services and equipment. Such revenue is recognized as services are rendered or as equipment is delivered.

Revenues are recorded net of indirect taxes.

### Accounts Receivable and Allowance for Doubtful Accounts

Billed accounts receivable are recorded at the invoiced amount, net of allowance for doubtful accounts. Unbilled accounts receivable are recorded at their estimated value. Overdue amounts related to regulated billings bear interest at OEB-approved rates. The allowance for doubtful accounts reflects the Company's best estimate of losses on billed accounts receivable balances. The Company estimates the allowance for doubtful accounts on billed accounts receivable by applying internally developed loss rates to the outstanding receivable balances by aging category. Loss rates applied to the billed accounts receivable balances are based on historical overdue balances, customer payments and write-offs. Accounts receivable are written-off against the allowance when they are deemed uncollectible. The allowance for doubtful accounts is affected by changes in volume, prices and economic conditions.

### Noncontrolling interest

Noncontrolling interest represents the portion of equity ownership in subsidiaries that is not attributable to shareholders of Hydro One. Noncontrolling interest is initially recorded at fair value and subsequently the amount is adjusted for the proportionate share of net income and other comprehensive income attributable to the noncontrolling interest and any dividends or distributions paid to the noncontrolling interest.

If a transaction results in the acquisition of all, or part, of a noncontrolling interest in a subsidiary, the acquisition of the noncontrolling interest is accounted for as an equity transaction. No gain or loss is recognized in consolidated net income or comprehensive income as a result of changes in the noncontrolling interest, unless a change results in the loss of control by the Company.



## Income Taxes

Prior to the IPO, Hydro One was exempt from tax under the *Income Tax Act* (Canada) and the *Taxation Act, 2007* (Ontario) (Federal Tax Regime). However, under the *Electricity Act*, Hydro One was required to make payments in lieu of tax (PIls) to the Ontario Electricity Financing Corporation (OEFC) (PIls Regime). The PIls were, in general, based on the amount of tax that Hydro One would otherwise be liable to pay under the Federal Tax Regime if it was not exempt from taxes under those statutes. In connection with the IPO of Hydro One, Hydro One's exemption from tax under the Federal Tax Regime ceased to apply. Upon exiting the PIls Regime, Hydro One is required to make corporate income tax payments to the Canada Revenue Agency (CRA) under the Federal Tax Regime.

Current and deferred income taxes are computed based on the tax rates and tax laws enacted as at the balance sheet date. Tax benefits associated with income tax positions taken, or expected to be taken, in a tax return are recorded only when the "more-likely-than-not" recognition threshold is satisfied and are measured at the largest amount of benefit that has a greater than 50% likelihood of being realized upon settlement. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. Significant management judgment is required to determine recognition thresholds and the related amount of tax benefits to be recognized in the Consolidated Financial Statements. Management re-evaluates tax positions each period using new information about recognition or measurement as it becomes available.

## Deferred Income Taxes

Deferred income taxes are provided for using the liability method. Deferred income taxes are recognized based on the estimated future tax consequences attributable to temporary differences between the carrying amount of assets and liabilities in the Consolidated Financial Statements and their corresponding tax bases.

Deferred income tax liabilities are recognized on all taxable temporary differences. Deferred tax assets are recognized to the extent that it is more-likely-than-not that these assets will be realized from taxable income available against which deductible temporary differences can be utilized.

Deferred income taxes are calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized, based on the tax rates and tax laws that have been enacted as at the balance sheet date. Deferred income taxes that are not included in the rate-setting process are charged or credited to the Consolidated Statements of Operations and Comprehensive Income.

If management determines that it is more-likely-than-not that some or all of a deferred income tax asset will not be realized, a valuation allowance is recorded against the deferred income tax asset to report the net balance at the amount expected to be realized. Previously unrecognized deferred income tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become more-likely-than-not that the tax benefit will be realized.

The Company records regulatory assets and liabilities associated with deferred income taxes that will be included in the rate-setting process.

The Company uses the flow-through method to account for investment tax credits (ITCs) earned on eligible scientific research and experimental development expenditures, and apprenticeship job creation. Under this method, only non-refundable ITCs are recognized as a reduction to income tax expense.

## Materials and Supplies

Materials and supplies represent consumables, small spare parts and construction materials held for internal construction and maintenance of property, plant and equipment. These assets are carried at average cost less any impairments recorded.

## Property, Plant and Equipment

Property, plant and equipment is recorded at original cost, net of customer contributions, and any accumulated impairment losses. The cost of additions, including betterments and replacement asset components, is included on the Consolidated Balance Sheets as property, plant and equipment.

The original cost of property, plant and equipment includes direct materials, direct labour (including employee benefits), contracted services, attributable capitalized financing costs, asset retirement costs, and direct and indirect overheads that are related to the capital project or program. Indirect overheads include a portion of corporate costs such as finance, treasury, human resources, information technology and executive costs. Overhead costs, including corporate functions and field services costs, are capitalized on a fully allocated basis, consistent with an OEB-approved methodology.

Property, plant and equipment in service consists of transmission, distribution, communication, administration and service assets and land easements. Property, plant and equipment also includes future use assets, such as land, major components and spare parts, and capitalized project development costs associated with deferred capital projects.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Transmission

Transmission assets include assets used for the transmission of high-voltage electricity, such as transmission lines, support structures, foundations, insulators, connecting hardware and grounding systems, and assets used to step up the voltage of electricity from generating stations for transmission and to step down voltages for distribution, including transformers, circuit breakers and switches.

### Distribution

Distribution assets include assets related to the distribution of low-voltage electricity, including lines, poles, switches, transformers, protective devices and metering systems.

### Communication

Communication assets include fibre optic and microwave radio systems, optical ground wire, towers, telephone equipment and associated buildings.

### Administration and Service

Administration and service assets include administrative buildings, personal computers, transport and work equipment, tools and other minor assets.

### Easements

Easements include statutory rights of use for transmission corridors and abutting lands granted under the *Reliable Energy and Consumer Protection Act, 2002*, as well as other land access rights.

### Intangible Assets

Intangible assets separately acquired or internally developed are measured on initial recognition at cost, which comprises purchased software, direct labour (including employee benefits), consulting, engineering, overheads and attributable capitalized financing charges. Following initial recognition, intangible assets are carried at cost, net of any accumulated amortization and accumulated impairment losses. The Company's intangible assets primarily represent major computer applications.

### Capitalized Financing Costs

Capitalized financing costs represent interest costs attributable to the construction of property, plant and equipment or development of intangible assets. The financing cost of attributable borrowed funds is capitalized as part of the acquisition cost of such assets. The capitalized financing costs are a reduction of financing charges recognized in the Consolidated Statements of Operations and Comprehensive Income. Capitalized financing costs are calculated using the Company's weighted average effective cost of debt.

### Construction and Development in Progress

Construction and development in progress consists of the capitalized cost of constructed assets that are not yet complete and which have not yet been placed in service.

### Depreciation and Amortization

The cost of property, plant and equipment and intangible assets is depreciated or amortized on a straight-line basis based on the estimated remaining service life of each asset category, except for transport and work equipment, which is depreciated on a declining balance basis.

The Company periodically initiates an external independent review of its property, plant and equipment and intangible asset depreciation and amortization rates, as required by the OEB. Any changes arising from OEB approval of such a review are implemented on a remaining service life basis, consistent with their inclusion in electricity rates. The last review resulted in changes to rates effective January 1, 2015. A summary of average service lives and depreciation and amortization rates for the various classes of assets is included below:

	Average Service Life	Rate Range	Average Rate
Property, plant and equipment:			
Transmission	56 years	1% – 3%	2%
Distribution	46 years	1% – 7%	2%
Communication	16 years	1% – 15%	6%
Administration and service	18 years	1% – 20%	7%
Intangible assets	10 years	10%	10%

In accordance with group depreciation practices, the original cost of property, plant and equipment, or major components thereof, and intangible assets that are normally retired, is charged to accumulated depreciation, with no gain or loss being reflected in results of operations. Where a disposition of property, plant and equipment occurs through sale, a gain or loss is calculated based on proceeds and such gain or loss is included in depreciation expense.

## Acquisitions and Goodwill

The Company accounts for business acquisitions using the acquisition method of accounting and, accordingly, the assets and liabilities of the acquired entities are primarily measured at their estimated fair value at the date of acquisition. Goodwill represents the cost of acquired companies that is in excess of the fair value of the net identifiable assets acquired at the acquisition date. Goodwill is not included in rate base.

Goodwill is evaluated for impairment on an annual basis, or more frequently if circumstances require. The Company performs a qualitative assessment to determine whether it is more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount. If the Company determines, as a result of its qualitative assessment, that it is not more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount, no further testing is required. If the Company determines, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of the applicable reporting unit is less than its carrying amount, a goodwill impairment assessment is performed using a two-step, fair value-based test. The first step compares the fair value of the applicable reporting unit to its carrying amount, including goodwill. If the carrying amount of the applicable reporting unit exceeds its fair value, a second step is performed. The second step requires an allocation of fair value to the individual assets and liabilities using purchase price allocation in order to determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount, an impairment loss is recorded as a reduction to goodwill and as a charge to results of operations.

For the year ended December 31, 2016, based on the qualitative assessment performed as at September 30, 2016, the Company has determined that it is not more-likely-than-not that the fair value of each applicable reporting unit assessed is less than its carrying amount. As a result, no further testing was performed, and the Company has concluded that goodwill was not impaired at December 31, 2016.

## Long-Lived Asset Impairment

When circumstances indicate the carrying value of long-lived assets may not be recoverable, the Company evaluates whether the carrying value of such assets, excluding goodwill, has been

impaired. For such long-lived assets, the Company evaluates whether impairment may exist by estimating future estimated undiscounted cash flows expected to result from the use and eventual disposition of the asset. When alternative courses of action to recover the carrying amount of a long-lived asset are under consideration, a probability-weighted approach is used to develop estimates of future undiscounted cash flows. If the carrying value of the long-lived asset is not recoverable based on the estimated future undiscounted cash flows, an impairment loss is recorded, measured as the excess of the carrying value of the asset over its fair value. As a result, the asset's carrying value is adjusted to its estimated fair value.

Within its regulated business, the carrying costs of most of Hydro One's long-lived assets are included in rate base where they earn an OEB-approved rate of return. Asset carrying values and the related return are recovered through approved rates. As a result, such assets are only tested for impairment in the event that the OEB disallows recovery, in whole or in part, or if such a disallowance is judged to be probable.

Hydro One regularly monitors the assets of its unregulated Hydro One Telecom subsidiary for indications of impairment. Management assesses the fair value of such long-lived assets using commonly accepted techniques. Techniques used to determine fair value include, but are not limited to, the use of recent third-party comparable sales for reference and internally developed discounted cash flow analysis. Significant changes in market conditions, changes to the condition of an asset, or a change in management's intent to utilize the asset are generally viewed by management as triggering events to reassess the cash flows related to these long-lived assets. As at December 31, 2016 and 2015, no asset impairment had been recorded for assets within either the Company's regulated or unregulated businesses.

## Costs of Arranging Debt Financing

For financial liabilities classified as other than held-for-trading, the Company defers the external transaction costs related to obtaining debt financing and presents such amounts net of related debt on the Consolidated Balance Sheets. Deferred debt issuance costs are amortized over the contractual life of the related debt on an effective-interest basis and the amortization is included within financing charges in the Consolidated Statements of Operations and Comprehensive Income. Transaction costs for items classified as held-for-trading are expensed immediately.

## Comprehensive Income

Comprehensive income is comprised of net income and other comprehensive income (OCI). Hydro One presents net income and OCI in a single continuous Consolidated Statement of Operations and Comprehensive Income.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Financial Assets and Liabilities

All financial assets and liabilities are classified into one of the following five categories: held-to-maturity; loans and receivables; held-for-trading; other liabilities; or available-for-sale. Financial assets and liabilities classified as held-for-trading are measured at fair value. All other financial assets and liabilities are measured at amortized cost, except accounts receivable and amounts due from related parties, which are measured at the lower of cost or fair value. Accounts receivable and amounts due from related parties are classified as loans and receivables. The Company considers the carrying amounts of accounts receivable and amounts due from related parties to be reasonable estimates of fair value because of the short time to maturity of these instruments. Provisions for impaired accounts receivable are recognized as adjustments to the allowance for doubtful accounts and are recognized when there is objective evidence that the Company will not be able to collect amounts according to the original terms. All financial instrument transactions are recorded at trade date.

Derivative instruments are measured at fair value. Gains and losses from fair valuation are included within financing charges in the period in which they arise. The Company determines the classification of its financial assets and liabilities at the date of initial recognition. The Company designates certain of its financial assets and liabilities to be held at fair value, when it is consistent with the Company's risk management policy disclosed in Note 16 – Fair Value of Financial Instruments and Risk Management.

### Derivative Instruments and Hedge Accounting

The Company closely monitors the risks associated with changes in interest rates on its operations and, where appropriate, uses various instruments to hedge these risks. Certain of these derivative instruments qualify for hedge accounting and are designated as accounting hedges, while others either do not qualify as hedges or have not been designated as hedges (hereinafter referred to as undesignated contracts) as they are part of economic hedging relationships.

The accounting guidance for derivative instruments requires the recognition of all derivative instruments not identified as meeting the normal purchase and sale exemption as either assets or liabilities recorded at fair value on the Consolidated Balance Sheets. For derivative instruments that qualify for hedge accounting, the Company may elect to designate such derivative instruments as either cash flow hedges or fair value hedges. The Company offsets fair value amounts recognized on its Consolidated Balance Sheets related to derivative instruments executed with the same counterparty under the same master netting agreement.

For derivative instruments that qualify for hedge accounting and which are designated as cash flow hedges, the effective portion of any gain or loss, net of tax, is reported as a component of accumulated OCI (AOCI) and is reclassified to results of operations in the same period or periods during which the hedged transaction affects results of operations. Any gains or losses on the derivative instrument that represent either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in results of operations. For fair value hedges, changes in fair value of both the derivative instrument and the underlying hedged exposure are recognized in the Consolidated Statements of Operations and Comprehensive Income in the current period. The gain or loss on the derivative instrument is included in the same line item as the offsetting gain or loss on the hedged item in the Consolidated Statements of Operations and Comprehensive Income. The changes in fair value of the undesignated derivative instruments are reflected in results of operations.

Embedded derivative instruments are separated from their host contracts and are carried at fair value on the Consolidated Balance Sheets when: (a) the economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract; (b) the hybrid instrument is not measured at fair value, with changes in fair value recognized in results of operations each period; and (c) the embedded derivative itself meets the definition of a derivative. The Company does not engage in derivative trading or speculative activities and had no embedded derivatives at December 31, 2016 or 2015.

Hydro One periodically develops hedging strategies taking into account risk management objectives. At the inception of a hedging relationship where the Company has elected to apply hedge accounting, Hydro One formally documents the relationship between the hedged item and the hedging instrument, the related risk management objective, the nature of the specific risk exposure being hedged, and the method for assessing the effectiveness of the hedging relationship. The Company also assesses, both at the inception of the hedge and on a quarterly basis, whether the hedging instruments are effective in offsetting changes in fair values or cash flows of the hedged items.

### Employee Future Benefits

Employee future benefits provided by Hydro One include pension, post-retirement and post-employment benefits. The costs of the Company's pension, post-retirement and post-employment benefit plans are recorded over the periods during which employees render service.

The Company recognizes the funded status of its defined benefit pension, post-retirement and post-employment plans on its Consolidated Balance Sheets and subsequently recognizes the changes in funded status at the end of each reporting year. Defined benefit pension, post-retirement and post-employment plans are considered to be underfunded when the projected benefit obligation exceeds the fair value of the plan assets. Liabilities are recognized on the Consolidated Balance Sheets for any net underfunded projected benefit obligation. The net underfunded projected benefit obligation may be disclosed as a current liability, long-term liability, or both. The current portion is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next 12 months exceeds the fair value of plan assets. If the fair value of plan assets exceeds the projected benefit obligation of the plan, an asset is recognized equal to the net overfunded projected benefit obligation. The post-retirement and post-employment benefit plans are unfunded because there are no related plan assets.

