POWERING OTTAWA'S FUTURE

HYDRO OTTAWA HOLDING INC.
2005 ANNUAL REPORT

HydroOttawa
Holding Inc.

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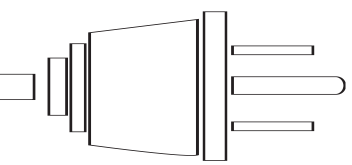
FINANCIAL HIGHLIGHTS

	2005	2004
REVENUES ($ thousands)		
Power recovery	**592,231**	507,838
Distribution sales	**90,884**	85,689
Other income	**24,333**	22,232
	707,448	615,759
EARNINGS FROM CONTINUING OPERATIONS ($ thousands)		
EBITDA	**71,260**	62,511
EBIT	**36,699**	32,751
Net Earnings	**22,086**	16,013
SOURCE (USE) OF CASH ($ thousands)		
Generated from operations	**87,606**	37,654
Capital assets	**(85,450)**	(77,351)
Financing	**(1,072)**	28,303
RATIOS		
Working capital	**1.03**	1.01
Debt to equity	**48:52**	50:50
CONSUMPTION		
Megawatt-hours	**7,911,789**	7,702,018

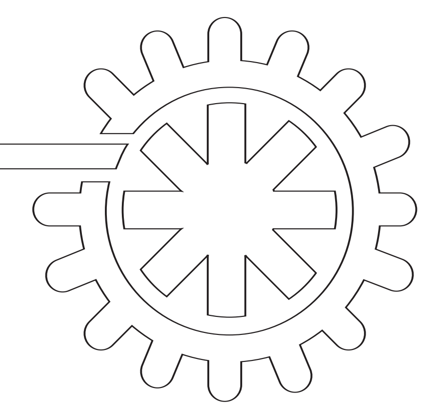
HYDRO OTTAWA GROUP OF COMPANIES AT A GLANCE

Hydro Ottawa Holding powers Ottawa's future by maintaining one of the most reliable and cost-effective electricity distribution systems in Ontario, by operating some of Canada's most environmentally-friendly power-generating stations, and by bringing high-speed data connections and services to the city's major public institutions and a growing number of businesses. These building blocks of a sound municipal economy are our responsibility. At the same time, we must be a well-governed corporate citizen, accountable to our shareholder, the City of Ottawa, as well as to the financial markets that underwrite our operations. We do this by adhering to high standards of corporate governance and by acting at all times as an involved and socially responsible member of the community we serve.



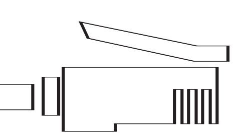
HYDRO OTTAWA

Hydro Ottawa is an electricity distribution company. As the second-largest municipally-owned local distribution company in Ontario, Hydro Ottawa serves 278,000 customers, both residential and commercial, across a 1,104 square kilometre service area. It receives power from the provincial electricity grid and transports it across a distribution network comprising 85 distribution stations, 1,900 kilometres (km) of underground cable, 3,000 km of overhead lines, 38,000 transformers and 71,000 hydro poles.



ENERGY OTTAWA

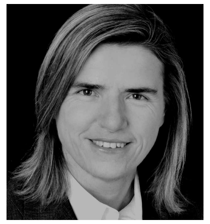
Energy Ottawa is a green power-generation company. Its twin generating stations at Chaudière Falls in the heart of the city produce 115,000 megawatt-hours (MWh) of the greenest electricity in Canada, while a new methane-powered generating station at the city's Trail Road landfill soon will be converting millions of tonnes of previously wasted methane gas into another 40,000 MWh of clean green power. Together, this output amounts to about 2% of Ottawa's total requirement, enough to meet the annual electricity needs of more than 17,000 homes.



TELECOM OTTAWA

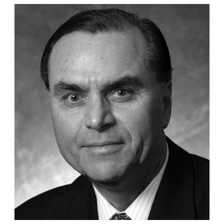
Telecom Ottawa is a broadband services company. The company owns and operates a 10 Gigabit network with more than 1,000 kilometres of fibre optic cable. This broadband infrastructure enables the provision of high-speed data connectivity and a host of valuable broadband network services to municipal offices, universities, schools and hospitals as well as nearly 500 businesses.

LETTER TO SHAREHOLDER



Rosemarie T. Leclair
President and
Chief Executive Officer

Pierre Richard, Q.C.
Chair
Board of Directors



The five years since the Hydro Ottawa group of companies was created from an amalgamation of local electricity distribution companies has largely been a period of planning for a whole new regulatory environment and reacting to change. In 2005, with the majority of day-to-day operational, organizational building and planning processes completed, the Corporation has concentrated on initiatives that will continue to ensure the long-term and cost-effective sustainability of the services we provide. In short, in 2005, we turned the corner from reacting to acting, from planning to implementing, and we stand ready to power Ottawa's future in 2006 and beyond.

Apart from amalgamation itself, which posed its own challenges for the integration of workforces, systems and procedures, the biggest hurdles Hydro Ottawa Holding has had to leap are related to the ongoing restructuring of the electricity market in Ontario and the fact that the province-wide system was facing, and continues to face, long-term supply and transmission challenges.

These realities define how we structure the family of companies that make up Hydro Ottawa Holding. We operate within the new regulatory framework, deal with industry challenges and deliver value to our shareholder. We may not be able to change these new realities, and we know there will be additional challenges on the road ahead, but we can ensure that our companies are properly positioned to provide the reliable, cost-effective services on which all people of Ottawa rely.

SUSTAINABLE COMPANIES REQUIRE FINANCIAL STABILITY, EFFECTIVE GOVERNANCE

Above all, our companies must be financially sustainable and effectively governed.

The underpinnings of our long-term financial sustainability were put in place early in 2005 when we completed our first-ever bond placement. This $200-million investment from the private markets allowed us to repay the bulk of what was owed to the City of Ottawa from the amalgamation-related transfer of city-owned assets.

The Corporation has successfully navigated the regulatory environment and produced steady earnings over the past two years, increasing our asset base. Net earnings in 2005 were $22.6 million, a nearly 15% increase over the $19.7 million earned in 2004. Retained earnings, meanwhile, rose to $25.4 million this past year. This improvement in retained earnings allowed us to pay our first-ever dividend to our shareholder, the City of Ottawa, on April 18, 2006 in the amount of $12 million.

Hydro Ottawa Holding provided further clear evidence of our financial sustainability by maintaining our A- level credit ratings.

Throughout 2005, our ongoing financial sustainability was a significant preoccupation as Hydro Ottawa Limited, our local distribution company, applied for a rate increase to more closely align revenue with the cost of providing distribution service. The increase, which was approved by the Ontario Energy Board (OEB) in April 2006 and became effective May 1, will be invested in sustaining the reliability and expansion of our electricity distribution system while still keeping our rates among the lowest in Ontario.

In keeping with progressive trends in Canada, Hydro Ottawa Holding strengthened corporate governance in our company. Major changes to our governance model in 2005 included the implementation of a code of conduct for employees and members of the Board of Directors, and director conflict of interest and conduct guidelines.

We also adopted a mandate for the Board and defined the relative roles of the Board, the Chair, individual directors and the President and Chief Executive Officer. All, based on best practices.

A new board structure will be implemented by July 1, 2006 in order to make additional improvements to the Corporation's governance and to comply with the OEB's requirements for the creation of a separate board for Hydro Ottawa Limited.

SUSTAINABLE GROWTH DEMANDS INFRASTRUCTURE INVESTMENT

At Hydro Ottawa, the sustainability of the local electricity distribution system is paramount. This past year we developed a comprehensive asset management plan that, with the financial support provided by the rate increase, will allow the distribution company to renew aging infrastructure and to invest in the growth and expansion of services our city requires.

A new, technologically-advanced system control centre on Merivale Road was opened in November with audiovisual systems and ergonomic operator consoles that will provide better communications and coordination for field operations. Earlier in the year, a new work centre was opened in Kanata to serve as headquarters for design and construction crews based in the west end, a significant example of Hydro Ottawa's commitment to its customers in Kanata and Goulbourn.

These long-term plans and initiatives will sustain the reliability of a city-wide distribution system that in 2005 saw significant improvements to an already excellent record. Our service quality performance was better in every area than the targets mandated by the OEB, and we operated the system well within the OEB's requirements for both the frequency and duration of service interruptions to our customers. The impact of this sustained system reliability, and other measures we have taken to improve customer service, were felt in a number of ways in 2005. A new Customer Information System, installed in 2004 and stabilized in 2005, drove a dramatic improvement in the timeliness of our bills. And while we measure ourselves against the OEB guidelines – we don't stop there. It is our goal to improve the customer experience and we will continue to do so by offering more services online, implementing measures to fix recurring customer concerns, and providing a quicker resolution for those that do occur.

Our Telecom Ottawa subsidiary provides high-speed data connections and critical business services to both the broad public sector in Ottawa and to a growing number of commercial customers. In 2005, the company qualified as a Converged Network Services supplier to the federal government, opening up its potential to generate new revenues from the largest sector of the National Capital's economy.

SUSTAINABILITY REQUIRES LEADERSHIP IN CONSERVATION

Ensuring a reliable and cost-effective electricity distribution system is not enough. To help our customers reduce electricity costs and to help mitigate the impact of a constrained energy-supply system in Ontario, it is essential that we realize the maximum benefit from this limited resource.

This means ensuring that our operations are energy efficient, keeping a strong focus on sustainability in our everyday operations and in our long-term strategies. This includes retrofitting our own buildings to reduce electricity and natural gas consumption and improve air quality, and moving our crews and equipment to several locations around the city to reduce vehicle expenses and energy consumption and to respond more quickly to customer needs.

Hydro Ottawa's commitment to a sustainable community was underscored in early 2005 when its own internal environmental management system was certified under ISO 14001. This voluntary compliance means that the company meets or exceeds international standards for managing the impact that its operations have on the local environment.

LETTER TO SHAREHOLDER

Hydro Ottawa further demonstrated its leadership in energy conservation and demand management by joining with five other large electricity distributors in Ontario to form an energy conservation partnership called powerWISE®. Together last year, we collectively invested $19.4 million in innovative and creative projects that saved over 110,600 MWh of electricity, enough to power more than 12,250 Ontario homes.

In Ottawa, more than $2.1 million was spent by Hydro Ottawa on conservation programs in 2005, the successful launch year of our three-year, $9.3 million commitment. Significant progress was made in developing and implementing programs for residential and business consumers. These programs included an initiative that took more than 500 old, energy-wasting fridges out of circulation; Project Porchlight that seeks to replace at least one incandescent bulb in every household with an energy-saving compact fluorescent bulb; and the launch of pilot projects for the provincially-mandated smart meter program.

Among large electricity consumers, we experimented with the concept of reducing their load on the grid during periods of peak demand. In 2005, Energy Ottawa, our green-power subsidiary, piloted the first program in Eastern Ontario that saw two large users, including the City of Ottawa's water purification plant, reduce demand by curtailing their consumption or turning on standby generators.

Ottawa's impact on the grid, reduced through these conservation efforts, was further enhanced when Energy Ottawa's second, completely refurbished generating station at Chaudière Falls, came back on-stream in 2005, increasing to 115,000 MWh the amount of green power the company contributes to the provincial grid every year. Last year also saw work begin on an innovative generating station at the City's Trail Road landfill that will capture the damaging greenhouse gas, methane, and convert it into a further 40,000 MWh annually of green energy.

SUSTAINABILITY IS DRIVEN BY OUR PEOPLE

The close to 600 employees of the Hydro Ottawa group of companies play a valuable role, both in terms of the services we deliver and in the contributions we make to our community.

First and foremost, we are concerned with the safety of our employees and in 2005, our safety record continued to be strong. Hydro Ottawa, our electricity distribution company, was awarded the Electrical and Utilities Safety Association's President's Award for the successful completion of 250,000 hours without a lost-time injury during the second half of 2005. We are committed to a goal of zero injuries by protecting the health and safety of all employees, contractors and visitors and we strive to eliminate all foreseeable hazards that could result in harm to people, the environment, or damage to property.