Hydro One recognizes its contributions to the defined contribution pension plan as pension expense, with a portion being capitalized as part of labour costs included in capital expenditures. The expensed amount is included in operation, maintenance and administration costs in the Consolidated Statements of Operations and Comprehensive Income.

## Defined Benefit Pension

Defined benefit pension costs are recorded on an accrual basis for financial reporting purposes. Pension costs are actuarially determined using the projected benefit method prorated on service and are based on assumptions that reflect management's best estimate of the effect of future events, including future compensation increases. Past service costs from plan amendments and all actuarial gains and losses are amortized on a straight-line basis over the expected average remaining service period of active employees in the plan, and over the estimated remaining life expectancy of inactive employees in the plan. Pension plan assets, consisting primarily of listed equity securities as well as corporate and government debt securities, are fair valued at the end of each year. Hydro One records a regulatory asset equal to the net underfunded projected benefit obligation for its pension plan.

## Post-retirement and Post-employment Benefits

Post-retirement and post-employment benefits are recorded and included in rates on an accrual basis. Costs are determined by independent actuaries using the projected benefit method prorated on service and based on assumptions that reflect management's best estimates. Past service costs from plan amendments are amortized to results of operations based on the expected average remaining service period.

For post-retirement benefits, all actuarial gains or losses are deferred using the "corridor" approach. The amount calculated above the "corridor" is amortized to results of operations on a straight-line basis over the expected average remaining service life of active employees in the plan and over the remaining life expectancy of inactive employees in the plan. The post-retirement benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment.

For post-employment obligations, the associated regulatory liabilities representing actuarial gains on transition to US GAAP are amortized to results of operations based on the "corridor" approach. The actuarial gains and losses on post-employment obligations that are incurred during the year are recognized immediately to results of operations. The post-employment benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment.

All post-retirement and post-employment future benefit costs are attributed to labour and are either charged to results of operations or capitalized as part of the cost of property, plant and equipment and intangible assets.

## Stock-Based Compensation

### Share Grant Plans

Hydro One measures share grant plans based on fair value of share grants as estimated based on the grant date share price. The costs are recognized in the financial statements using the graded-vesting attribution method for share grant plans that have both a performance condition and a service condition. The Company records a regulatory asset equal to the accrued costs of share grant plans recognized in each period. Forfeitures are recognized as they occur (see note 3).

### Directors' Deferred Share Unit (DSU) Plan

The Company records the liabilities associated with its Directors' DSU Plan at fair value at each reporting date until settlement, recognizing compensation expense over the vesting period on a straight-line basis. The fair value of the DSU liability is based on the Company's common share closing price at the end of each reporting period.

### Long-term Incentive Plan (LTIP)

The Company measures its LTIP at fair value based on the grant date share price. The related compensation expense is recognized over the vesting period on a straight-line basis. Forfeitures are recognized as they occur.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Loss Contingencies

Hydro One is involved in certain legal and environmental matters that arise in the normal course of business. In the preparation of its Consolidated Financial Statements, management makes judgments regarding the future outcome of contingent events and records a loss for a contingency based on its best estimate when it is determined that such loss is probable and the amount of the loss can be reasonably estimated. Where the loss amount is recoverable in future rates, a regulatory asset is also recorded. When a range estimate for the probable loss exists and no amount within the range is a better estimate than any other amount, the Company records a loss at the minimum amount within the range.

Management regularly reviews current information available to determine whether recorded provisions should be adjusted and whether new provisions are required. Estimating probable losses may require analysis of multiple forecasts and scenarios that often depend on judgments about potential actions by third parties, such as federal, provincial and local courts or regulators. Contingent liabilities are often resolved over long periods of time. Amounts recorded in the Consolidated Financial Statements may differ from the actual outcome once the contingency is resolved. Such differences could have a material impact on future results of operations, financial position and cash flows of the Company.

Provisions are based upon current estimates and are subject to greater uncertainty where the projection period is lengthy. A significant upward or downward trend in the number of claims filed, the nature of the alleged injuries, and the average cost of resolving each claim could change the estimated provision, as could any substantial adverse or favourable verdict at trial. A federal or provincial legislative outcome or structured settlement could also change the estimated liability. Legal fees are expensed as incurred.

### Environmental Liabilities

Environmental liabilities are recorded in respect of past contamination when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated.

Hydro One records a liability for the estimated future expenditures associated with contaminated land assessment and remediation and for the phase-out and destruction of polychlorinated biphenyl (PCB)-contaminated mineral oil removed from electrical equipment, based on the present value of these estimated future expenditures. The Company determines the present value with a discount rate equal to its credit-adjusted risk-free interest rate on financial instruments with comparable maturities to the pattern of future environmental expenditures. As the Company anticipates that the future expenditures

will continue to be recoverable in future rates, an offsetting regulatory asset has been recorded to reflect the future recovery of these environmental expenditures from customers. Hydro One reviews its estimates of future environmental expenditures annually, or more frequently if there are indications that circumstances have changed.

### Asset Retirement Obligations

Asset retirement obligations are recorded for legal obligations associated with the future removal and disposal of long-lived assets. Such obligations may result from the acquisition, construction, development and/or normal use of the asset. Conditional asset retirement obligations are recorded when there is a legal obligation to perform a future asset retirement activity but where the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Company. In such a case, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement.

When recording an asset retirement obligation, the present value of the estimated future expenditures required to complete the asset retirement activity is recorded in the period in which the obligation is incurred, if a reasonable estimate can be made. In general, the present value of the estimated future expenditures is added to the carrying amount of the associated asset and the resulting asset retirement cost is depreciated over the estimated useful life of the asset. Where an asset is no longer in service when an asset retirement obligation is recorded, the asset retirement cost is recorded in results of operations.

Some of the Company's transmission and distribution assets, particularly those located on unowned easements and rights-of-way, may have asset retirement obligations, conditional or otherwise. The majority of the Company's easements and rights-of-way are either of perpetual duration or are automatically renewed annually. Land rights with finite terms are generally subject to extension or renewal. As the Company expects to use the majority of its facilities in perpetuity, no asset retirement obligations have been recorded for these assets. If, at some future date, a particular facility is shown not to meet the perpetuity assumption, it will be reviewed to determine whether an estimable asset retirement obligation exists. In such a case, an asset retirement obligation would be recorded at that time.

The Company's asset retirement obligations recorded to date relate to estimated future expenditures associated with the removal and disposal of asbestos-containing materials installed in some of its facilities and with the decommissioning of specific switching stations located on unowned sites.

### 3. New Accounting Pronouncements

The following tables present Accounting Standards Updates (ASUs) issued by the Financial Accounting Standards Board (FASB) that are applicable to Hydro One:

#### Recently Adopted Accounting Guidance

ASU	Date issued	Description	Effective date	Impact on Hydro One
2014-16	November 2014	This update clarifies that all relevant terms and features should be considered in evaluating the nature of a host contract for hybrid financial instruments issued in the form of a share. The nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument.	January 1, 2016	No material impact upon adoption
2015-01	January 2015	Extraordinary items are no longer required to be presented separately in the income statement.	January 1, 2016	No material impact upon adoption
2015-02	February 2015	Guidance on analysis to be performed to determine whether certain types of legal entities should be consolidated.	January 1, 2016	No material impact upon adoption
2015-03	April 2015	Debt issuance costs are required to be presented on the balance sheet as a direct deduction from the carrying amount of the related debt liability consistent with debt discounts or premiums.	January 1, 2016	Reclassification of deferred debt issuance costs and net unamortized debt premiums as an offset to long-term debt. Applied retrospectively (see note 15).
2015-05	April 2015	Cloud computing arrangements that have been assessed to contain a software licence should be accounted for as internal-use software.	January 1, 2016	No material impact upon adoption
2015-16	September 2015	Adjustments to provisional amounts that are identified during the measurement period of a business combination in the reporting period in which the adjustment amount is determined are required to be recognized. The amount recorded in current period earnings are required to be presented separately on the face of the income statement or disclosed in the notes by line item.	January 1, 2016	No material impact upon adoption
2015-17	November 2015	All deferred tax assets and liabilities are required to be classified as noncurrent on the balance sheet.	January 1, 2017	This ASU was early adopted as of April 1, 2016 and was applied prospectively. As a result, the current portions of the Company's deferred income tax assets are reclassified as noncurrent assets on the consolidated Balance Sheet. Prior periods were not retrospectively adjusted (see note 7).
2016-09	March 2016	Several aspects of the accounting for share-based payment transactions were simplified, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows.	January 1, 2017	This ASU was early adopted as of October 1, 2016 and was applied retrospectively. As a result, the Company accounts for forfeitures as they occur. There were no other material impacts upon adoption.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Recently Issued Accounting Guidance Not Yet Adopted

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2014-09 2015-14 2016-08 2016-10 2016-12 2016-20	May 2014 – December 2016	ASU 2014-09 was issued in May 2014 and provides guidance on revenue recognition relating to the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. ASU 2015-14 deferred the effective date of ASU 2014-09 by one year. Additional ASUs were issued in 2016 that simplify transition and provide clarity on certain aspects of the new standard.	January 1, 2018	Hydro One has completed its initial assessment and has identified relevant revenue streams. No quantitative determination has been made as a detailed assessment is now underway and will continue through to the third quarter of 2017, with the end result being a determination of the financial impact of this standard. The Company is on track for implementation of this standard by the effective date.
2016-01	January 2016	This update requires equity investments to be measured at fair value with changes in fair value recognized in net income, and requires enhanced disclosures and presentation of financial assets and liabilities in the financial statements. This ASU also simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment.	January 1, 2018	Under assessment
2016-02	February 2016	Lessees are required to recognize the rights and obligations resulting from operating leases as assets (right to use the underlying asset for the term of the lease) and liabilities (obligation to make future lease payments) on the balance sheet.	January 1, 2019	An initial assessment is currently underway encompassing a review of all existing leases, which will be followed by a detailed review of relevant contracts. No quantitative determination has been made at this time. The Company is on track for implementation of this standard by the effective date.
2016-05	March 2016	The amendments clarify that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require de-designation of that hedging relationship provided that all other hedge accounting criteria continue to be met.	January 1, 2018	Under assessment
2016-06	March 2016	Contingent call (put) options that are assessed to accelerate the payment of principal on debt instruments need to meet the criteria of being "clearly and closely related" to their debt hosts.	January 1, 2017	No material impact
2016-07	March 2016	The requirement to retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in the level of ownership or degree of influence has been eliminated.	January 1, 2017	No material impact
2016-11	May 2016	This amendment covers the SEC Staff's rescinding of certain SEC Staff observer comments that are codified in Topic 605 and Topic 932, effective upon the adoption of Topic 606 and Topic 815, effective to coincide with the effective date of Update 2014-16.	January 1, 2019	No material impact

ASU	Date issued	Description	Effective date	Anticipated impact on Hydro One
2016-13	June 2016	The amendment provides users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date.	January 1, 2019	Under assessment
2016-15	August 2016	The amendments provide guidance for eight specific cash flow issues with the objective of reducing the existing diversity in practice.	January 1, 2018	Under assessment
2016-16	October 2016	The amendment eliminates the prohibition of recognizing current and deferred income taxes for an intra-entity asset transfer, other than inventory, until the asset has been sold to an outside party. The amendment will permit income tax consequences of such transfers to be recognized when the transfer occurs.	January 1, 2018	Under assessment
2016-18	November 2016	The amendment requires that restricted cash or restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning and end-of-period balances in the statement of cash flows.	January 1, 2018	Under assessment
2017-01	January 2017	The amendment clarifies the definition of a business and provides additional guidance on evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses.	January 1, 2018	Under assessment

#### 4. Business Combinations

##### Acquisition of Great Lakes Power

On October 31, 2016, Hydro One acquired Great Lakes Power, an Ontario regulated electricity transmission business operating along the eastern shore of Lake Superior, north and east of Sault Ste. Marie, Ontario from Brookfield Infrastructure Holdings Inc. The total purchase price for Great Lakes Power was approximately \$376 million,

*(millions of dollars)*

Cash and cash equivalents	5
Property, plant and equipment	221
Intangible assets	1
Regulatory assets	50
Goodwill	159
Working capital	(2)
Long-term debt	(186)
Pension and post-employment benefit liabilities, net	(5)
Deferred income taxes	(17)
	<b>226</b>

Goodwill of approximately \$159 million arising from the Great Lakes Power acquisition consists largely of the synergies and economies of

including the assumption of approximately \$150 million in outstanding indebtedness. The following table summarizes the determination of the final fair value of the assets acquired and liabilities assumed:

scale expected from combining the operations of Hydro One and Great Lakes Power. Great Lakes Power contributed revenues of

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

\$6 million and less than \$1 million of net income to the Company's consolidated financial results for the year ended December 31, 2016. All costs related to the acquisition have been expensed through the Consolidated Statements of Operations and Comprehensive Income. Great Lakes Power's financial information is not material to the Company's consolidated financial results for the year ended December 31, 2016 and therefore, has not been disclosed on a pro forma basis. On January 16, 2017, the name of Great Lakes Power was changed to Hydro One Sault Ste. Marie LP.

### Agreement to Purchase Orillia Power

On August 15, 2016, the Company reached an agreement to acquire Orillia Power Distribution Corporation (Orillia Power), an electricity distribution company located in Simcoe County, Ontario, from the City of Orillia for approximately \$41 million, including the assumption of approximately \$15 million in outstanding indebtedness and regulatory liabilities, subject to closing adjustments. The acquisition is subject to regulatory approval by the OEB.

### Acquisition of Woodstock Hydro

On October 31, 2015, Hydro One acquired Woodstock Hydro Holdings Inc. (Woodstock Hydro), an electricity distribution company located in southwestern Ontario. The total purchase price for Woodstock Hydro was approximately \$32 million. The purchase

*(millions of dollars)*

Working capital	4
Property, plant and equipment	27
Intangible assets	1
Deferred income tax assets	2
Goodwill	22
Long-term debt	(17)
Derivative instruments	(3)
Post-retirement and post-employment benefit liability	(1)
Regulatory liabilities	(1)
Other long-term liabilities	(2)
	<b>32</b>

price was finalized and the Company made the final purchase price payment of \$3 million in 2016. The following table summarizes the determination of the fair value of the assets acquired and liabilities assumed:

Goodwill of approximately \$22 million arising from the Woodstock Hydro acquisition consists largely of the synergies and economies of scale expected from combining the operations of Hydro One and Woodstock Hydro. All of the goodwill was assigned to Hydro One's Distribution Business segment. Woodstock Hydro contributed revenues of \$12 million and net income of \$2 million to the Company's consolidated financial results for the year ended

December 31, 2015. All costs related to the acquisition have been expensed through the Consolidated Statements of Operations and Comprehensive Income. Woodstock Hydro's financial information is not material to the Company's consolidated financial results for the year ended December 31, 2015 and therefore, has not been disclosed on a pro forma basis.

### Acquisition of Haldimand Hydro

On June 30, 2015, Hydro One acquired Haldimand County Utilities Inc. (Haldimand Hydro), an electricity distribution company located in southwestern Ontario. The total purchase price for Haldimand Hydro

*(millions of dollars)*

Cash and cash equivalents	3
Working capital	5
Property, plant and equipment	52
Deferred income tax assets	1
Goodwill	33
Long-term debt	(18)
Regulatory liabilities	(3)
	<b>73</b>

was approximately \$73 million. The purchase price was finalized in 2016. The following table summarizes the determination of the fair value of the assets acquired and liabilities assumed:

Goodwill of approximately \$33 million arising from the Haldimand Hydro acquisition consists largely of the synergies and economies of scale expected from combining the operations of Hydro One and Haldimand Hydro. All of the goodwill was assigned to Hydro One's Distribution Business segment. Haldimand Hydro contributed revenues of \$32 million and net income of \$6 million to the Company's consolidated financial results for the year ended December 31,

2015. All costs related to the acquisition have been expensed through the Consolidated Statements of Operations and Comprehensive Income. Haldimand Hydro's financial information is not material to the Company's consolidated financial results for the year ended December 31, 2015 and therefore, has not been disclosed on a pro forma basis.