With more than 50% of the trade group employees in Hydro Ottawa eligible to retire within 10 years, the very sustainability of our workforce has long been a concern to us. In 2005, we launched our first-ever apprenticeship program that will see 40 or more people trained over the next four years as power line maintainers, and other skilled tradespeople, to renew our highly-skilled frontline workforce.

We thank our employees for their tremendous efforts in 2005 and we look forward to continuing our work together to help power Ottawa's future.

SUSTAINABLE COMMUNITIES NEED AN INVOLVED PARTNER

Powering Ottawa's future means more than just providing the electricity and other services our growing city requires. All our companies must also have a sustainable partnership with the community in which we operate, and in 2005 we sought out opportunities where we could provide leadership and demonstrate our social commitment.

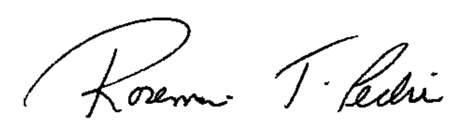
Hydro Ottawa is a founding sponsor of the Ottawa Safe Communities Network which has just received the Children's Hospital of Eastern Ontario's first annual Let's Keep Kids Out of Hospital award for its efforts to promote safety and prevent injuries among children and youth. Hydro Ottawa and its employees raised more than $76,000 for the United Way last year, and every year, many of our employees volunteer their time so that hundreds of physically and mentally challenged children can enjoy their own special day at the Gloucester Fair.

At Telecom Ottawa, an exciting community endeavour was achieved when the first-ever live video feed from a Mount Everest climb was transmitted directly into Ottawa classrooms. The program not only showcased the company's unique broadband capabilities, it also enriched the curriculum for thousands of the city's students who could monitor the Everest campaign of local climbers Shaunna Burke and Ben Webster.

SUSTAINABILITY MEANS WE CAN POWER OTTAWA'S FUTURE

The record of achievements throughout 2005 demonstrate that our companies are properly positioned to sustain the critical role we play in the economic and environmental well-being of our city. Financial and organizational structures have been put in place. Investment plans have been developed and are being implemented. A number of initiatives that were either begun or evaluated in 2005 will allow us to continue providing cost-effective and reliable electricity, new conservation and green power programs and projects, and carrier-class high-speed broadband services.

As our city and our companies look to the future, we will continue to work together with our community partners to power Ottawa's future.



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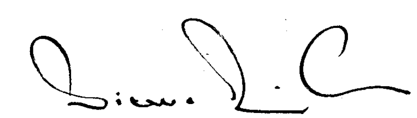


Pierre Richard, Q.C.
Chair, Board of Directors
Hydro Ottawa Holding Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) is intended to provide a review and analysis of Hydro Ottawa Holding Inc.'s results of operations and financial position based upon its Consolidated Financial Statements for the years ended December 31, 2005 and December 31, 2004. All amounts are expressed in Canadian dollars.

BACKGROUND OF THE BUSINESS

Hydro Ottawa Holding Inc. (the Corporation or Hydro Ottawa Holding) wholly owns the following subsidiaries:

- **Hydro Ottawa Limited (Hydro Ottawa or the LDC)** – a regulated electricity Local Distribution company (LDC) that owns and operates distribution infrastructure in the City of Ottawa and the Village of Casselman;
- **Energy Ottawa Inc. (Energy Ottawa)** – a generator of EcoLogo-certified green power and provider of commercial energy management services; and
- **Telecom Ottawa Holding Inc. (Telecom Ottawa)** – a specialized telecommunications carrier that provides broadband and Internet services.

The Corporation is wholly owned by the City of Ottawa (the Shareholder). The Corporation and its three subsidiaries are incorporated under the *Ontario Business Corporations Act*.

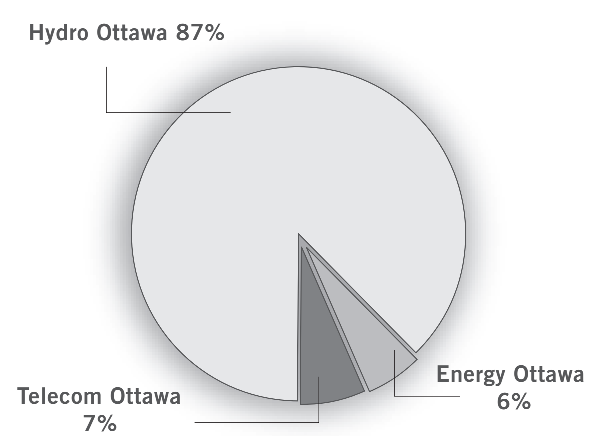
Hydro Ottawa Holding strives to produce a financial return that allows it to reinvest in its businesses and maintain and improve the quality of service provided. The Corporation also seeks to grow and enhance the value of the City of Ottawa's investment on behalf of the residents of Ottawa.

The principal business of the Corporation and its subsidiaries is the distribution of electricity by the LDC, the second-largest municipally-owned electricity distribution company in Ontario. More than 87% of the assets and 96% of the Corporation's revenues are related to the LDC.

The following charts provide a percentage breakdown of the Corporation's capital assets and revenues by subsidiary as at December 31, 2005.

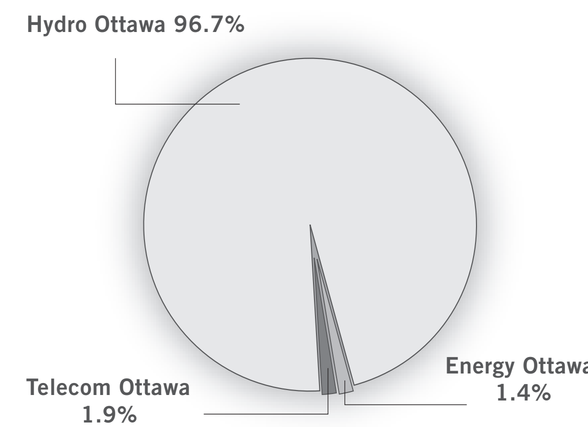
Capital Asset Breakdown by Company (2005)

The LDC is the Corporation's largest subsidiary and principal business.