## Hydro One Brampton Spin-off

On August 31, 2015, Hydro One completed the spin-off of its subsidiary, Hydro One Brampton. The spin-off was accounted as a non-monetary, nonreciprocal transfer with the Province, based on its carrying values at August 31, 2015. Transactions that immediately preceded the spin-off as well as the spin-off were as follows:

- Hydro One subscribed for 357 common shares of Hydro One Brampton for an aggregate subscription price of \$53 million; and

- Hydro One transferred to a company wholly owned by the Province all the issued and outstanding shares of Hydro One Brampton as a dividend-in-kind; and all of the long-term intercompany debt in aggregate principal amount of \$193 million plus accrued interest of \$3 million owed by Hydro One Brampton to Hydro One as a return of stated capital of \$196 million on its common shares.

As a result of the spin-off, goodwill related to Hydro One Brampton of \$60 million was eliminated from the Consolidated Balance Sheet.

## 5. Depreciation And Amortization

Year ended December 31

(millions of dollars)

	2016	2015
Depreciation of property, plant and equipment	612	595
Asset removal costs	90	91
Amortization of intangible assets	56	54
Amortization of regulatory assets	20	19
	778	759

## 6. Financing Charges

Year ended December 31

(millions of dollars)

	2016	2015
Interest on long-term debt	424	417
Interest on short-term notes	9	2
Other	16	14
Less: Interest capitalized on construction and development in progress	(54)	(52)
Interest earned on investments	(2)	(3)
Gain on interest-rate swap agreements	-	(2)
	393	376



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 7. Income Taxes

Income taxes / provision for PILs differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rate. The reconciliation between the statutory and the effective tax rates is provided as follows:

Year ended December 31

<i>(millions of dollars)</i>	2016	2015
Income taxes / provision for PILs at statutory rate	235	217
Increase (decrease) resulting from:		
Net temporary differences recoverable in future rates charged to customers:		
Capital cost allowance in excess of depreciation and amortization	(53)	(37)
Pension contributions in excess of pension expense	(16)	(25)
Overheads capitalized for accounting but deducted for tax purposes	(16)	(15)
Interest capitalized for accounting but deducted for tax purposes	(14)	(13)
Environmental expenditures	(5)	(5)
Other	5	(6)
Net temporary differences	(99)	(101)
Net tax benefit resulting from transition from PILs Regime to Federal Tax Regime	–	(19)
Hydro One Brampton spin-off	–	7
Net permanent differences	3	1
Total income taxes / provision for PILs	139	105

The major components of income tax expense are as follows:

Year ended December 31

<i>(millions of dollars)</i>	2016	2015
Current income taxes / provision for PILs	25	2,949
Deferred income taxes / provision for (recovery of) PILs	114	(2,844)
Total income taxes / provision for PILs	139	105
Effective income tax rate	15.7%	12.8%

The provision for current income taxes / PILs is remitted to the CRA (Federal Tax Regime) and the OEFC (PILs Regime). At December 31, 2016, \$14 million (2015 – \$1 million) receivable from the CRA was included in other current assets and \$6 million (2015 – \$12 million) receivable from the OEFC was included in due from related parties on the Consolidated Balance Sheet.

In connection with the IPO in 2015, Hydro One's exemption from tax under the Federal Tax Regime ceased to apply. Under the PILs Regime, Hydro One was deemed to have disposed of its assets immediately before it lost its tax exempt status under the Federal Tax Regime, resulting in Hydro One making payments in lieu of tax (Departure Tax) totalling \$2.6 billion. To enable Hydro One to make

the Departure Tax payment, the Province subscribed for common shares of Hydro One for \$2.6 billion in 2015 (see note 21). Hydro One used the proceeds of this share subscription to pay the Departure Tax.

The 2015 total income taxes / provision for PILs included a current provision of \$2,600 million and a deferred recovery of \$2,810 million resulting from the transition from the PILs Regime to the Federal Tax Regime. The deferred recovery was not included in the rate-setting process. Deferred income tax balances expected to be included in the rate-setting process are offset by regulatory assets and liabilities to reflect the anticipated recovery or disposition of these balances within future electricity rates.

## Deferred Income Tax Assets and Liabilities

Deferred income tax assets and liabilities arise from differences between the carrying amounts and tax basis of the Company's assets and liabilities. At December 31, 2016 and 2015, deferred income tax assets and liabilities consisted of the following:

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
<b>Deferred income tax assets</b>		
Depreciation and amortization in excess of capital cost allowance	495	937
Non-depreciable capital property	271	271
Post-retirement and post-employment benefits expense in excess of cash payments	607	578
Environmental expenditures	74	75
Non-capital losses	213	62
Investment in subsidiaries	75	55
Other	30	10
	<u>1,765</u>	<u>1,988</u>
Less: valuation allowance	(352)	(333)
Total deferred income tax assets	1,413	1,655
Less: current portion	–	19
	<u>1,413</u>	<u>1,636</u>

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
<b>Deferred income tax liabilities</b>		
Regulatory amounts that are not recognized for tax purposes	(153)	(153)
Goodwill	(10)	(10)
Capital cost allowance in excess of depreciation and amortization	(64)	(42)
Other	(11)	(2)
	<u>(238)</u>	<u>(207)</u>
Total deferred income tax liabilities	(238)	(207)
Less: current portion	–	–
	<u>(238)</u>	<u>(207)</u>
Net deferred income tax assets	<u>1,175</u>	<u>1,448</u>

The net deferred income tax assets are presented on the Consolidated Balance Sheets as follows:

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
Current:		
Other current assets	–	19
Long-term:		
Deferred income tax assets	1,235	1,636
Deferred income tax liabilities	(60)	(207)
Net deferred income tax assets	<u>1,175</u>	<u>1,448</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The valuation allowance for deferred tax assets as at December 31, 2016 was \$352 million (2015 – \$333 million). The valuation allowance primarily relates to temporary differences for non-depreciable assets and investments in subsidiaries. As of

December 31, 2016, the Company had non-capital losses carried forward available to reduce future years' taxable income, which expire as follows:

<i>Year of expiry</i> <i>(millions of dollars)</i>	2016	2015
2034	2	2
2035	222	232
2036	580	–
<b>Total losses</b>	<b>804</b>	<b>234</b>

### 8. Accounts Receivable

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
Accounts receivable – billed	431	379
Accounts receivable – unbilled	442	458
Accounts receivable, gross	873	837
Allowance for doubtful accounts	(35)	(61)
<b>Accounts receivable, net</b>	<b>838</b>	<b>776</b>

The following table shows the movements in the allowance for doubtful accounts for the years ended December 31, 2016 and 2015:

<i>Year ended December 31</i> <i>(millions of dollars)</i>	2016	2015
Allowance for doubtful accounts – January 1	(61)	(66)
Write-offs	37	37
Additions to allowance for doubtful accounts	(11)	(32)
<b>Allowance for doubtful accounts – December 31</b>	<b>(35)</b>	<b>(61)</b>

### 9. Other Current Assets

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
Regulatory assets (Note 12)	37	36
Materials and supplies	19	21
Deferred income tax assets (Notes 3, 7)	–	19
Prepaid expenses and other assets	46	29
	<b>102</b>	<b>105</b>

## 10. Property, Plant And Equipment

<i>December 31, 2016</i> <i>(millions of dollars)</i>	Property, Plant and Equipment	Accumulated Depreciation	Construction in Progress	Total
Transmission	14,692	4,862	910	10,740
Distribution	9,656	3,305	243	6,594
Communication	1,233	777	20	476
Administration and service	1,632	924	61	769
Easements	628	67	–	561
	<b>27,841</b>	<b>9,935</b>	<b>1,234</b>	<b>19,140</b>

<i>December 31, 2015</i> <i>(millions of dollars)</i>	Property, Plant and Equipment	Accumulated Depreciation	Construction in Progress	Total
Transmission	13,704	4,621	853	9,936
Distribution	9,205	3,177	238	6,266
Communication	1,165	704	28	489
Administration and service	1,531	848	36	719
Easements	622	64	–	558
	<b>26,227</b>	<b>9,414</b>	<b>1,155</b>	<b>17,968</b>

Financing charges capitalized on property, plant and equipment under construction were \$52 million in 2016 (2015 – \$50 million).

## 11. Intangible Assets

<i>December 31, 2016</i> <i>(millions of dollars)</i>	Intangible Assets	Accumulated Amortization	Development in Progress	Total
Computer applications software	621	326	53	348
Other	5	4	–	1
	<b>626</b>	<b>330</b>	<b>53</b>	<b>349</b>

<i>December 31, 2015</i> <i>(millions of dollars)</i>	Intangible Assets	Accumulated Amortization	Development in Progress	Total
Computer applications software	579	270	24	333
Other	7	4	–	3
	<b>586</b>	<b>274</b>	<b>24</b>	<b>336</b>

Financing charges capitalized to intangible assets under development were \$2 million in 2016 (2015 – \$1 million). The estimated annual amortization expense for intangible assets is as follows: 2017 – \$54 million; 2018 – \$54 million; 2019 – \$45 million; 2020 – \$27 million; and 2021 – \$26 million.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 12. Regulatory Assets And Liabilities

Regulatory assets and liabilities arise as a result of the rate-setting process. Hydro One has recorded the following regulatory assets and liabilities:

December 31

(millions of dollars)

	2016	2015
<b>Regulatory assets:</b>		
Deferred income tax regulatory asset	1,587	1,445
Pension benefit regulatory asset	900	952
Post-retirement and post-employment benefits	243	240
Environmental	204	207
Retail settlement variance account	145	110
Debt premium	32	–
Share-based compensation	31	10
Distribution system code exemption	10	10
2015-2017 rate rider	7	20
B2M LP start-up costs	5	8
Pension cost variance	4	37
Other	14	12
<b>Total regulatory assets</b>	<b>3,182</b>	<b>3,051</b>
Less: current portion	37	36
	<b>3,145</b>	<b>3,015</b>
<b>Regulatory liabilities:</b>		
Green Energy expenditure variance	69	76
External revenue variance	64	87
CDM deferral variance	54	53
Deferred income tax regulatory liability	4	23
Other	18	16
<b>Total regulatory liabilities</b>	<b>209</b>	<b>255</b>
Less: current portion	–	19
	<b>209</b>	<b>236</b>

#### Deferred Income Tax Regulatory Asset and Liability

Deferred income taxes are recognized on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable income. The Company has recognized regulatory assets and liabilities that correspond to deferred income taxes that flow through the rate-setting process. In the absence of rate-regulated accounting, the Company's income tax expense would have been recognized using the liability method and there would be no regulatory accounts established for taxes to be recovered through future rates. As a result, the 2016 income tax expense would have been higher by approximately \$104 million (2015 – \$101 million).

#### Pension Benefit Regulatory Asset

In accordance with OEB rate orders, pension costs are recovered on a cash basis as employer contributions are paid to the pension fund

in accordance with the *Pension Benefits Act* (Ontario). The Company recognizes the net unfunded status of pension obligations on the Consolidated Balance Sheets with an offset to the associated regulatory asset. A regulatory asset is recognized because management considers it to be probable that pension benefit costs will be recovered in the future through the rate-setting process. The pension benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the remeasurement adjustment. In the absence of rate-regulated accounting, 2016 OCI would have been higher by \$52 million (2015 – \$284 million).

#### Post-Retirement and Post-Employment Benefits

The Company recognizes the net unfunded status of post-retirement and post-employment obligations on the Consolidated Balance Sheets with an incremental offset to the associated regulatory assets. A regulatory asset is recognized because management considers it to

be probable that post-retirement and post-employment benefit costs will be recovered in the future through the rate-setting process. The post-retirement and post-employment benefit obligation is remeasured to its fair value at each year end based on an annual actuarial report, with an offset to the associated regulatory asset, to the extent of the re-measurement adjustment. In the absence of rate-regulated accounting, 2016 OCI would have been lower by \$3 million (2015 – higher by \$33 million).

## Environmental

Hydro One records a liability for the estimated future expenditures required to remediate environmental contamination. Because such expenditures are expected to be recoverable in future rates, the Company has recorded an equivalent amount as a regulatory asset. In 2016, the environmental regulatory asset decreased by \$1 million (2015 – \$24 million) to reflect related changes in the Company's PCB liability, and increased by \$10 million (2015 – \$1 million) due to changes in the land assessment and remediation liability. The environmental regulatory asset is amortized to results of operations based on the pattern of actual expenditures incurred and charged to environmental liabilities. The OEB has the discretion to examine and assess the prudence and the timing of recovery of all of Hydro One's actual environmental expenditures. In the absence of rate-regulated accounting, 2016 operation, maintenance and administration expenses would have been higher by \$9 million (2015 – lower by \$23 million). In addition, 2016 amortization expense would have been lower by \$20 million (2015 – \$19 million), and 2016 financing charges would have been higher by \$8 million (2015 – \$10 million).

## Retail Settlement Variance Account (RSVA)

Hydro One has deferred certain retail settlement variance amounts under the provisions of Article 490 of the OEB's Accounting Procedures Handbook. In March 2015, the OEB approved the disposition of the total RSVA balance accumulated from January 2012 to December 2013, including accrued interest, to be recovered through the 2015-2017 Rate Rider.

## Debt Premium

The value of debt assumed in the acquisition of Great Lakes Power has been recorded at fair value in accordance with US GAAP – Business Combinations. The OEB allows for recovery of interest at the coupon rate of the Senior Secured Bonds and a regulatory asset has been recorded for the difference between the fair value and face value of this debt. The debt premium is recovered over the remaining term of the debt (see note 15).

## Share-based Compensation

The Company recognizes costs associated with share grant plans in a regulatory asset as management considers it probable that share grant plans costs will be recovered in the future through the rate-setting process. In the absence of rate-regulated accounting, 2016 operation, maintenance and administration expenses would have been higher by \$9 million (2015 – \$5 million).

## Distribution System Code (DSC) Exemption

In June 2010, Hydro One Networks filed an application with the OEB regarding the OEB's new cost responsibility rules contained in the OEB's October 2009 Notice of Amendment to the DSC, with respect to the connection of certain renewable generators that were already connected or that had received a connection impact assessment prior to October 21, 2009. The application sought approval to record and defer the unanticipated costs incurred by Hydro One Networks that resulted from the connection of certain renewable generation facilities. The OEB ruled that identified specific expenditures can be recorded in a deferral account subject to the OEB's review in subsequent Hydro One Network distribution applications. In March 2015, the OEB approved the disposition of the DSC exemption deferral account at December 31, 2013, including accrued interest, which is being recovered through the 2015-2017 Rate Rider. In addition, the OEB also approved Hydro One's request to discontinue this deferral account. There were no additions to this regulatory account in 2015 or 2016.

## 2015-2017 Rate Rider

In March 2015, as part of its decision on Hydro One Networks' distribution rate application for 2015-2019, the OEB approved the disposition of certain deferral and variance accounts, including RSVAs and accrued interest. The 2015-2017 Rate Rider account includes the balances approved for disposition by the OEB and is being disposed in accordance with the OEB decision over a 32-month period ending on December 31, 2017.

## B2M LP Start-up Costs

In December 2015, OEB issued its decision on B2M LP's application for 2015-2019 and as part of the decision approved the recovery of \$8 million of start-up costs relating to B2M LP. The costs are being recovered over a four-year period which began in 2016, in accordance with the OEB decision.

## Pension Cost Variance

A pension cost variance account was established for Hydro One Networks' transmission and distribution businesses to track the difference between the actual pension expenses incurred and



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

estimated pension costs approved by the OEB. The balance in this regulatory account reflects the excess of pension costs paid as compared to OEB-approved amounts. In March 2015, the OEB approved the disposition of the distribution business portion of the total pension cost variance account at December 31, 2013, including accrued interest, which is being recovered through the 2015-2017 Rate Rider. In the absence of rate-regulated accounting, 2016 revenue would have been higher by \$25 million (2015 – lower by \$6 million).

### Green Energy Expenditure Variance

In April 2010, the OEB requested the establishment of deferral accounts which capture the difference between the revenue recorded on the basis of Green Energy Plan expenditures incurred and the actual recoveries received.

### External Revenue Variance

In May 2009, the OEB approved forecasted amounts related to export service revenue, external revenue from secondary land use, and external revenue from station maintenance and engineering and construction work. In November 2012, the OEB again approved

forecasted amounts related to these revenue categories and extended the scope to encompass all other external revenues. The external revenue variance account balance reflects the excess of actual external revenues compared to the OEB-approved forecasted amounts.