Revenue Allocation by Company (2005)

More than 96% of the Corporation's revenues are related to the LDC.



Hydro Ottawa derives its revenues primarily from the distribution of electricity from the provincial transmission grid through its local distribution network to local homes, businesses and institutions. Throughout a service area of 1,104 square kilometres in the City of Ottawa and the Village of Casselman, the LDC serves approximately 278,000 residential, business and industrial customers. Approximately 90% of the customer base in the city of Ottawa receives its electricity through the LDC, while the remaining 10% is served by Hydro One Networks, the provincially-owned transmission and distribution company. The rates the LDC charges its customers are regulated by the Ontario Energy Board (OEB). The LDC employs approximately 500 people.

Energy Ottawa owns and operates two, run-of-the-river hydroelectric generating plants on the Ottawa River and provides energy conservation and demand management services. Energy Ottawa generates approximately 115,000 megawatt hours (MWh) of electricity annually that it supplies to the Ontario grid, the equivalent of 1.5% of the total consumption of the city of Ottawa. The company, through its newly incorporated joint venture PowerTrail Inc., is in the process of constructing a gas collection system and generation plant at the Trail Road landfill site in Ottawa. The plant, when completed later in 2006, will convert methane gas into enough electrical power to serve approximately 5,000 homes and reduce greenhouse gas emissions by up to 1.3 million tonnes.

Energy Ottawa's demand management services assist customers in reducing their electricity loads, especially during high- or peak-demand periods. This is accomplished by modernizing commercial building systems so that they are significantly more energy efficient than existing systems.

Energy Ottawa is licensed to generate electricity by the OEB. Its generation revenue is based on the market price of electricity. The company employs eight people.

Telecom Ottawa provides high-speed broadband data and Internet services. Telecom Ottawa operates a 1,000-kilometre, all-optical high-speed data transmission network with a primary focus on municipalities, universities, schools and hospitals (MUSH), other telecommunications carriers and business customers. Telecom Ottawa is a registered facility-based non-dominant carrier with the Canadian Radio-television and Telecommunications Commission (CRTC), and is regulated under the CRTC's authority. Telecom Ottawa employs 58 people.

HYDRO OTTAWA – THE LDC

The Regulatory Environment

Ontario Electricity Market

Over the past few years, the provincial electricity distribution industry has undergone substantial change. In April 1999, the Province of Ontario initiated a restructuring of Ontario's distribution industry that was intended, among other things, to facilitate competition in the generation and sale of electricity, to protect consumers' interests with respect to prices, reliability and quality of electricity service, and to promote economic efficiency in the generation, transmission and distribution of electricity.

On May 1, 2002, the Ontario electricity market was opened to competition at both the wholesale and retail levels by providing generating companies, retailers and consumers with open access to Ontario's transmission and distribution network.

In the new electricity market, all customers initially were billed based on electricity commodity prices established provincially through the competitive bidding process facilitated by the Independent Electricity System Operator (IESO). These spot-market prices changed based on the supply and demand for electricity.

At the opening of the electricity market in 2002, market prices were higher and more volatile than expected. Customers were concerned about high electricity prices and uncertain rates for future electricity delivery. In the fall of 2002, the Ontario government placed a price cap on the commodity for low-volume consumers and other designated customers with the *Electricity Pricing, Conservation and Supply Act, 2002* (Bill 210). High-volume users continued to pay open-market prices. This legislation also froze distribution rates and deemed certain variance accounts held by distributors to be regulatory assets, which are reflected on the balance sheets of LDCs until the OEB determines the manner and timing of their disposition.

Following a change in provincial government, the *Ontario Energy Amendment Act (Electricity Pricing), 2003* (Bill 4) was passed enabling the government to make changes to the commodity price. As a result of this legislation, on April 1, 2004, the capped commodity price changed to an interim pricing plan consisting of a new two-tier price structure.

The interim pricing structure was replaced on April 1, 2005 by the OEB's Regulated Price Plan (RPP) which also consisted of a two-tiered pricing structure of 5.0 cents per kWh for the first 750 kWh consumed each month and 5.8 cents per kWh for any additional consumption. Effective November 1, 2005, the first 750 kWh threshold was increased for residential consumers to 1,000 kWh for the winter and reduced to 600 kWh in the spring of 2006. Consumers who are not eligible for this RPP continue to pay market prices for electricity.

On October 20, 2005, the Ontario government announced that residential and small business electricity consumers, schools, hospitals and others covered by the RPP would receive a one-time credit on their electricity bill to compensate them because moderate weather had resulted in lower-than-expected cost of power in 2004. Hydro Ottawa applied this Ontario Price Credit rebate to the accounts of active customers in December 2005, and issued cheques in early 2006 to customers who no longer had an account with Hydro Ottawa.

The OEB announced on April 12, 2006 that the charge for the electricity commodity on utility bills would increase effective May 1, 2006. For residential customers, the new commodity prices are 5.8 cents for the first 600 kWh from May to October, and the first 1000 kWh from November to April, and 6.7 cents for all remaining consumption.

Electricity Distribution Rates

The Ontario Minister of Energy advised all distributors in December 2003 that they would be permitted to apply to the OEB for the final distribution rate instalment to achieve the maximum allowable return on equity of 9.88%. Approval of rate submissions was contingent on making a commitment to reinvest one year of the incremental funds on Conservation and Demand Management (CDM) programs by September 2007. The LDC received approval of its CDM plan on December 10, 2004. A rate increase was approved by the OEB and subsequently implemented on April 1, 2005 to provide funding for the CDM plan.

The $9.3 million collected through rates from April 2005 to March 2006, will be invested in CDM programs over three years with $2.1 million spent in 2005.

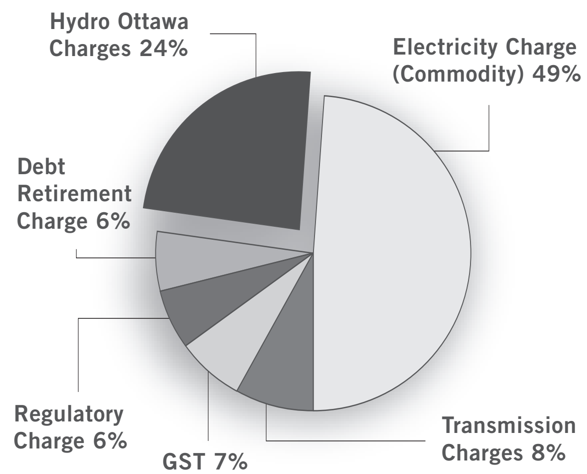
On August 2, 2005, Hydro Ottawa filed with the OEB its Electricity Distribution Rate (EDR) Application based on a forecast of 2006 costs and electricity loads. In addition to the proposed increase to distribution rates, the application sought approval for a decrease in retail transmission rates and final approval to recover all regulatory assets accumulated to December 31, 2004. The OEB approved a revenue requirement for Hydro Ottawa on April 12, 2006 that principally reflected the negotiated settlement with interveners.

The new distribution and transmission rates, effective May 1, 2006, result in an increase of approximately 1.9% on total electricity bills across all customer classes, or $2.67 per month for the average residential customer.

Hydro Ottawa's Residential Customer Electricity Bill

Portion that stays with Hydro Ottawa: 24%
What Hydro Ottawa collects on behalf of others: 76%

The LDC's portion of average customers' monthly bills represents only 24%, the balance being made up of the cost of electricity, regulatory charges and debt retirement relating to the former Ontario Hydro.



The chart above is based on average monthly residential usage in Ottawa of 750 kWh.

Security Deposits

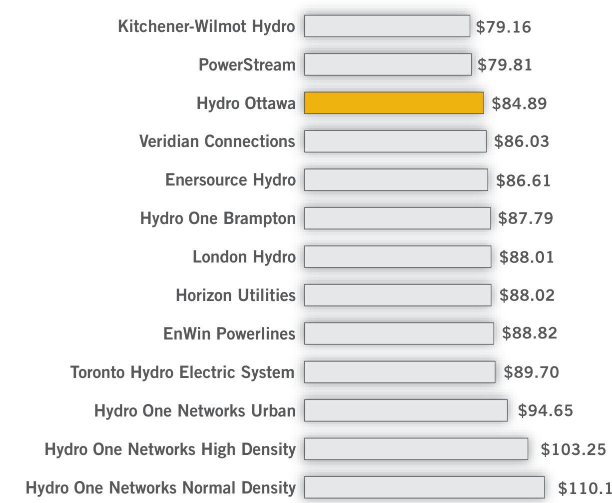
On February 3, 2004, the OEB released amendments to the Distribution System Code (DSC) with respect to consumer security deposits. The DSC sets the maximum consumer security deposits permitted, the length of time that deposits can be held, how consumers can seek exemption for all or part of the deposit and the interest distributors must pay.

The Corporation has decided to collect the maximum deposit permitted by the DSC to reduce the risk of bad debt. This applies both to the distribution rates for which the LDC is responsible and to the flow-through commodity and other charges that are collected on behalf of other electricity organizations. Commencing February 2005, the LDC began repaying customer deposits previously collected in excess of the amount allowed under this new code. During 2005, approximately $3.8 million of the total $14.3 million customer deposits were repaid.

Hydro Ottawa Rates

As of May 1, 2006, the average Hydro Ottawa residential customer using 750 kWh per month pays $84.89 per month.

Residential Bill – 750 kWh/month*



* Based on an annualized threshold for two tier pricing.

The changing face of electricity delivery in Ontario has meant that Hydro Ottawa has had to continually adapt its service delivery model to ensure that it can adapt to the regulated environment, while never losing sight of the customer's requirements. Hydro Ottawa has worked within the regulatory framework outlined by the government to deliver its customers top-quality service at distribution rates that are among the lowest in the province.

2005 ACCOMPLISHMENTS

Hydro Ottawa Holding Inc. – The Corporation

The Corporation provides strategic direction to its subsidiaries on matters of business development, financing and risk management. Hydro Ottawa Holding also ensures that its group of companies abide by the regulations set by the province and the Affiliate Relationships Code issued by the OEB.

In 2005, the organization implemented new corporate governance policies and procedures, including a code of conduct and conflict of interest guidelines, based on best practices. Further improvements to the Corporation's governance will be implemented by July 1, 2006 to comply with OEB requirements for a new board structure.

Hydro Ottawa Holding completed the organization's first bond placement in 2005 and secured a revolving credit facility, while maintaining the Corporation's A- level credit ratings. The Corporation's financial position and consolidated earnings generated in 2005 enabled the payment of a $12 million dividend in April 2006 to its shareholder.

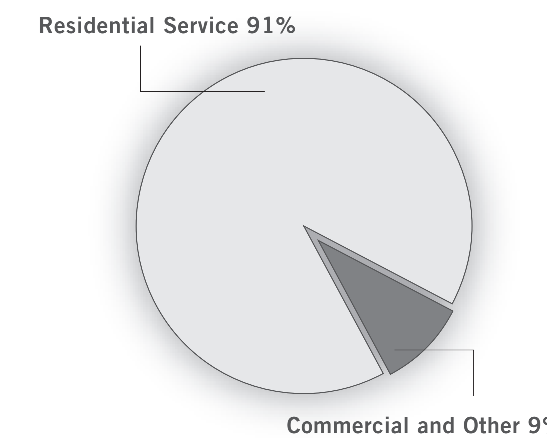
Hydro Ottawa – The LDC

The LDC's business involves buying, transforming and distributing electricity. It buys the electricity from the Independent Electricity System Operator (IESO) at wholesale market rates. The electricity typically is received at transformer stations owned and maintained by Hydro One. The LDC then transforms that electricity to primary distribution voltages at its own substations. From there, power is delivered to customers using a network of overhead lines and underground cables.