### CDM Deferral Variance Account

As part of Hydro One Networks' application for 2013 and 2014 transmission rates, Hydro One agreed to establish a new regulatory deferral variance account to track the impact of actual Conservation and Demand Management (CDM) and demand response results on the load forecast compared to the estimated load forecast included in the revenue requirement. The balance in the CDM deferral variance account relates to the actual 2013 and 2014 CDM compared to the amounts included in 2013 and 2014 revenue requirements, respectively. There were no additions to this regulatory account in 2016.

## 13. Accounts Payable and Other Current Liabilities

December 31

(millions of dollars)

	2016	2015
Accounts payable	181	155
Accrued liabilities	659	598
Accrued interest	105	96
Regulatory liabilities (Note 12)	–	19
	<u>945</u>	<u>868</u>

## 14. Other Long-Term Liabilities

December 31

(millions of dollars)

	2016	2015
Post-retirement and post-employment benefit liability (Note 18)	1,641	1,560
Pension benefit liability (Note 18)	900	952
Environmental liabilities (Note 19)	177	185
Asset retirement obligations (Note 20)	9	9
Long-term accounts payable and other liabilities	25	17
	<u>2,752</u>	<u>2,723</u>

## 15. Debt and Credit Agreements Short-Term Notes and Credit Facilities

Hydro One meets its short-term liquidity requirements in part through the issuance of commercial paper under Hydro One Inc.'s Commercial Paper Program which has a maximum authorized amount of \$1.5 billion. These short-term notes are denominated in Canadian dollars with varying maturities up to 365 days. The Commercial Paper Program is supported by Hydro One Inc.'s committed revolving credit facilities totalling \$2.3 billion.

On August 15, 2016, Hydro One Inc. terminated its \$1.5 billion revolving standby credit facility maturing in June 2020 and its \$800 million three-year senior, revolving term credit facility maturing in October 2018 (collectively Prior Credit Facilities). On the same date, Hydro One Inc. entered into a new credit agreement for a \$2.3 billion revolving credit facility maturing in June 2021 (New Credit Facility). The New Credit Facility ranks equally with any existing and future senior debt of Hydro One Inc., and has customary covenants substantially similar to the covenants under the Prior Credit Facilities. In addition, on November 7, 2016, the maturity date of Hydro One's \$250 million credit facility was extended from November 2020 to November 2021.

At December 31, 2016, Hydro One's consolidated committed, unsecured and undrawn credit facilities totalling \$2,550 million consisted of the following:

<i>(millions of dollars)</i>	Maturity	Amount
<b>Hydro One Inc.</b>		
Revolving standby credit facility	June 2021	2,300
<b>Hydro One</b>		
Five-year senior, revolving term credit facility	November 2021	250
<b>Total</b>		<b>2,550</b>

The Company may use the credit facilities for working capital and general corporate purposes. If used, interest on the credit facilities would apply based on Canadian benchmark rates. The obligation of each lender to make any credit extension under its credit facility is subject to various conditions including that no event of default has occurred or would result from such credit extension.

### Long-Term Debt

At December 31, 2016, \$10,523 million long-term debt was issued by Hydro One Inc. under Hydro One Inc.'s Medium-Term Note (MTN) Program. The maximum authorized principal amount of notes issuable under the current MTN Program prospectus filed in December 2015 is \$3.5 billion. At December 31, 2016, \$1.2 billion remained available for issuance until January 2018. In addition, at December 31, 2016, the Company had long-term debt of \$184 million assumed as part of the Great Lakes Power acquisition.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents outstanding long-term debt at December 31, 2016 and 2015:

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
4.64% Series 10 notes due 2016	–	450
Floating-rate Series 27 notes due 2016 <sup>1</sup>	–	50
5.18% Series 13 notes due 2017	600	600
2.78% Series 28 notes due 2018	750	750
Floating-rate Series 31 notes due 2019 <sup>1</sup>	228	228
1.48% Series 37 notes due 2019 <sup>2</sup>	500	–
4.40% Series 20 notes due 2020	300	300
1.62% Series 33 notes due 2020 <sup>2</sup>	350	350
1.84% Series 34 notes due 2021	500	–
3.20% Series 25 notes due 2022	600	600
2.77% Series 35 notes due 2026	500	–
7.35% Debentures due 2030	400	400
6.93% Series 2 notes due 2032	500	500
6.35% Series 4 notes due 2034	385	385
5.36% Series 9 notes due 2036	600	600
4.89% Series 12 notes due 2037	400	400
6.03% Series 17 notes due 2039	300	300
5.49% Series 18 notes due 2040	500	500
4.39% Series 23 notes due 2041	300	300
6.59% Series 5 notes due 2043	315	315
4.59% Series 29 notes due 2043	435	435
4.17% Series 32 notes due 2044	350	350
5.00% Series 11 notes due 2046	325	325
3.91% Series 36 notes due 2046	350	–
3.72% Series 38 notes due 2047	450	–
4.00% Series 24 notes due 2051	225	225
3.79% Series 26 notes due 2062	310	310
4.29% Series 30 notes due 2064	50	50
<b>Hydro One Inc. long-term debt</b>	<b>10,523</b>	<b>8,723</b>
6.6% Senior Secured Bonds due 2023 (Face value – \$112 million)	144	–
4.6% Note Payable due 2023 (Face value – \$36 million)	40	–
<b>Great Lakes Power long-term debt</b>	<b>184</b>	<b>–</b>
	<b>10,707</b>	<b>8,723</b>
Add: Net unamortized debt premiums <sup>3</sup>	15	17
Add: Unrealized mark-to-market loss (gain) <sup>2</sup>	(2)	1
Less: Deferred debt issuance costs <sup>3</sup>	(40)	(34)
<b>Total long-term debt</b>	<b>10,680</b>	<b>8,707</b>

<sup>1</sup> The interest rates of the floating-rate notes are referenced to the 3-month Canadian dollar bankers' acceptance rate, plus a margin.

<sup>2</sup> The unrealized mark-to-market net gain relates to \$50 million of the Series 33 notes due 2020 and \$500 million Series 37 notes due 2019 (2015 – loss relates to \$50 million of the Series 33 notes due 2020). The unrealized mark-to-market net gain is offset by a \$2 million (2015 – \$1 million) unrealized mark-to-market net loss (2015 – gain) on the related fixed-to-floating interest-rate swap agreements, which are accounted for as fair value hedges. See note 16 – Fair Value of Financial Instruments and Risk Management for details of fair value hedges.

<sup>3</sup> Effective January 1, 2016, deferred debt issuance costs and net unamortized debt premiums were reclassified from other long-term assets and other long-term liabilities, respectively, as an offset to long-term debt upon adoption of ASU 2015-03 (see note 3). Balances as at December 31, 2015 were updated to reflect the retrospective adoption of ASU 2015-03.

The total long-term debt is presented on the consolidated balance sheets as follows:

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
Current liabilities:		
Long-term debt payable within one year	602	500
Long-term liabilities:		
Long-term debt	10,078	8,207
<b>Total long-term debt</b>	<b>10,680</b>	<b>8,707</b>

In 2016, Hydro One issued \$2,300 million (2015 – \$350 million) of long-term debt under the MTN Program, and repaid \$502 million (2015 – \$550 million) of total long-term debt.

Principal repayments and related weighted average interest rates are summarized by the number of years to maturity in the following table:

<b>Years to Maturity</b>	<b>Long-term Debt Principal Repayments</b> <i>(millions of dollars)</i>	<b>Weighted Average Interest Rate</b> <i>(%)</i>
1 year	602	5.2
2 years	753	2.8
3 years	731	1.4
4 years	653	2.9
5 years	503	1.9
	3,242	2.8
6 – 10 years	1,234	3.3
Over 10 years	6,195	5.2
	<b>10,671</b>	<b>4.3</b>

Interest payment obligations related to long-term debt are summarized by year in the following table:

<b>Year</b>	<b>Interest Payments</b> <i>(millions of dollars)</i>
2017	456
2018	425
2019	402
2020	384
2021	370
	2,037
2022-2026	1,703
2027+	4,405
	<b>8,145</b>

## 16. Fair Value of Financial Instruments and Risk Management

Fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition focuses on an exit price, which is the price that would be received in the sale of an asset or the amount that would be paid to transfer a liability.

Hydro One classifies its fair value measurements based on the following hierarchy, as prescribed by the accounting guidance for fair value, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that Hydro One has the ability to access.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information.

Level 2 inputs are those other than quoted market prices that are observable, either directly or indirectly, for an asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted market prices that are observable for the asset or liability, such as interest-rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk and default rates. A Level 2 measurement cannot have more than an insignificant portion of the valuation based on unobservable inputs.

Level 3 inputs are any fair value measurements that include unobservable inputs for the asset or liability for more than an insignificant portion of the valuation. A Level 3 measurement may be based primarily on Level 2 inputs.

### Non-Derivative Financial Assets and Liabilities

At December 31, 2016 and 2015, the Company's carrying amounts of cash and cash equivalents, accounts receivable, due from related parties, short-term notes payable, accounts payable, and due to related parties are representative of fair value because of the short-term nature of these instruments.

### Fair Value Measurements of Long-Term Debt

The fair values and carrying values of the Company's long-term debt at December 31, 2016 and 2015 are as follows:

<i>December 31</i> <i>(millions of dollars)</i>	2016 Carrying Value	2016 Fair Value	2015 Carrying Value	2015 Fair Value
Long-term debt				
\$50 million of MTN Series 33 notes	50	50	51	51
\$500 million of MTN Series 37 notes	498	498	–	–
Other notes and debentures	10,132	11,462	8,656	9,942
	10,680	12,010	8,707	9,993

### Fair Value Measurements of Derivative Instruments

At December 31, 2016, Hydro One Inc. had interest-rate swaps in the amount of \$550 million (2015 – \$50 million) that was used to convert fixed-rate debt to floating-rate debt. These swaps are classified as a fair value hedges. Hydro One Inc.'s fair value hedge exposure was equal to about 5% (2015 – 1%) of its total long-term debt. At December 31, 2016, Hydro One Inc. had the following interest-rate swaps designated as fair value hedges:

- a \$50 million fixed-to-floating interest-rate swap agreement to convert \$50 million of the \$350 million MTN Series 33 notes maturing April 30, 2020 into three-month variable rate debt; and

- two \$125 million and one \$250 million fixed-to-floating interest-rate swap agreements to convert the \$500 million MTN Series 37 notes maturing November 18, 2019 into three-month variable rate debt.

At December 31, 2016 and 2015, the Company had no interest-rate swaps classified as undesignated contracts.

### Fair Value Hierarchy

The fair value hierarchy of financial assets and liabilities at December 31, 2016 and 2015 is as follows:

<i>December 31, 2016</i> <i>(millions of dollars)</i>	Carrying Value	Fair Value	Level 1	Level 2	Level 3
<b>Assets:</b>					
Cash and cash equivalents	50	50	50	–	–
	50	50	50	–	–
<b>Liabilities:</b>					
Short-term notes payable	469	469	469	–	–
Long-term debt, including current portion	10,680	12,010	–	12,010	–
Derivative instruments					
Fair value hedges – interest-rate swaps	2	2	2	–	–
	11,151	12,481	471	12,010	–

<i>December 31, 2015</i> <i>(millions of dollars)</i>	Carrying Value	Fair Value	Level 1	Level 2	Level 3
<b>Assets:</b>					
Cash and cash equivalents	94	94	94	–	–
Derivative instruments					
Fair value hedge – interest-rate swap	1	1	1	–	–
	95	95	95	–	–
<b>Liabilities:</b>					
Short-term notes payable	1,491	1,491	1,491	–	–
Long-term debt, including current portion	8,707	9,993	–	9,993	–
	10,198	11,484	1,491	9,993	–

Cash and cash equivalents include cash and short-term investments. The carrying values are representative of fair value because of the short-term nature of these instruments.

The fair value of the hedged portion of the long-term debt is primarily based on the present value of future cash flows using a swap yield curve to determine the assumption for interest rates. The fair value of the unhedged portion of the long-term debt is based on unadjusted period-end market prices for the same or similar debt of the same remaining maturities.

There were no significant transfers between any of the fair value levels during the years ended December 31, 2016 and 2015.

## Risk Management

Exposure to market risk, credit risk and liquidity risk arises in the normal course of the Company's business.

## Market Risk

Market risk refers primarily to the risk of loss that results from changes in costs, foreign exchange rates and interest rates. The Company is exposed to fluctuations in interest rates as its regulated return on equity is derived using a formulaic approach that takes into account anticipated interest rates. The Company is not currently exposed to material commodity price risk or material foreign exchange risk.

The Company uses a combination of fixed and variable-rate debt to manage the mix of its debt portfolio. The Company also uses derivative financial instruments to manage interest-rate risk. The Company utilizes interest-rate swaps, which are typically designated as fair value hedges, as a means to manage its interest rate exposure to achieve a lower cost of debt. The Company may also utilize interest-rate derivative instruments to lock in interest-rate levels in anticipation of future financing.

A hypothetical 100 basis points increase in interest rates associated with variable-rate debt would not have resulted in a significant decrease in Hydro One's net income for the years ended December 31, 2016 or 2015.

For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the Consolidated Statements of Operations and Comprehensive Income. The net unrealized loss (gain) on the hedged debt and the related interest-rate swaps for the years ended December 31, 2016 and 2015 was not significant.

## Credit Risk

Financial assets create a risk that a counterparty will fail to discharge an obligation, causing a financial loss. At December 31, 2016 and 2015, there were no significant concentrations of credit risk with respect to any class of financial assets. The Company's revenue is earned from a broad base of customers. As a result, Hydro One did not earn a significant amount of revenue from any single customer. At December 31, 2016 and 2015, there was no significant accounts receivable balance due from any single customer.

At December 31, 2016, the Company's provision for bad debts was \$35 million (2015 – \$61 million). Adjustments and write-offs were determined on the basis of a review of overdue accounts, taking into consideration historical experience. At December 31, 2016, approximately 6% (2015 – 6%) of the Company's net accounts receivable were aged more than 60 days.

Hydro One manages its counterparty credit risk through various techniques including: entering into transactions with highly rated counterparties; limiting total exposure levels with individual counterparties; entering into master agreements which enable net settlement and the contractual right of offset; and monitoring the financial condition of counterparties. The Company monitors current



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

credit exposure to counterparties both on an individual and an aggregate basis. The Company's credit risk for accounts receivable is limited to the carrying amounts on the Consolidated Balance Sheets.

Derivative financial instruments result in exposure to credit risk since there is a risk of counterparty default. The credit exposure of derivative contracts, before collateral, is represented by the fair value of contracts at the reporting date. At December 31, 2016 and 2015, the counterparty credit risk exposure on the fair value of these interest-rate swap contracts was not significant. At December 31, 2016, Hydro One's credit exposure for all derivative instruments, and applicable payables and receivables, had a credit rating of investment grade, with four financial institutions as the counterparty.

### Liquidity Risk

Liquidity risk refers to the Company's ability to meet its financial obligations as they come due. Hydro One meets its short-term liquidity requirements using cash and cash equivalents on hand, funds

from operations, the issuance of commercial paper, and the revolving standby credit facilities. The short-term liquidity under the Commercial Paper Program, revolving standby credit facilities, and anticipated levels of funds from operations are expected to be sufficient to fund normal operating requirements.

At December 31, 2016, accounts payable and accrued liabilities in the amount of \$840 million (2015 – \$753 million) were expected to be settled in cash at their carrying amounts within the next 12 months.

### 17. Capital Management

The Company's objectives with respect to its capital structure are to maintain effective access to capital on a long-term basis at reasonable rates, and to deliver appropriate financial returns. In order to ensure ongoing access to capital, the Company targets to maintain strong credit quality. At December 31, 2016 and 2015, the Company's capital structure was as follows:

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
Long-term debt payable within one year	602	500
Short-term notes payable	469	1,491
Less: cash and cash equivalents	50	94
	1,021	1,897
Long-term debt	10,078	8,207
Preferred shares	418	418
Common shares	5,623	5,623
Retained earnings	3,950	3,806
<b>Total capital</b>	<b>21,090</b>	<b>19,951</b>

Hydro One Inc. and Great Lakes Power have customary covenants typically associated with long-term debt. Hydro One Inc.'s long-term debt and credit facility covenants limit permissible debt to 75% of its total capitalization, limit the ability to sell assets and impose a negative pledge provision, subject to customary exceptions. At December 31, 2016, Hydro One Inc. and Great Lakes Power were in compliance with all covenants and limitations.

### 18. Pension and Post-retirement and Post-employment Benefits

Hydro One has a defined benefit pension plan (Pension Plan), a defined contribution pension plan (DC Plan), a supplementary pension plan, and post-retirement and post-employment benefit plans.

#### Defined Contribution Pension Plan

Hydro One established a DC Plan effective January 1, 2016. The DC Plan is mandatory and covers eligible management employees hired on or after January 1, 2016, as well as management employees hired before January 1, 2016 who were not eligible or had not irrevocably elected to join the Pension Plan as of September 30, 2015. Members of the DC Plan have an option to contribute 4%, 5% or 6% of their pensionable earnings, with matching contributions by Hydro One.

Hydro One contributions to the DC Plan for the year ended December 31, 2016 were less than \$1 million (2015 – \$nil). At December 31, 2016, Company contributions payable included in accrued liabilities on the Consolidated Balance Sheets were less than \$1 million (2015 – \$nil).

## Defined Benefit Pension Plan, Supplementary Pension Plan, and Post-Retirement and Post-Employment Plans

The Pension Plan is a defined benefit contributory plan which covers all regular employees of Hydro One and its subsidiaries. The Pension Plan provides benefits based on highest three-year average pensionable earnings. For Management employees who commenced employment on or after January 1, 2004, and for Society of Energy Professionals-represented staff hired after November 17, 2005, benefits are based on highest five-year average pensionable earnings. After retirement, pensions are indexed to inflation. Membership in the Pension Plan was closed to Management employees who were not eligible or had not irrevocably elected to join the Pension Plan as of September 30, 2015. These employees are eligible to join the DC Plan.

Company and employee contributions to the Pension Plan are based on actuarial valuations performed at least every three years. Annual Pension Plan contributions for 2016 of \$108 million (2015 – \$177 million) were based on an actuarial valuation effective December 31, 2015 (2015 – based on an actuarial valuation effective December 31, 2013) and the level of pensionable earnings. Estimated annual Pension Plan contributions for 2017 and 2018 are approximately \$105 million and \$102 million, respectively, based on the actuarial valuation as at December 31, 2015 and projected levels of pensionable earnings.

Future minimum contributions beyond 2018 will be based on an actuarial valuation effective no later than December 31, 2018. Contributions are payable one month in arrears. All of the contributions are expected to be in the form of cash.

The Hydro One Supplemental Pension Plan (Supplemental Plan) provides members of the Pension Plan with benefits that would have been earned and payable under the Pension Plan but for limitations imposed by the *Income Tax Act* (Canada). The Supplemental Plan obligation is included with other post-retirement and post-employment benefit obligations on the Consolidated Balance Sheets.

Hydro One recognizes the overfunded or underfunded status of the Pension Plan, and post-retirement and post-employment benefit plans (Plans) as an asset or liability on its Consolidated Balance Sheets, with offsetting regulatory assets and liabilities as appropriate. The underfunded benefit obligations for the Plans, in the absence of regulatory accounting, would be recognized in AOCI. The impact of changes in assumptions used to measure pension, post-retirement and post-employment benefit obligations is generally recognized over the expected average remaining service period of the employees. The measurement date for the Plans is December 31.

Year ended December 31 (millions of dollars)	Pension Benefits		Post-Retirement and Post-Employment Benefits	
	2016	2015	2016	2015
<b>Change in projected benefit obligation</b>				
Projected benefit obligation, beginning of year	7,683	7,535	1,610	1,582
Current service cost	144	146	42	43
Employee contributions	45	40	–	–
Interest cost	308	302	67	64
Benefits paid	(354)	(334)	(43)	(47)
Net actuarial loss (gain)	(52)	(6)	14	(27)
Change due to Hydro One Brampton spin-off	–	–	–	(5)
Projected benefit obligation, end of year	7,774	7,683	1,690	1,610
<b>Change in plan assets</b>				
Fair value of plan assets, beginning of year	6,731	6,299	–	–
Actual return on plan assets	370	582	–	–
Benefits paid	(354)	(334)	(43)	(47)
Employer contributions	108	177	43	47
Employee contributions	45	40	–	–
Administrative expenses	(26)	(33)	–	–
Fair value of plan assets, end of year	6,874	6,731	–	–
Unfunded status	900	952	1,690	1,610

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Hydro One presents its benefit obligations and plan assets net on its Consolidated Balance Sheets as follows:

<i>December 31</i> <i>(millions of dollars)</i>	Pension Benefits		Post-Retirement and Post-Employment Benefits	
	2016	2015	2016	2015
Other assets	1 <sup>1</sup>	–	–	–
Accrued liabilities	–	–	56	50
Pension benefit liability	900	952	–	–
Post-retirement and post-employment benefit liability	–	–	1,641 <sup>2</sup>	1,560
<b>Net unfunded status</b>	<b>899</b>	<b>952</b>	<b>1,697</b>	<b>1,610</b>

<sup>1</sup> Represents the funded status of Great Lakes Power's defined benefit pension plan.

<sup>2</sup> Includes \$7 million (2015 – \$nil) relating to Great Lakes Power's post-employment benefit plans.

The funded or unfunded status of the pension, post-retirement and post-employment benefit plans refers to the difference between the fair value of plan assets and the projected benefit obligations for the

Plans. The funded/unfunded status changes over time due to several factors, including contribution levels, assumed discount rates and actual returns on plan assets.

The following table provides the projected benefit obligation (PBO), accumulated benefit obligation (ABO) and fair value of plan assets for the Pension Plan:

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
PBO	7,774	7,683
ABO	7,094	7,020
Fair value of plan assets	6,874	6,731

On an ABO basis, the Pension Plan was funded at 97% at December 31, 2016 (2015 – 96%). On a PBO basis, the Pension Plan was funded at 88% at December 31, 2016 (2015 – 88%). The

ABO differs from the PBO in that the ABO includes no assumption about future compensation levels.

### Components of Net Periodic Benefit Costs

The following table provides the components of the net periodic benefit costs for the years ended December 31, 2016 and 2015 for the Pension Plan:

<i>Year ended December 31</i> <i>(millions of dollars)</i>	2016	2015
Current service cost, net of employee contributions	144	146
Interest cost	308	302
Expected return on plan assets, net of expenses	(432)	(406)
Amortization of actuarial losses	96	119
Prior service cost amortization	–	2
<b>Net periodic benefit costs</b>	<b>116</b>	<b>163</b>
<b>Charged to results of operations<sup>1</sup></b>	<b>48</b>	<b>81</b>

<sup>1</sup> The Company follows the cash basis of accounting consistent with the inclusion of pension costs in OEB-approved rates. During the year ended December 31, 2016, pension costs of \$108 million (2015 – \$177 million) were attributed to labour, of which \$48 million (2015 – \$81 million) was charged to operations, and \$60 million (2015 – \$96 million) was capitalized as part of the cost of property, plant and equipment and intangible assets.

The following table provides the components of the net periodic benefit costs for the years ended December 31, 2016 and 2015 for the post-retirement and post-employment benefit plans:

Year ended December 31

(millions of dollars)	2016	2015
Current service cost, net of employee contributions	42	43
Interest cost	67	64
Amortization of actuarial losses	15	14
Prior service cost amortization	–	–
Net periodic benefit costs	124	121
Charged to results of operations	55	55

## Assumptions

The measurement of the obligations of the Plans and the costs of providing benefits under the Plans involves various factors, including the development of valuation assumptions and accounting policy elections. When developing the required assumptions, the Company considers historical information as well as future expectations. The measurement of benefit obligations and costs is impacted by several assumptions including the discount rate applied to benefit obligations, the long-term expected rate of return on plan assets, Hydro One's expected level of contributions to the Plans, the incidence of mortality, the expected remaining service period of plan participants, the level

of compensation and rate of compensation increases, employee age, length of service, and the anticipated rate of increase of health care costs, among other factors. The impact of changes in assumptions used to measure the obligations of the Plans is generally recognized over the expected average remaining service period of the plan participants. In selecting the expected rate of return on plan assets, Hydro One considers historical economic indicators that impact asset returns, as well as expectations regarding future long-term capital market performance, weighted by target asset class allocations. In general, equity securities, real estate and private equity investments are forecasted to have higher returns than fixed-income securities.

The following weighted average assumptions were used to determine the benefit obligations at December 31, 2016 and 2015:

Year ended December 31	Pension Benefits		Post-Retirement and Post-Employment Benefits	
	2016	2015	2016	2015
<b>Significant assumptions:</b>				
Weighted average discount rate	3.90%	4.00%	3.90%	4.10%
Rate of compensation scale escalation (long-term)	2.50%	2.50%	2.50%	2.50%
Rate of cost of living increase	2.00%	2.00%	2.00%	2.00%
Rate of increase in health care cost trends <sup>1</sup>	–	–	4.36%	4.36%

<sup>1</sup> 6.25% per annum in 2017, grading down to 4.36% per annum in and after 2031 (2015 – 6.38% in 2016, grading down to 4.36% per annum in and after 2031).

The following weighted average assumptions were used to determine the net periodic benefit costs for the years ended December 31, 2016 and 2015. Assumptions used to determine current yearend benefit obligations are the assumptions used to estimate the subsequent year's net periodic benefit costs.

Year ended December 31	2016	2015
<b>Pension Benefits:</b>		
Weighted average expected rate of return on plan assets	6.50%	6.50%
Weighted average discount rate	4.00%	4.00%
Rate of compensation scale escalation (long-term)	2.50%	2.50%
Rate of cost of living increase	2.00%	2.00%
Average remaining service life of employees (years)	15	13
<b>Post-Retirement and Post-Employment Benefits:</b>		
Weighted average discount rate	4.10%	4.00%
Rate of compensation scale escalation (long-term)	2.50%	2.50%
Rate of cost of living increase	2.00%	2.00%
Average remaining service life of employees (years)	15.3	13.8
Rate of increase in health care cost trends <sup>1</sup>	4.36%	4.36%

<sup>1</sup> 6.38% per annum in 2016, grading down to 4.36% per annum in and after 2031 (2015 – 6.52% in 2015, grading down to 4.36% per annum in and after 2031).

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The discount rate used to determine the current year pension obligation and the subsequent year's net periodic benefit costs is based on a yield curve approach. Under the yield curve approach, expected future benefit payments for each plan are discounted by a

rate on a third-party bond yield curve corresponding to each duration. The yield curve is based on "AA" long-term corporate bonds. A single discount rate is calculated that would yield the same present value as the sum of the discounted cash flows.

The effect of a 1% change in health care cost trends on the projected benefit obligation for the post-retirement and post-employment benefits at December 31, 2016 and 2015 is as follows:

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
<b>Projected benefit obligation:</b>		
Effect of a 1% increase in health care cost trends	289	252
Effect of a 1% decrease in health care cost trends	(221)	(196)

The effect of a 1% change in health care cost trends on the service cost and interest cost for the post-retirement and post-employment benefits for the years ended December 31, 2016 and 2015 is as follows:

<i>Year ended December 31</i> <i>(millions of dollars)</i>	2016	2015
<b>Service cost and interest cost:</b>		
Effect of a 1% increase in health care cost trends	23	22
Effect of a 1% decrease in health care cost trends	(17)	(16)

The following approximate life expectancies were used in the mortality assumptions to determine the projected benefit obligations for the pension and post-retirement and post-employment plans at December 31, 2016 and 2015:

December 31, 2016				December 31, 2015			
Life expectancy at 65 for a member currently at				Life expectancy at 65 for a member currently at			
Age 65		Age 45		Age 65		Age 45	
Male	Female	Male	Female	Male	Female	Male	Female
22	24	23	24	23	25	24	26

### Estimated Future Benefit Payments

At December 31, 2016, estimated future benefit payments to the participants of the Plans were:

<i>(millions of dollars)</i>	Pension Benefits	Post-Retirement and Post-Employment Benefits
2017	321	56
2018	331	57
2019	340	60
2020	349	62
2021	358	64
2022 through to 2026	1,910	355
Total estimated future benefit payments through to 2026	3,609	654

## Components of Regulatory Assets

A portion of actuarial gains and losses and prior service costs is recorded within regulatory assets on Hydro One's Consolidated Balance Sheets to reflect the expected regulatory inclusion of these

amounts in future rates, which would otherwise be recorded in OCI. The following table provides the actuarial gains and losses and prior service costs recorded within regulatory assets:

<i>Year ended December 31</i> <i>(millions of dollars)</i>	2016	2015
<b>Pension Benefits:</b>		
Actuarial loss (gain) for the year	35	(181)
Amortization of actuarial losses	(96)	(119)
Prior service cost amortization	–	(2)
	<b>(61)</b>	<b>(302)</b>
<b>Post-Retirement and Post-Employment Benefits:</b>		
Actuarial loss (gain) for the year	14	(27)
Amortization of actuarial losses	(15)	(14)
Prior service cost amortization	–	–
	<b>(1)</b>	<b>(41)</b>

The following table provides the components of regulatory assets that have not been recognized as components of net periodic benefit costs for the years ended December 31, 2016 and 2015:

<i>Year ended December 31</i> <i>(millions of dollars)</i>	2016	2015
<b>Pension Benefits:</b>		
Prior service cost	–	–
Actuarial loss	900	952
	<b>900</b>	<b>952</b>
<b>Post-Retirement and Post-Employment Benefits:</b>		
Actuarial loss	243	240
	<b>243</b>	<b>240</b>

The following table provides the components of regulatory assets at December 31 that are expected to be amortized as components of net periodic benefit costs in the following year:

<i>December 31</i> <i>(millions of dollars)</i>	Pension Benefits		Post-Retirement and Post-Employment Benefits	
	2016	2015	2016	2015
Prior service cost	–	–	–	–
Actuarial loss	79	96	6	8
	<b>79</b>	<b>96</b>	<b>6</b>	<b>8</b>



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Pension Plan Assets

#### Investment Strategy

On a regular basis, Hydro One evaluates its investment strategy to ensure that Pension Plan assets will be sufficient to pay Pension Plan benefits when due. As part of this ongoing evaluation, Hydro One may make changes to its targeted asset allocation and investment strategy. The Pension Plan is managed at a net asset level. The main objective of the Pension Plan is to sustain a certain level of net assets in order to meet the pension obligations of the Company. The Pension Plan fulfills its primary objective by adhering to specific investment policies outlined in its Summary of Investment Policies and

Procedures (SIPP), which is reviewed and approved by the Human Resource Committee of Hydro One's Board of Directors. The Company manages net assets by engaging knowledgeable external investment managers who are charged with the responsibility of investing existing funds and new funds (current year's employee and employer contributions) in accordance with the approved SIPP. The performance of the managers is monitored through a governance structure. Increases in net assets are a direct result of investment income generated by investments held by the Pension Plan and contributions to the Pension Plan by eligible employees and by the Company. The main use of net assets is for benefit payments to eligible Pension Plan members.

#### Pension Plan Asset Mix

At December 31, 2016, the Pension Plan target asset allocations and weighted average asset allocations were as follows:

	Target Allocation (%)	Pension Plan Assets (%)
Equity securities	55.0	58.7
Debt securities	35.0	33.6
Other <sup>1</sup>	10.0	7.7
	100.0	100.0

<sup>1</sup> Other investments include real estate and infrastructure investments.

At December 31, 2016, the Pension Plan held \$11 million (2015 – \$9 million) Hydro One corporate bonds and \$450 million (2015 – \$420 million) of debt securities of the Province.

significant concentrations (defined as greater than 10% of plan assets) of risk in the Pension Plan's assets.

#### Concentrations of Credit Risk

Hydro One evaluated its Pension Plan's asset portfolio for the existence of significant concentrations of credit risk as at December 31, 2016 and 2015. Concentrations that were evaluated include, but are not limited to, investment concentrations in a single entity, concentrations in a type of industry, and concentrations in individual funds. At December 31, 2016 and 2015, there were no

The Pension Plan manages its counterparty credit risk with respect to bonds by investing in investment-grade and government bonds and with respect to derivative instruments by transacting only with financial institutions rated at least "A+" by Standard & Poor's Rating Services, DBRS Limited, and Fitch Ratings Inc., and "A1" by Moody's Investors Service, and also by utilizing exposure limits to each counterparty and ensuring that exposure is diversified across counterparties. The risk of default on transactions in listed securities is considered minimal, as the trade will fail if either party to the transaction does not meet its obligation.