The LDC had total assets of approximately $571 million as at December 31, 2005, including about $410 million of capital assets. Distribution system assets consist of 85 distribution substations and approximately 38,000 distribution

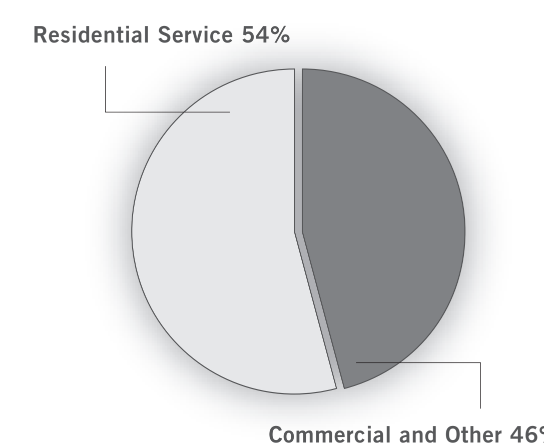
Total Number of Customers by Type (2005)

More than 90% of the LDC's customers are residential. The largest single customer is the federal government.



Distribution Revenue (2005)

Although Commercial and Other represent only 9% of the customer base they generate 46% of the revenue.



transformers. The LDC distributes electricity utilizing 3,000 km of overhead lines, 1,900 km of underground cable and 71,000 poles.

The customers' electricity consumption for the year ended December 31, 2005, net of line loss, totalled 7,663,200 MWh.

System reliability. The LDC recently completed its 2005 Asset Management Plan (AMP), which provides a picture of the asset-inspection, maintenance, replacement and refurbishment programs needed to sustain its distribution systems, and covers 99% of the utility distribution assets by value. The plan prescribes asset-replacement schedules based on condition and risk assessment, with consideration given to financial, resource and technical issues.

From a reliability point of view, the LDC has been very successful to date in dealing with asset management. The AMP provides current and future direction for investments in infrastructure to ensure continued reliability performance. As part of the overall AMP strategy, Hydro Ottawa has been working since 2003 on various technological initiatives to better manage its electrical distribution assets. The technology is being delivered in distinct phases.

Reliability Statistics (2005) (in hours)

	2005 Year End Results	OEB Standard
System Average Interruption Frequency Index (SAIFI)	0.74	0.75
System Average Interruption Duration Index (SAIDI)	0.97	0.97

In the first phase, an OMS (Outage Management System) was implemented. This system has greatly reduced the effort required to pinpoint locations of power outages. The second phase relates to the Geographical Information System (GIS) computerized mapping system which requires the conversion of thousands of graphic and database records of the electrical network assets from the six former utilities into one digital standard. Completion of the data conversion is expected by December 2006. The final phase resulting in the integration of GIS data with the OMS and Supervisor Control And Data Acquisition (SCADA) system will allow Hydro Ottawa staff to quickly determine how many and which customers are affected by outages and where the most probable cause of an event is located.

Account and System Management. The Ontario Price Credit applied to customer accounts at year-end greatly reduced the LDC's aged arrears and bad debts provision. In addition, the LDC prioritized its collection agency referral process in the fourth quarter of 2005, which should help reduce bad debts expense.

Full Rate of Return. The LDC spent considerable time and effort to ensure that the 2006 Rate Application process was completed on a timely and accurate basis. The LDC was one of only three Corporations to proactively change to a forward test year as this helps ensure revenues are more closely aligned with the true cost of providing distribution services. A nine percent return on equity for the LDC was approved April 12, 2006, as part of a distribution rate increase effective May 1, 2006.

Operational efficiency. Hydro Ottawa must train and maintain a well-qualified, sustainable workforce that not only can address the customer's electricity demands but can also ensure that the service they receive is of the utmost quality. With many of the organization's skilled tradespeople who hold leadership positions retiring within 10 years, the company recognizes the need to develop and retain core competencies to meet future needs. The Power Line Maintainer, Cable Jointer, Electrician and Operator demographics are such that in five years, a large number of these skilled tradespeople will begin leaving the workforce. In addition, most of the trades' supervisors and coordinators will be eligible for retirement. An apprenticeship program was developed and implemented in 2005 to address present and future resource requirements.

In the fall 2005, Hydro Ottawa's management and the International Brotherhood of Electrical Workers (IBEW) local 636 (the Union) initiated a Joint Cultural Change program to improve labour relations. The cultural change initiative is aimed at changing the current position based approach to labour relations to a more collaborative problem solving one that has a longer-term focus on what the parties would like the future to be.

Significant operational efficiencies were also implemented over the management of inventory including planned disposal of obsolete material and progressive efforts to acquire material on a just-in-time basis.

Safety and environment. Maintaining an electricity distribution system poses a variety of risks centered around the hands-on work that must be done every day. The safety of Hydro Ottawa's people is and must be a daily priority. Across Canada, Hydro Ottawa ranks in the top 10 of electricity distributors of comparable size in all areas of safety performance that are routinely benchmarked.

On the environmental front, the LDC maintains its status under ISO 14001 in good standing.

The LDC's pairing of operational efficiency with environmental sustainability will continue to ensure exceptional quality of service for now and the future.

Growing customer base. The LDC delivers dependable and affordable electricity to an increasing number of customers. The city of Ottawa continues to grow steadily, adding about 4,000 new residential customers each year. Hydro Ottawa exceeds all of the OEB service quality

indicators to connect new customers and respond to its customers (in 2005 there were on average 1,362 calls per day). The organization does not stop there, focusing on providing additional services online and continually making improvements in customer service. Hydro Ottawa also provides conservation and money saving information to customers through the LDC's extensive CDM programs and provides assistance to low-income earners through support of the Winter Warmth Fund in partnership with the United Way.

OEB Service Quality Indicators (2005)

All 2005 Service Quality Indicators were better than the OEB Standard.