#### Fair Value Measurements

The following tables present the Pension Plan assets measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy at December 31, 2016 and 2015:

December 31, 2016  
(millions of dollars)

	Level 1	Level 2	Level 3	Total
Pooled funds	–	20	425	445
Cash and cash equivalents	146	–	–	146
Short-term securities	–	127	–	127
Corporate shares – Canadian	911	–	–	911
Corporate shares – Foreign	2,985	113	–	3,098
Bonds and debentures – Canadian	–	1,943	–	1,943
Bonds and debentures – Foreign	–	193	–	193
Total fair value of plan assets <sup>1</sup>	4,042	2,396	425	6,863

<sup>1</sup> At December 31, 2016, the total fair value of Pension Plan assets excludes \$27 million of interest and dividends receivable, \$15 million of purchased investments payable, \$9 million of pension administration expenses payable, and \$7 million of sold investments receivable.

December 31, 2015

(millions of dollars)

	Level 1	Level 2	Level 3	Total
Pooled funds	–	23	301	324
Cash and cash equivalents	191	–	–	191
Short-term securities	–	80	–	80
Corporate shares – Canadian	807	–	–	807
Corporate shares – Foreign	2,931	116	–	3,047
Bonds and debentures – Canadian	–	2,072	–	2,072
Bonds and debentures – Foreign	–	201	–	201
<b>Total fair value of plan assets<sup>1</sup></b>	<b>3,929</b>	<b>2,492</b>	<b>301</b>	<b>6,722</b>

<sup>1</sup> At December 31, 2015, the total fair value of Pension Plan assets excludes \$27 million of interest and dividends receivable, and \$18 million relating to accruals for pension administration expense and foreign exchange contracts payable.

See note 16 – Fair Value of Financial Instruments and Risk Management for a description of levels within the fair value hierarchy.

### Changes in the Fair Value of Financial Instruments Classified in Level 3

The following table summarizes the changes in fair value of financial instruments classified in Level 3 for the years ended December 31, 2016 and 2015. The Pension Plan classifies financial instruments as

Level 3 when the fair value is measured based on at least one significant input that is not observable in the markets or due to lack of liquidity in certain markets. The gains and losses presented in the table below may include changes in fair value based on both observable and unobservable inputs.

Year ended December 31

(millions of dollars)

	2016	2015
Fair value, beginning of year	301	144
Realized and unrealized gains	23	51
Purchases	151	106
Sales and disbursements	(50)	–
<b>Fair value, end of year</b>	<b>425</b>	<b>301</b>

There were no significant transfers between any of the fair value levels during the years ended December 31, 2016 and 2015.

The Company performs sensitivity analysis for fair value measurements classified in Level 3, substituting the unobservable inputs with one or more reasonably possible alternative assumptions. These sensitivity analyses resulted in negligible changes in the fair value of financial instruments classified in this level.

### Valuation Techniques Used to Determine Fair Value

Pooled funds mainly consist of private equity, real estate and infrastructure investments. Private equity investments represent private equity funds that invest in operating companies that are not publicly traded on a stock exchange. Investment strategies in private equity include limited partnerships in businesses that are characterized by high internal growth and operational efficiencies, venture capital, leveraged buyouts and special situations such as distressed investments. Real estate and infrastructure investments represent funds that invest in real assets which are not publicly traded on a stock

exchange. Investment strategies in real estate include limited partnerships that seek to generate a total return through income and capital growth by investing primarily in global and Canadian limited partnerships. Investment strategies in infrastructure include limited partnerships in core infrastructure assets focusing on assets that generate stable, long-term cash flows and deliver incremental returns relative to conventional fixed-income investments. Private equity, real estate and infrastructure valuations are reported by the fund manager and are based on the valuation of the underlying investments which includes inputs such as cost, operating results, discounted future cash flows and market-based comparable data. Since these valuation inputs are not highly observable, private equity and infrastructure investments have been categorized as Level 3 within pooled funds.

Cash equivalents consist of demand cash deposits held with banks and cash held by the investment managers. Cash equivalents are categorized as Level 1.

Short-term securities are valued at cost plus accrued interest, which approximates fair value due to their short-term nature. Short-term securities are categorized as Level 2.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Corporate shares are valued based on quoted prices in active markets and are categorized as Level 1. Investments denominated in foreign currencies are translated into Canadian currency at year-end rates of exchange.

Bonds and debentures are presented at published closing trade quotations, and are categorized as Level 2.

### 19. Environmental Liabilities

The following tables show the movements in environmental liabilities for the years ended December 31, 2016 and 2015:

<i>Year ended December 31, 2016</i> <i>(millions of dollars)</i>	PCB	Land Assessment and Remediation	Total
Environmental liabilities, January 1	148	59	207
Interest accretion	7	1	8
Expenditures	(11)	(9)	(20)
Revaluation adjustment	(1)	10	9
Environmental liabilities, December 31	143	61	204
Less: current portion	18	9	27
	125	52	177

<i>Year ended December 31, 2015</i> <i>(millions of dollars)</i>	PCB	Land Assessment and Remediation	Total
Environmental liabilities, January 1	172	67	239
Interest accretion	8	2	10
Expenditures	(8)	(11)	(19)
Revaluation adjustment	(24)	1	(23)
Environmental liabilities, December 31	148	59	207
Less: current portion	12	10	22
	136	49	185

The following tables show the reconciliation between the undiscounted basis of the environmental liabilities and the amount recognized on the Consolidated Balance Sheets after factoring in the discount rate:

<i>December 31, 2016</i> <i>(millions of dollars)</i>	PCB	Land Assessment and Remediation	Total
Undiscounted environmental liabilities	158	66	224
Less: discounting accumulated liabilities to present value	15	5	20
Discounted environmental liabilities	143	61	204

<i>December 31, 2015</i> <i>(millions of dollars)</i>	PCB	Land Assessment and Remediation	Total
Undiscounted environmental liabilities	168	61	229
Less: discounting accumulated liabilities to present value	20	2	22
Discounted environmental liabilities	148	59	207

At December 31, 2016, the estimated future environmental expenditures were as follows:

(millions of dollars)

2017	27
2018	26
2019	25
2020	29
2021	36
Thereafter	81
	224

Hydro One records a liability for the estimated future expenditures for land assessment and remediation and for the phase-out and destruction of PCB-contaminated mineral oil removed from electrical equipment when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated.

There are uncertainties in estimating future environmental costs due to potential external events such as changes in legislation or regulations, and advances in remediation technologies. In determining the amounts to be recorded as environmental liabilities, the Company estimates the current cost of completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. A long-term inflation rate assumption of approximately 2% has been used to express these current cost estimates as estimated future expenditures. Future expenditures have been discounted using factors ranging from approximately 2.0% to 6.3%, depending on the appropriate rate for the period when expenditures are expected to be incurred. All factors used in estimating the Company's environmental liabilities represent management's best estimates of the present value of costs required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company's current assumptions. In addition, with respect to the PCB environmental liability, the availability of critical resources such as skilled labour and replacement assets and the ability to take maintenance outages in critical facilities may influence the timing of expenditures.

### PCBs

The Environment Canada regulations, enacted under the *Canadian Environmental Protection Act, 1999*, govern the management, storage and disposal of PCBs based on certain criteria, including type of equipment, in-use status, and PCB-contamination thresholds. Under current regulations, Hydro One's PCBs have to be disposed of by the end of 2025, with the exception of specifically exempted equipment. Contaminated equipment will generally be replaced, or

will be decontaminated by removing PCB-contaminated insulating oil and retro filling with replacement oil that contains PCBs in concentrations of less than 2 ppm.

The Company's best estimate of the total estimated future expenditures to comply with current PCB regulations is \$158 million (2015 – \$168 million). These expenditures are expected to be incurred over the period from 2017 to 2025. As a result of its annual review of environmental liabilities, the Company recorded a revaluation adjustment in 2016 to reduce the PCB environmental liability by \$1 million (2015 – \$24 million).

### Land Assessment and Remediation

The Company's best estimate of the total estimated future expenditures to complete its land assessment and remediation program is \$66 million (2015 – \$61 million). These expenditures are expected to be incurred over the period from 2017 to 2032. As a result of its annual review of environmental liabilities, the Company recorded a revaluation adjustment in 2016 to increase the land assessment and remediation environmental liability by \$10 million (2015 – \$1 million).

### 20. Asset Retirement Obligations

Hydro One records a liability for the estimated future expenditures for the removal and disposal of asbestos-containing materials installed in some of its facilities and for the decommissioning of specific switching stations located on unowned sites. Asset retirement obligations, which represent legal obligations associated with the retirement of certain tangible long-lived assets, are computed as the present value of the projected expenditures for the future retirement of specific assets and are recognized in the period in which the liability is incurred, if a reasonable estimate of fair value can be made. If the asset remains in service at the recognition date, the present value of the liability is added to the carrying amount of the associated asset in the period the liability is incurred and this additional carrying amount is depreciated over the remaining life of the asset. If an asset retirement obligation is recorded in respect of an out-of-service asset, the asset retirement cost is charged to results of operations. Subsequent to the

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

initial recognition, the liability is adjusted for any revisions to the estimated future cash flows associated with the asset retirement obligation, which can occur due to a number of factors including, but not limited to, cost escalation, changes in technology applicable to the assets to be retired, changes in legislation or regulations, as well as for accretion of the liability due to the passage of time until the obligation is settled. Depreciation expense is adjusted prospectively for any increases or decreases to the carrying amount of the associated asset.

In determining the amounts to be recorded as asset retirement obligations, the Company estimates the current fair value for completing required work and makes assumptions as to when the future expenditures will actually be incurred, in order to generate future cash flow information. A long-term inflation assumption of approximately 2% has been used to express these current cost estimates as estimated future expenditures. Future expenditures have been discounted using factors ranging from approximately 3.0% to 5.0%, depending on the appropriate rate for the period when expenditures are expected to be incurred. All factors used in estimating the Company's asset retirement obligations represent management's best estimates of the cost required to meet existing legislation or regulations. However, it is reasonably possible that numbers or volumes of contaminated assets, cost estimates to perform work, inflation assumptions and the assumed pattern of annual cash flows may differ significantly from the Company's current assumptions. Asset retirement obligations are reviewed annually or more frequently if significant changes in regulations or other relevant factors occur. Estimate changes are accounted for prospectively.

At December 31, 2016, Hydro One had recorded asset retirement obligations of \$9 million (2015 – \$9 million), primarily consisting of the estimated future expenditures associated with the removal and disposal of asbestos-containing materials installed in some of its facilities. The amount of interest recorded is nominal.

### 21. Share Capital Common Shares

The Company is authorized to issue an unlimited number of common shares. At December 31, 2016 and 2015, the Company had 595 million common shares issued and outstanding.

The amount and timing of any dividends payable by Hydro One is at the discretion of the Hydro One Board of Directors and is established on the basis of Hydro One's results of operations, maintenance of its deemed regulatory capital structure, financial condition, cash requirements, the satisfaction of solvency tests imposed by corporate laws for the declaration and payment of dividends and other factors that the Board of Directors may consider relevant.

### Common Share Offerings

In November 2015, Hydro One and the Province completed an initial public offering (IPO) on the Toronto Stock Exchange of approximately 15% of its 595 million outstanding common shares. In April 2016, the Province completed a secondary offering of approximately 83.3 million or 14% common shares of Hydro One on the Toronto Stock Exchange. Hydro One did not receive any of the proceeds from the sale of the common shares by the Province.

### Preferred Shares

The Company is authorized to issue an unlimited number of preferred shares, issuable in series. At December 31, 2016, two series of preferred shares are authorized for issuance: the Series 1 preferred shares and the Series 2 preferred shares. At December 31, 2016, the Company had 16,720,000 Series 1 preferred shares and no Series 2 preferred shares issued and outstanding.

Hydro One may from time to time issue preferred shares in one or more series. Prior to issuing shares in a series, the Hydro One Board of Directors is required to fix the number of shares in the series and determine the designation, rights, privileges, restrictions and conditions attaching to that series of preferred shares. Holders of Hydro One's preferred shares are not entitled to receive notice of, to attend or to vote at any meeting of the shareholders of Hydro One except that votes may be granted to a series of preferred shares when dividends have not been paid on any one or more series as determined by the applicable series provisions. Each series of preferred shares ranks on parity with every other series of preferred shares, and are entitled to a preference over the common shares and any other shares ranking junior to the preferred shares, with respect to dividends and the distribution of assets and return of capital in the event of the liquidation, dissolution or winding up of Hydro One.

For the period commencing from the date of issue of the Series 1 preferred shares and ending on and including November 19, 2020, the holders of Series 1 preferred shares are entitled to receive fixed cumulative preferential dividends of \$1.0625 per share per year, if and when declared by the Board of Directors, payable quarterly. The dividend rate will reset on November 20, 2020 and every five years thereafter at a rate equal to the sum of the then five-year Government of Canada bond yield and 3.53%. The Series 1 preferred shares will not be redeemable by Hydro One prior to November 20, 2020, but will be redeemable by Hydro One on November 20, 2020 and on November 20 of every fifth year thereafter at a redemption price equal to \$25.00 for each Series 1 preferred share redeemed, plus any accrued or unpaid dividends. The holders of Series 1 preferred shares will have the right, at their option, on November 20, 2020 and on November 20 of every fifth year thereafter, to convert all or any of their Series 1 preferred shares into Series 2 preferred shares

on a one-for-one basis, subject to certain restrictions on conversion. At December 31, 2016, no preferred share dividends were in arrears.

The holders of Series 2 preferred shares will be entitled to receive quarterly floating rate cumulative dividends, if and when declared by the Board of Directors, at a rate equal to the sum of the then three-month Government of Canada treasury bill rate and 3.53% as reset quarterly. The Series 2 preferred shares will not be redeemable by Hydro One prior to November 20, 2020, but will be redeemable by Hydro One at a redemption price equal to \$25.00 for each Series 2 preferred share redeemed, if redeemed on November 20, 2025 or on November 20 of every fifth year thereafter, or \$25.50 for each Series 2 preferred share redeemed, if redeemed on any other date after November 20, 2020, in each case plus any

accrued or unpaid dividends. The holders of Series 2 preferred shares will have the right, at their option, on November 20, 2025 and on November 20 of every fifth year thereafter, to convert all or any of their Series 2 preferred shares into Series 1 preferred shares on a one-for-one basis, subject to certain restrictions on conversion.

## Reorganization

Prior to the completion of the IPO, Hydro One and Hydro One Inc. completed a series of transactions (Pre-IPO Transactions) that resulted in, among other things, on October 31, 2015, Hydro One acquiring all of the issued and outstanding shares of Hydro One Inc. from the Province and issuing new common shares and preferred shares to the Province.

The following tables present the changes to common and preferred shares as a result of Pre-IPO Transactions, as well as the movement in the number of common and preferred shares during the year ended December 31, 2015. There was no movement in common or preferred shares during the year ended December 31, 2016.

<i>(millions of dollars)</i>	Common Shares	Preferred Shares	
		Equity	Temporary Equity
Common shares issued – purchase and cancellation of preferred shares <i>(c)</i>	323	–	(323)
Acquisition of Hydro One Inc. <i>(d)</i>			
Common shares of Hydro One Inc. acquired by Hydro One	(3,441)	–	–
Common shares of Hydro One issued to Province	3,023	–	–
Preferred shares of Hydro One issued to Province	–	418	–
Common shares issued <i>(e)</i>	2,600	–	–
<b>Total Pre-IPO Transactions adjustment</b>	<b>2,505</b>	<b>418</b>	<b>(323)</b>

<i>(number of shares)</i>	Common Shares	Preferred Shares	
		Equity	Temporary Equity
Number of shares – January 1, 2015 <i>(a)</i>	100,000	–	12,920,000
Common shares issued <i>(b)</i>	100,000	–	–
Pre-IPO Transactions:			
Common shares issued – purchase and cancellation of preferred shares <i>(c)</i>	2,640	–	(12,920,000)
Acquisition of Hydro One Inc. <i>(d)</i>			
Common shares of Hydro One Inc. acquired by Hydro One	(102,640)	–	–
Common shares of Hydro One issued to Province	12,197,500,000	–	–
Preferred shares of Hydro One issued to Province	–	16,720,000	–
Common shares issued <i>(e)</i>	2,600,000,000	–	–
Common shares consolidation <i>(f)</i>	(14,202,600,000)	–	–
<b>Number of shares – December 31, 2015</b>	<b>595,000,000</b>	<b>16,720,000</b>	<b>–</b>

*(a)* At January 1, 2015, all common and preferred shares represent the shares of Hydro One Inc.

*(b)* On August 31, 2015, Hydro One was incorporated under the *Business Corporations Act* (Ontario) and issued 100,000 common shares to the Province for proceeds of \$100,000.

*(c)* On October 31, 2015, Hydro One Inc. purchased and cancelled 12,920,000 preferred shares of Hydro One Inc. previously held by the Province for cancellation at a price equal to the redemption price of the preferred shares totalling \$323 million, which was satisfied by the issuance to the Province of 2,640 common shares of Hydro One Inc.

*(d)* On October 31, 2015, all of the issued and outstanding common shares of Hydro One Inc. were acquired by Hydro One from the Province in return for 12,197,500,000 common shares of Hydro One and 16,720,000 Series 1 preferred shares of Hydro One.

*(e)* On November 4, 2015, Hydro One issued 2.6 billion common shares to the Province for proceeds of \$2.6 billion.

*(f)* On November 4, 2015, the common shares of Hydro One were consolidated by way of articles of amendment approved by the Province as sole shareholder so that, after such consolidation, 595,000,000 common shares of Hydro One were issued and outstanding.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Share Ownership Restrictions

The *Electricity Act* imposes share ownership restrictions on securities of Hydro One carrying a voting right (Voting Securities). These restrictions provide that no person or company (or combination of persons or companies acting jointly or in concert) may beneficially own or exercise control or direction over more than 10% of any class or series of Voting Securities, including common shares of the Company (Share Ownership Restrictions). The Share Ownership Restrictions do not apply to Voting Securities held by the Province, nor to an underwriter who holds Voting Securities solely for the purpose of distributing those securities to purchasers who comply with the Share Ownership Restrictions.

### 22. Dividends

In 2016, preferred share dividends in the amount of \$19 million (2015 – \$13 million) and common share dividends in the amount of \$577 million (2015 – \$875 million) were declared. The 2016 common share dividends include \$77 million for the post-IPO period

from November 5 to December 31, 2015, and \$500 million for the year ended December 31, 2016.

In August 2015, Hydro One declared a dividend in-kind on its common shares payable in all of the issued and outstanding shares of Hydro One Brampton (see note 4).

### 23. Earnings Per Share

Basic earnings per common share (EPS) is calculated by dividing net income attributable to common shareholders of Hydro One by the weighted average number of common shares outstanding. Diluted EPS is calculated by dividing net income attributable to common shareholders of Hydro One by the weighted average number of common shares outstanding adjusted for the effects of potentially dilutive stock-based compensation plans, including the share grant plans and the Long-term Incentive Plan, which are calculated using the treasury stock method.

<i>Year ended December 31</i>	2016	2015
Net income attributable to common shareholders ( <i>millions of dollars</i> )	721	690
Weighted average number of shares		
Basic	595,000,000	496,272,733
Effect of dilutive stock-based compensation plans ( <i>Note 24</i> )	1,700,823	94,691
Diluted	596,700,823	496,367,424
EPS		
Basic	\$1.21	\$1.39
Diluted	\$1.21	\$1.39

### Pro forma Adjusted non-GAAP Basic and Diluted EPS

The following pro forma adjusted non-GAAP basic and diluted EPS has been prepared by management on a supplementary basis which assumes that the total number of common shares outstanding was 595,000,000 in each of the years ended December 31, 2016 and 2015. The supplementary pro forma disclosure is used internally by management subsequent to the IPO of Hydro One to assess the

Company's performance and is considered useful because it eliminates the impact of a different number of shares outstanding and held by the Province prior to the IPO. EPS is considered an important measure and management believes that presenting it for all periods based on the number of outstanding shares on, and subsequent to, the IPO provides users with a comparable basis to evaluate the operations of the Company.

<i>Year ended December 31</i> <i>(unaudited)</i>	2016	2015
Net income attributable to common shareholders ( <i>millions of dollars</i> )	721	690
Pro forma weighted average number of common shares		
Basic	595,000,000	595,000,000
Effect of dilutive stock-based compensation plans ( <i>Note 24</i> )	1,700,823	94,691
Diluted	596,700,823	595,094,691
Pro forma adjusted non-GAAP EPS		
Basic	\$1.21	\$1.16
Diluted	\$1.21	\$1.16

The above pro forma adjusted non-GAAP basic and diluted EPS does not have any standardized meaning in US GAAP.

## 24. Stock-based Compensation Share Grant Plans

At December 31, 2016, Hydro One had two share grant plans (Share Grant Plans), one for the benefit of certain members of the Power Workers' Union (the PWU Share Grant Plan) and one for the benefit of certain members of The Society of Energy Professionals (the Society Share Grant Plan).

The PWU Share Grant Plan provides for the issuance of common shares of Hydro One from treasury to certain eligible members of the Power Workers' Union annually, commencing on April 1, 2017 and continuing until the earlier of April 1, 2028 or the date an eligible employee no longer meets the eligibility criteria of the PWU Share Grant Plan. To be eligible, an employee must be a member of the Pension Plan on April 1, 2015, be employed on the date annual share issuance occurs and continue to have under 35 years of service. The requisite service period for the PWU Share Grant Plan begins on July 3, 2015, which is the date the share grant plan was ratified by the PWU. The number of common shares issued annually to each eligible employee will be equal to 2.7% of such eligible employee's salary as at April 1, 2015, divided by \$20.50, being the price of the common shares of Hydro One in the IPO. The aggregate number of common shares issuable under the PWU Share Grant Plan shall not exceed 3,981,763 common shares. In 2015, 3,979,062 common shares were granted under the PWU Share Grant Plan.

The Society Share Grant Plan provides for the issuance of common shares of Hydro One from treasury to certain eligible members of The Society of Energy Professionals annually, commencing on April 1,

2018 and continuing until the earlier of April 1, 2029 or the date an eligible employee no longer meets the eligibility criteria of the Society Share Grant Plan. To be eligible, an employee must be a member of the Pension Plan on September 1, 2015, be employed on the date annual share issuance occurs and continue to have under 35 years of service. Therefore the requisite service period for the Society Share Grant Plan begins on September 1, 2015. The number of common shares issued annually to each eligible employee will be equal to 2.0% of such eligible employee's salary as at September 1, 2015, divided by \$20.50, being the price of the common shares of Hydro One in the IPO. The aggregate number of common shares issuable under the Society Share Grant Plan shall not exceed 1,434,686 common shares. In 2015, 1,433,292 common shares were granted under the Society Share Grant Plan.

The fair value of the Hydro One Limited 2015 share grants of \$111 million was estimated based on the grant date share price of \$20.50 and is recognized using the graded-vesting attribution method as the share grant plans have both a performance condition and a service condition. No shares were granted under the Share Grant Plans in 2016. Total share based compensation recognized during 2016 was \$21 million (2015 – \$10 million) and was recorded as a regulatory asset.

A summary of share grant activity under the Share Grant Plans during years ended December 31, 2016 and 2015 is presented below:

<i>Year ended December 31, 2016</i>	Share Grants <i>(number of common shares)</i>	Weighted- Average Price
Share grants outstanding – January 1, 2016	5,412,354	\$20.50
Granted (non-vested)	–	–
Forfeited	(77,939)	\$20.50
Share grants outstanding – December 31, 2016	5,334,415	\$20.50
<i>Year ended December 31, 2015</i>	<i>(number of common shares)</i>	<i>Weighted- Average Price</i>
Share grants outstanding – January 1, 2015	–	–
Granted (non-vested)	5,412,354	\$20.50
Share grants outstanding – December 31, 2015	5,412,354	\$20.50

### Directors' DSU Plan

Under the Company's Directors' DSU Plan, directors can elect to receive credit for their annual cash retainer in a notional account of

DSUs in lieu of cash. Hydro One's Board of Directors may also determine from time to time that special circumstances exist that would reasonably justify the grant of DSUs to a director as compensation in addition to any regular retainer or fee to which the director is entitled.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Each DSU represents a unit with an underlying value equivalent to the value of one common share of the Company and is entitled to accrue common share dividend equivalents in the form of additional DSUs at the time dividends are paid, subsequent to declaration by Hydro One's Board of Directors.

Year ended December 31

(number of DSUs)	2016	2015
DSUs outstanding – January 1	20,525	–
DSUs granted	78,558	20,525
DSUs outstanding – December 31	99,083	20,525

For the year ended December 31, 2016, an expense of \$2 million (2015 – less than \$1 million) was recognized in earnings with respect to the DSU Plan. At December 31, 2016, a liability of \$2 million (December 31, 2015 – less than \$1 million), related to outstanding DSUs has been recorded at the closing price of the Company's common shares of \$23.58 and is included in accrued liabilities on the Consolidated Balance Sheets.

### Employee Share Ownership Plan

Effective December 15, 2015, Hydro One established an Employee Share Ownership Plan (ESOP). Under the ESOP, certain eligible management and non-represented employees may contribute between 1% and 6% of their base salary towards purchasing common shares of Hydro One. The Company matches 50% of the employee's contributions, up to a maximum Company contribution of \$25,000 per calendar year. In 2016, Company contributions made under the ESOP were \$2 million (2015 – \$nil).

### Long-term Incentive Plan

Effective August 31, 2015, the Board of Directors of Hydro One adopted an LTIP. Under the LTIP, long-term incentives are granted to certain executive and management employees of Hydro One and its subsidiaries, and all equity-based awards will be settled in newly issued shares of Hydro One from treasury, consistent with the provisions of the plan. The aggregate number of shares issuable under the LTIP shall not exceed 11,900,000 shares of Hydro One.

The LTIP provides flexibility to award a range of vehicles, including restricted share units (RSUs), performance share units (PSUs), stock options, share appreciation rights, restricted shares, deferred share units and other share-based awards. The mix of vehicles is intended to vary by role to recognize the level of executive accountability for overall business performance.

During 2016, the Company granted awards under its LTIP, consisting of PSUs and RSUs, all of which are equity settled, as follows:

Year ended December 31, 2016	Number of PSUs	Number of RSUs
Units outstanding – January 1, 2016	–	–
Units granted	235,420	258,970
Units forfeited	(4,820)	(4,820)
Units outstanding – December 31, 2016	230,600	254,150

The grant date total fair value of the awards was \$12 million (2015 – \$nil). The compensation expense recognized by the Company relating to these awards during 2016 was \$3 million (2015 – \$nil).

### 25. Noncontrolling Interest

On December 16, 2014, transmission assets totalling \$526 million were transferred from Hydro One Networks to B2M LP. This was financed by 60% debt (\$316 million) and 40% equity (\$210 million). On December 17, 2014, the Saugeen Ojibway Nation (SON) acquired a 34.2% equity interest in B2M LP for consideration of

\$72 million, representing the fair value of the equity interest acquired. The SON's initial investment in B2M LP consists of \$50 million of Class A units and \$22 million of Class B units.

The Class B units have a mandatory put option which requires that upon the occurrence of an enforcement event (i.e. an event of default such as a debt default by the SON or insolvency event), Hydro One purchase the Class B units of B2M LP for net book value on the redemption date. The noncontrolling interest relating to the Class B units is classified on the Consolidated Balance Sheet as temporary equity because the redemption feature is outside the control of the Company. The balance of the noncontrolling interest is classified within equity.

The following tables show the movements in noncontrolling interest for the years ended December 31, 2016 and 2015:

<i>Year ended December 31, 2016</i> <i>(millions of dollars)</i>	Temporary Equity	Equity	Total
Noncontrolling interest – January 1, 2016	23	52	75
Distributions to noncontrolling interest	(3)	(6)	(9)
Net income attributable to noncontrolling interest	2	4	6
<b>Noncontrolling interest – December 31, 2016</b>	<b>22</b>	<b>50</b>	<b>72</b>

<i>Year ended December 31, 2015</i> <i>(millions of dollars)</i>	Temporary Equity	Equity	Total
Noncontrolling interest – January 1, 2015	21	49	70
Distributions to noncontrolling interest	(1)	(4)	(5)
Net income attributable to noncontrolling interest	3	7	10
<b>Noncontrolling interest – December 31, 2015</b>	<b>23</b>	<b>52</b>	<b>75</b>

## 26. Related Party Transactions

The Province is the majority shareholder of Hydro One. The IESO, Ontario Power Generation Inc. (OPG), OEFC, OEB, and Hydro One Brampton are related parties to Hydro One because they are controlled or significantly influenced by the Province.

Related Party	Transaction	Year ended December 31	
		2016	2015
		<i>(millions of dollars)</i>	
Province <sup>1</sup>	Dividends paid	451	888
	Common shares issued <sup>2</sup>	–	2,600
	IPO costs subsequently reimbursed by the Province <sup>3</sup>	–	7
IESO	Power purchased	2,096	2,318
	Revenues for transmission services	1,549	1,548
	Distribution revenues related to rural rate protection	125	127
	Distribution revenues related to the supply of electricity to remote northern communities	32	32
	Funding received related to Conservation and Demand Management programs	63	70
OPG	Power purchased	6	11
	Revenues related to provision of construction and equipment maintenance services	5	7
	Costs expensed related to the purchase of services	1	1
OEFC	Payments in lieu of corporate income taxes <sup>4</sup>	–	2,933
	Power purchased from power contracts administered by the OEFC	1	6
	Indemnification fee paid (terminated effective October 31, 2015)	–	8
OEB	OEB fees	11	12
Hydro One Brampton <sup>1</sup>	Revenues from management, administrative and smart meter network services	3	1

<sup>1</sup> On August 31, 2015, Hydro One Inc. completed the spin-off of its subsidiary, Hydro One Brampton, to the Province.

<sup>2</sup> On November 4, 2015, Hydro One issued common shares to the Province for proceeds of \$2.6 billion.

<sup>3</sup> In 2015, Hydro One incurred certain IPO related expenses totalling \$7 million, which were subsequently reimbursed to the Company by the Province.

<sup>4</sup> In 2015, Hydro One made PILs to the OEFC totalling \$2.9 billion, including Departure Tax of \$2.6 billion.

Sales to and purchases from related parties are based on the requirements of the OEB's Affiliate Relationships Code. Outstanding balances at period end are interest free and settled in cash.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The amounts due to and from related parties as a result of the transactions referred to above are as follows:

<i>December 31</i> <i>(millions of dollars)</i>	2016	2015
Due from related parties	158	191
Due to related parties <sup>1</sup>	(147)	(138)

<sup>1</sup> Included in due to related parties at December 31, 2016 are amounts owing to the IESO in respect of power purchases of \$143 million (2015 – \$134 million).