Service Quality Indicator	2005	OEB Standard
New Low-voltage service connections % completed ≤5 days	98%	90%
New High-voltage service connections % completed ≤10 days	100%	90%
Underground cable locates % completed ≤5 days	91%	90%
Emergency Response % response ≤60 minutes	98%	80%

Conservation leadership. The LDC collected $9.3 million through the incremental rate increase from April 2005 to March 2006, an amount it must spend on approved CDM projects. The Corporation spent $2.1 million in 2005 through the participation in, or implemention of, new CDM programs such as the retail coupon campaign, the Fridge Bounty, Project Porchlight and powerWISE® Electric Avenue Program.

Hydro Ottawa's Fridge Bounty Program was launched in June 2005. The goal was to remove 500 refrigerators from area homes over a 16-week period. It took only two months to reach this target. By the end of May 2006, 1,500 old, inefficient refrigerators had been removed from customer homes saving 1.7 MWh per year – enough to power 200 homes for a year. Response to this program was so overwhelming that Hydro Ottawa expanded it to include old energy-wasting freezers as well. Due to its initial success and overwhelming participation, Hydro Ottawa has decided to run the program until December 31, 2006 or until 1,000 freezers and an additional 1,000 refrigerators have been recovered.

Project Porchlight was another first for Hydro Ottawa, one of the founding sponsors. The Project's overall goal is to bring together volunteer groups and community businesses to deliver one free energy efficient compact fluorescent light bulb to every household in Canada. The premise is that if every household nation-wide replaces just one regular light bulb with a compact fluorescent bulb, the reduction in pollution would be the equivalent of taking 66,000 cars off the road. So far, a total of 25,000 light bulbs have been distributed in Ottawa South representing enough electricity saved to power 250 homes.

Hydro Ottawa's conservation programs are also being developed in conjunction with powerWISE® – a conservation initiative among six of Ontario's largest electricity distribution companies to promote energy conservation to consumers and to reduce the demand for electricity. Collectively, the group invested $19.4 million in CDM initiatives in 2005, resulting in 110.6 million kWh of electricity savings, enough power to supply over 12,250 homes.

Hydro Ottawa also conducted a pilot program for residential smart meters in the second half of 2005 to assess the customer experience related to time-of-use electricity information, communications technology required, and metering aspects.

The pilot program saw approximately 200 smart meters installed during 2005. Participants were mailed a monthly report indicating their daily usage during the three different rate periods and were provided a comparison between the charge for the smart meter and conventional non time-of-use rates. A web-based service was provided to the participants which allowed them to see their per hour usage by 8 am the following day.

This program supports the Minister of Energy's newly enacted legislation, the *Energy Conservation Responsibility Act, 2005* introduced on November 3, 2005 which requires the installation of smart meters in all homes and small businesses by 2010, with 800,000 to be installed across Ontario by the end of 2007, 130,000 of these in Hydro Ottawa's service area. LDC's including Hydro Ottawa, will own, install, operate and maintain the meters.

Energy Ottawa

Energy Ottawa is first and foremost a green power generator. Its core business is the production of renewable energy through the acquisition, development and operation of power plants. In addition, Energy Ottawa provides commercial energy management services such as energy audits and the resulting implementation measures, and is involved in a demand response program that has as its objective reducing electricity at peak demand periods.

Green generation – hydroelectric. Energy Ottawa, upon completion of its refurbishment of Generating Station #4 in March 2005, was successful in obtaining Tier III EcoLogo certification for the plant's entire output. This certification, which allows the green attributes from the company's full output to qualify for a Public Works and Government Services Canada contract secured in 2004, allowed Energy Ottawa to maximize its 2005 revenues.

Green generation – methane gas conversion. On November 3, 2005, Energy Ottawa entered into a joint venture arrangement with Integrated Gas Recovery Systems Inc. (IGRS) of Thorold, Ontario. The joint venture, operating as PowerTrail Inc., was created to construct and operate the landfill gas-collection system and generating plant at the Trail Road landfill site in Ottawa.

Demand response pilot. In 2005, Energy Ottawa was selected as one of five participants to take part in an IESO-initiated demand response pilot program called the Transitional Demand Response Program. The objective of the two-year pilot is to evaluate the Ontario market's demand-response capability and infrastructure. The specific purpose of the pilot is to kick-start demand responsiveness in Ontario by working to overcome barriers that are currently preventing some Ontario loads from being responsive to wholesale market price signals. The ability to shed electricity demand has been coined Negawatts, reflecting that every kilowatt-hour that is not consumed is one less kilowatt-hour that needs to be generated. Should the pilot program prove successful, Energy Ottawa will be well positioned to be an active participant in the demand-response market.

Telecom Ottawa

Telecom Ottawa provides broadband data and Internet services to public sector organizations and businesses in the national capital region and across eastern Ontario. The company owns and operates a state-of-the-art 10 Gigabit Ethernet network with more than 1,000 kilometres of fibre optic cable. Its core business is the provision of reliable broadband services to organizations in the MUSH sector.

Core network. The company met its core network availability and reliability goals in 2005 with core network availability of 99.97% and on-time service delivery of 90%.

Growth. Telecom Ottawa continued to expand its fibre network both on- and off-net. Seventy-three new fibre route kilometres were installed and the company expanded its fibre-based services in 62 of its on-net buildings.

Throughout 2005, Telecom Ottawa aggressively pursued its strategy to sell large-scale services to the federal government. In July 2005, Telecom Ottawa became an eligible competitor to provide information technology to agencies, boards or clients based on its qualification under the Canadian government's Converged Network Services (CNS) Supply Arrangement.

Throughout 2005, Telecom Ottawa focused on partnering to provide value-added services [i.e. data backup and recovery, and Voice-over-Internet Protocol (VoIP)], and the capability to deliver a new suite of Synchronous Optical Network (SONET), wavelength division multiplexing (WDM) and storage extension services.

2005 PERFORMANCE

The Corporation made great strides in achieving its business objectives in the 2005 fiscal year by continually improving the quality of service to the customers in its service area, and demonstrating an ongoing dedication to the environment, positive financial results and operational profitability.