## 27. Consolidated Statements of Cash Flows

The changes in non-cash balances related to operations consist of the following:

<i>Year ended December 31</i> <i>(millions of dollars)</i>	2016	2015
Accounts receivable	(60)	245
Due from related parties	33	33
Materials and supplies	2	2
Prepaid expenses and other assets	(15)	4
Accounts payable	19	(23)
Accrued liabilities	53	(15)
Due to related parties	9	(89)
Accrued interest	9	(4)
Long-term accounts payable and other liabilities	6	–
Postretirement and post-employment benefit liability	78	60
	134	213

## Capital Expenditures

The following table reconciles between investments in property, plant and equipment and the amount presented in the Consolidated Statements of Cash Flows after accounting for capitalized depreciation and the net change in related accruals:

<i>Year ended December 31</i> <i>(millions of dollars)</i>	2016	2015
Capital investments in property, plant and equipment	(1,630)	(1,623)
Capitalized depreciation and net change in accruals included in capital investments in property, plant and equipment	30	28
Capital expenditures – property, plant and equipment	(1,600)	(1,595)

The following table reconciles between investments in intangible assets and the amount presented in the Consolidated Statements of Cash Flows after accounting for the net change in related accruals:

<i>Year ended December 31</i> <i>(millions of dollars)</i>	2016	2015
Capital investments in intangible assets	(67)	(40)
Net change in accruals included in capital investments in intangible assets	6	3
Capital expenditures – intangible assets	(61)	(37)

## Capital Contributions

Hydro One enters into contracts governed by the OEB Transmission System Code when a transmission customer requests a new or upgraded transmission connection. The customer is required to make a capital contribution to Hydro One based on the shortfall between the present value of the costs of the connection facility and the present value of revenues. The present value of revenues is based on an estimate of load forecast for the period of the contract with Hydro One. Once the connection facility is commissioned, in accordance

with the OEB Transmission System Code, Hydro One will periodically reassess the estimated of load forecast which will lead to a decrease, or an increase in the capital contributions from the customer. The increase or decrease in capital contributions is recorded directly to fixed assets in service. In 2016, capital contributions from these reassessments totalled \$21 million (2015 – \$57 million), which represents the difference between the revised load forecast of electricity transmitted compared to the load forecast in the original contract, subject to certain adjustments.

## Supplementary Information

Year ended December 31  
(millions of dollars)

	2016	2015
Net interest paid	418	416
Income taxes / PILs paid	32	2,933

## 28. Contingencies

### Legal Proceedings

Hydro One is involved in various lawsuits, claims and regulatory proceedings in the normal course of business. In the opinion of management, the outcome of such matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Hydro One Inc., Hydro One Networks, Hydro One Remote Communities, and Norfolk Power Distribution Inc. are defendants in a class action suit in which the representative plaintiff is seeking up to \$125 million in damages related to allegations of improper billing practices. A certification motion in the class action is pending. Due to the preliminary stage of legal proceedings, an estimate of a possible loss related to this claim cannot be made.

### Transfer of Assets

The transfer orders by which the Company acquired certain of Ontario Hydro's businesses as of April 1, 1999 did not transfer title to some assets located on Reserves (as defined in the *Indian Act* (Canada)). Currently, the OEFC holds these assets. Under the terms of the transfer orders, the Company is required to manage these assets until it has obtained all consents necessary to complete the transfer of title of these assets to itself. The Company cannot predict the aggregate amount that it may have to pay, either on an annual or one-time basis, to obtain the required consents. In 2016, the Company paid approximately \$1 million (2015 – \$1 million) in respect of consents obtained. If the Company cannot obtain the required consents, the OEFC will continue to hold these assets for an indefinite period of time. If the Company cannot reach a satisfactory settlement, it may have to relocate these assets to other locations at a cost that could be substantial or, in a limited number of cases, to abandon a line and replace it with diesel-generation facilities. The costs relating to these assets could have a material adverse effect on the Company's results of operations if the Company is not able to recover them in future rate orders.

## 29. Commitments

The following table presents a summary of Hydro One's commitments under leases, outsourcing and other agreements due in the next 5 years and thereafter.

December 31, 2016 (millions of dollars)	2017	2018	2019	2020	2021	Thereafter
Outsourcing agreements	165	102	94	2	2	9
Long-term software/meter agreement	17	17	16	17	1	5
Operating lease commitments	11	10	6	10	3	2



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Outsourcing Agreements

Inergi LP (Inergi), an affiliate of Capgemini Canada Inc., provides services to Hydro One, including settlements, source to pay services, pay operations services, information technology, finance and accounting services. The agreement with Inergi for these services expires in December 2019. In addition, Inergi provides customer service operations outsourcing services to Hydro One. The agreement for these services expires in February 2018.

Brookfield Global Integrated Solutions (formerly Brookfield Johnson Controls Canada LP) (Brookfield) provides services to Hydro One, including facilities management and execution of certain capital projects as deemed required by the Company. The agreement with Brookfield for these services expires in December 2024.

### Long-term software/meter agreement

Trilliant Holdings Inc. and Trilliant Networks (Canada) Inc. (collectively Trilliant) provide services to Hydro One for the supply, maintenance and support services for smart meters and related hardware and software, including additional software licences, as well as certain professional services. The agreement with Trilliant for these services expires in December 2025, but Hydro One has the option to renew for an additional term of five years at its sole discretion.

### Operating Leases

Hydro One is committed as lessee to irrevocable operating lease contracts for buildings used in administrative and service-related functions and storing telecommunications equipment. These leases have typical terms of between three and five years, but several leases have lesser or greater terms to address special circumstances and/or opportunities. Renewal options, which are generally prevalent in most leases, have similar terms of three to five years. All leases include a clause to enable upward revision of the rental charge on an annual basis or on renewal according to prevailing market conditions or pre-established rents. There are no restrictions placed upon Hydro One by entering into these leases. During the year ended December 31, 2016, the Company made lease payments totalling \$11 million (2015 – \$7 million).

### Other Commitments

#### Prudential Support

Purchasers of electricity in Ontario, through the IESO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. As at December 31, 2016, Hydro One Inc. provided prudential support to the IESO on behalf of its

subsidiaries using parental guarantees of \$329 million (2015 – \$329 million), and on behalf of a distributor using guarantees of \$1 million (2015 – \$1 million). In addition, as at December 31, 2016, Hydro One Inc. provided letters of credit in the amount of \$24 million (2015 – \$15 million), including \$17 million (2015 – \$15 million) to the IESO. The IESO could draw on these guarantees and/or letters of credit if these subsidiaries or distributor fail to make a payment required by a default notice issued by the IESO. The maximum potential payment is the face value of any letters of credit plus the amount of the parental guarantees.

### Retirement Compensation Arrangements

Bank letters of credit have been issued to provide security for Hydro One Inc.'s liability under the terms of a trust fund established pursuant to the supplementary pension plan for eligible employees of Hydro One Inc. The supplementary pension plan trustee is required to draw upon these letters of credit if Hydro One Inc. is in default of its obligations under the terms of this plan. Such obligations include the requirement to provide the trustee with an annual actuarial report as well as letters of credit sufficient to secure Hydro One Inc.'s liability under the plan, to pay benefits payable under the plan and to pay the letter of credit fee. The maximum potential payment is the face value of the letters of credit. At December 31, 2016, Hydro One Inc. had letters of credit of \$150 million (2015 – \$139 million) outstanding relating to retirement compensation arrangements.

## 30. Segmented Reporting

Hydro One has three reportable segments:

- The Transmission Business, which comprises the transmission of high voltage electricity across the province, interconnecting more than 70 local distribution companies and certain large directly connected industrial customers throughout the Ontario electricity grid;
- The Distribution Business, which comprises the delivery of electricity to end customers and certain other municipal electricity distributors; and
- Other Business, which includes certain corporate activities and the operations of the Company's telecommunications business.

The designation of segments has been based on a combination of regulatory status and the nature of the services provided. Operating segments of the Company are determined based on information used by the chief operating decision maker in deciding how to allocate resources and evaluate the performance of each of the segments. The Company evaluates segment performance based on income before financing charges and income taxes from continuing operations (excluding certain allocated corporate governance costs).

The accounting policies followed by the segments are the same as those described in the summary of significant accounting policies (see note 2).

*Year ended December 31, 2016*  
*(millions of dollars)*

	Transmission	Distribution	Other	Consolidated
Revenues	1,584	4,915	53	6,552
Purchased power	–	3,427	–	3,427
Operation, maintenance and administration	382	608	79	1,069
Depreciation and amortization	390	379	9	778
<b>Income (loss) before financing charges and income taxes</b>	<b>812</b>	<b>501</b>	<b>(35)</b>	<b>1,278</b>
<b>Capital investments</b>	<b>988</b>	<b>703</b>	<b>6</b>	<b>1,697</b>

*Year ended December 31, 2015*  
*(millions of dollars)*

	Transmission	Distribution	Other	Consolidated
Revenues	1,536	4,949	53	6,538
Purchased power	–	3,450	–	3,450
Operation, maintenance and administration	414	633	88	1,135
Depreciation and amortization	374	380	5	759
<b>Income (loss) before financing charges and income taxes</b>	<b>748</b>	<b>486</b>	<b>(40)</b>	<b>1,194</b>
<b>Capital investments</b>	<b>943</b>	<b>711</b>	<b>9</b>	<b>1,663</b>

### Total Assets by Segment:

*December 31*  
*(millions of dollars)*

	2016	2015
Transmission	13,007	12,045
Distribution	9,337	9,200
Other	3,007	3,049
<b>Total assets</b>	<b>25,351</b>	<b>24,294</b>

All revenues, costs and assets, as the case may be, are earned, incurred or held in Canada.

## 31. Subsequent Events

### Dividends

On February 9, 2017, preferred share dividends in the amount of \$4 million and common share dividends in the amount of \$125 million (\$0.21 per common share) were declared.

# BOARD OF DIRECTORS & SENIOR LEADERSHIP TEAM



 For detailed biographical information of Hydro One limited board members and senior leadership, go to [HydroOne.com/Investors](http://HydroOne.com/Investors)

## BOARD OF DIRECTORS

- |   |   |
|---|---|
| <p><b>1 David Denison, O.C., FCPA, FCA</b><br/>Chair of the Board</p> <p><b>2 Ian Bourne, ICD.D, F.ICD</b><br/>Board Chair, Ballard Power Systems</p> <p><b>3 Charles Brindamour</b><br/>CEO, Intact Financial Corporation</p> <p><b>4 Marcello (Marc) Caira</b><br/>Vice Chairman,<br/>Restaurants Brands International</p> <p><b>5 Christie Clark, FCA, FCPA</b><br/>Director, Loblaw Companies</p> <p><b>6 George Cooke</b><br/>Board Chair,<br/>OMERS Administration Corp</p> <p><b>7 Margaret (Marianne) Harris</b><br/>Board Chair, IIROC</p> | <p><b>8 James Hinds</b><br/>Former Board Chair, IESO and OPA</p> <p><b>9 Kathryn J. Jackson, PH.D</b><br/>Director, Portland General Electric</p> <p><b>10 Roberta Jamieson O.C., C.M., I.P.C, LL.B, LL.D (HON)</b><br/>President and CEO, Indspire</p> <p><b>11 Hon. Frances L. Lankin, O.C., P.C., C.M.</b><br/>Member of Senate of Canada</p> <p><b>12 Philip S. Orsino, O.C., FCPA, FCA</b><br/>Director, Bank of Montreal</p> <p><b>13 Jane Peverett, FCMA, ICD.D</b><br/>Director, Canadian Imperial<br/>Bank of Commerce</p> <p><b>14 Gale Rubenstein</b><br/>Partner, Goodmans LLP</p> <p><b>15 Mayo Schmidt</b><br/>President and CEO, Hydro One Limited</p> |
|---|---|

## SENIOR LEADERSHIP TEAM

- 15 Mayo Schmidt**  
President and CEO
- 16 Paul H. Barry**  
EVP, Strategy  
& Corporate Development
- 17 Greg Kiraly**  
Chief Operating Officer
- 18 Judy McKellar**  
EVP, Chief Human  
Resources Officer
- 19 Ferio Pugliese**  
EVP, Customer Care  
& Corporate Affairs
- 20 James (Jamie) Scarlett**  
EVP, Chief Legal Officer
- 21 Michael Vels**  
Chief Financial Officer

# CORPORATE & SHAREHOLDER INFORMATION

## CORPORATE OFFICES

483 Bay Street, South Tower  
Toronto, Ontario, M5G 2P5  
1.416.345.5000  
[www.HydroOne.com](http://www.HydroOne.com)

## CUSTOMER INQUIRIES

Customer Service:  
1.888.664.9376 or  
[CustomerCommunications@HydroOne.com](mailto:CustomerCommunications@HydroOne.com)  
Report an Emergency (24 hours):  
1.800.434.1235

## SHAREHOLDER SERVICES

If you are a registered shareholder and have inquiries regarding your account, wish to change your name or address, or have questions about dividends, duplicate mailings, lost stock certificates, share transfers or estate settlements, contact our transfer agent and registrar:  
**Computershare Trust Company of Canada**  
100 University Avenue, 8th Floor  
Toronto, ON M5J 2Y1  
1.514.982.7555 or 1.800.564.6253  
[service@computershare.com](mailto:service@computershare.com)

## INSTITUTIONAL INVESTORS AND ANALYSTS

Institutional investors, securities analysts and others requiring additional financial information can visit [HydroOne.com/Investors](http://HydroOne.com/Investors) or contact us at:  
1.416.345.6867  
[Investor.Relations@HydroOne.com](mailto:Investor.Relations@HydroOne.com) or  
[Bruce.Mann@HydroOne.com](mailto:Bruce.Mann@HydroOne.com)

## MEDIA INQUIRIES

1.416.345.6868 or 1.877.506.7584  
[Media.Relations@HydroOne.com](mailto:Media.Relations@HydroOne.com)

## SUSTAINABILITY

Hydro One is committed to continuing to grow responsibly and we focus our social and environmental sustainability efforts where we can make the most meaningful impacts on both. To learn more, visit [HydroOne.com/OurCommitment](http://HydroOne.com/OurCommitment)

## STOCK EXCHANGE LISTING

Toronto Stock Exchange (TSX): H  
(CUSIP #448811208)



## EQUITY INDEX INCLUSIONS

Dow Jones Select Utilities (Canada) Index  
FTSE All-World Index Series  
MSCI World (Canada) Index  
S&P/TSX Composite Index  
S&P/TSX Utilities Index  
S&P/TSX Composite Dividend Index  
S&P/TSX Composite Low Volatility Index

## DEBT SECURITIES

For details of the public debt securities of Hydro One and its subsidiaries, please refer to the "Debt Information" section under [HydroOne.com/Investors](http://HydroOne.com/Investors)

## INDEPENDENT AUDITORS

KPMG LLP

## ON-LINE INFORMATION

Hydro One is committed to open and full financial disclosure and best practices in corporate governance. We invite you to visit the Investor Relations section of [HydroOne.com/InvestorRelations](http://HydroOne.com/InvestorRelations) where you will find additional information about our business, including events and presentations, news releases, regulatory filings, governance practices, corporate social responsibility and our continuous disclosure materials, including quarterly financial releases, annual information forms and management information circulars. You may also subscribe to our news by email to automatically receive Hydro One news releases electronically.

## COMMON SHARE DIVIDEND INFORMATION

### 2017 Expected Dividend Dates

Record Date*:	Payment Date*:
March 14, 2017	March 31, 2017
June 13, 2017	June 30, 2017
September 12, 2017	September 29, 2017
December 12, 2017	December 29, 2017

\* Subject to Board approval

Unless indicated otherwise, all common share dividends paid by Hydro One are designated as "eligible" dividends for the purposes of the *Income Tax Act* (Canada) and any similar provincial legislation.

## DIVIDEND REINVESTMENT PLAN (DRIP)

Hydro One offers a convenient dividend reinvestment program for eligible shareholders to purchase additional Hydro One shares by reinvesting their cash dividends without incurring brokerage or administration fees. For plan information and enrolment materials or to learn more about the Hydro One DRIP, visit [HydroOne.com/DRIP](http://HydroOne.com/DRIP) or Computershare Trust Company of Canada at [InvestorCentre.com/HydroOne](http://InvestorCentre.com/HydroOne)

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## CAUTION REGARDING FORWARD-LOOKING INFORMATION AND OTHER RISKS

This annual report includes forward-looking statements about the financial condition, plans and prospects of Hydro One that involve risks and uncertainties and non-GAAP measures that are detailed in the "Risk Management and Risk Factors", "Forward-Looking Statements and Information", and "Non-GAAP Measures" sections of the MD&A contained herein, which should be read in conjunction with all sections of this document.



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**HYDRO ONE LIMITED** IS ONE OF NORTH AMERICA'S LARGEST ELECTRIC UTILITIES, WITH A REGULATED TRANSMISSION GRID TRANSMITTING 98 PERCENT OF ONTARIO'S ELECTRIC POWER, AND A REGULATED LOCAL DISTRIBUTION OPERATION DELIVERING ELECTRICITY TO MORE THAN 1.3 MILLION RESIDENTIAL AND BUSINESS CUSTOMERS ACROSS 75 PERCENT OF THE GEOGRAPHY OF THE PROVINCE.



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