Revenue

Revenue is earned from:

- growth-related electricity consumption;
- distribution of electricity;
- growth-related installation contracts for others;
- power generation;
- communication services; and
- fibre-based connectivity products.

Consolidated revenue in 2005 increased by $91.7 million.

Revenue (2003-2005) Consolidated Financial Results

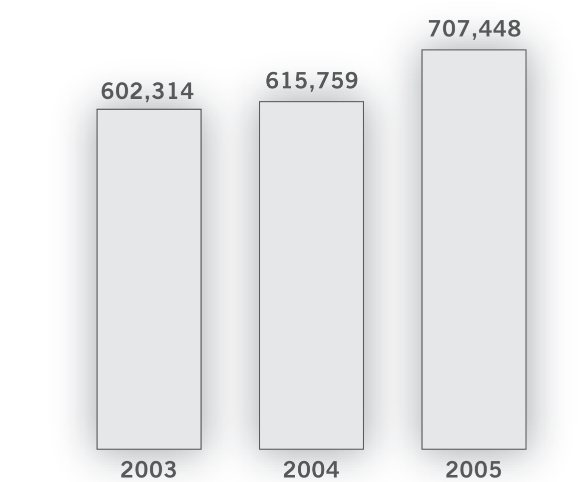
Operating Data	2005	2004	2003 ($ thousands)
Total Revenues*	707,448	615,759	602,314
Net Earnings from Continuing Operations	22,086	16,013	1,108
Net Earnings	22,565	19,700	2,599
Retained Earnings (Deficit)	25,369	2,804	(16,896)
Balance Sheet Data			
Total Assets	633,819	587,909	547,244
Net Regulatory Assets	6,610	5,469	5,820
Non-current Liabilities	231,517	17,764	257,565
Shareholder's Equity	253,822	231,257	173,732

*Approximately 83% is a flow-through recovery of power purchased on behalf of Hydro Ottawa customers.

Hydro Ottawa's flow-through power recovery revenue and purchased power expense increased by $84.4 million primarily due to the increase in the two-tiered commodity pricing rates, higher average spot-market prices for the year and a 1.7% increase in its customer base. The net purchased power increase of $81.4 million represents $84.4 million flow-through cost, less the net of Energy Ottawa's increased electricity sales of $3.0 million. Energy Ottawa's increase resulted from a spot market increase of 1.8 cents over the prior year and additional production as Generating Station #4, which had been shut down for a six-month refurbishment in 2004, was fully operational as of March 5, 2005.

Revenue (2003-2005) ($ thousands)

Revenue continues to grow with the population and business growth in the Ottawa area.



Electricity distribution sales increased by $5.2 million, $2.4 million related to customer growth and weather-related consumption factors, $2.1 million related to the recognition of CDM revenue for expenditures made during the year and $0.7 million related to amendments to the amounts for payment in lieu of taxes (PILs).

Other revenue increased by $2.1 million reflecting a full year of green premiums received on Energy Ottawa's EcoLogo-certified production, as compared to only eight months of revenue in the prior year.

Expenses

Operating, maintenance and administration expenses over the year were slightly higher than the previous year mainly as the result of the following significant changes:

- increased spending of $1.4 million on CDM programs;
- return to normal maintenance costs, since the prior year's results were impacted by the seven-week labour disruption and the six-month shut down of Generating Station #4, reducing costs by approximately $1.6 million;
- increased compensation expense due to negotiated and economic salary increases;
- decreased pension costs of $0.9 million, given OEB approval to set up a deferral account for the increase in Ontario Municipal Employees Retirement System (OMERS) contributions, until such time as approved in future rates; and
- reduced recoverable work expenses of $2.6 million, mainly related to reduction in street-lighting work.

Transition costs are specific regulatory assets representing costs incurred to prepare for the opening of the electricity market of which the LDC recovered $1.8 million through its 2005 rates.

Amortization increased by $4.5 million mainly due to increased capital spending by all operating companies in recent years, and in particular on general plant that is subject to much shorter amortization periods. General plant includes facilities, vehicles, furniture, equipment, and computer hardware and software.

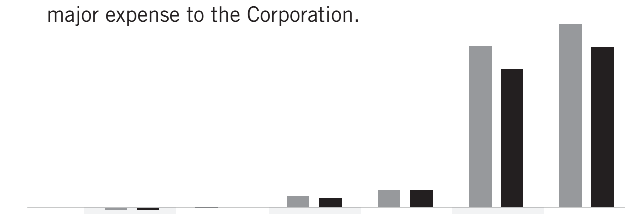
Net recovery of the provision for regulatory assets decreased $2.1 million from the previous year. Large power variances of approximately $3.3 million, predominantly due to imported power not recovered from customers by year-end, were provisioned. Offsetting this amount was a recovery through rates of amounts previously provisioned in the amount of $1.2 million.

Other expenses

Other expenses decreased by $4 million mainly due to a reduction in interest expense as a result of converting $32.8 million of shareholder debt outstanding at December 31, 2004 into equity and reducing the interest rate paid on long-term debt from 6.9% to 4.93% by accessing private markets. (See notes 8 and 10 of the December 31, 2005 consolidated financial statements.)

Expenses ($ thousands)

The flow through costs of purchased power represents the major expense to the Corporation.



	Recovery of regulatory assets	Restructuring costs	Amortization of capital and intangible assets	Operating, maintenance and administration	Purchased power	Total
2004	(7,928)	851	29,760	54,677	503,749	581,109
2005	(7,618)	–	34,219	55,943	585,175	667,719

Payment in Lieu of Taxes (PILs)

The Corporation's effective income tax rate was 16.67% in 2005 compared to 9.1% in 2004. During 2005, the LDC's 2005 taxable income exceeded its loss carry forwards and therefore for the first time incurred PILs based on taxable income. PILs related to large Corporations and alternative minimum taxes that are not based on income were consistent with the previous year.

Discontinued Operations

The final favourable resolution of the contingent closing criteria on the sale of Energy Ottawa's water heater rental business, which was sold in November 2004, resulted in a $0.5 million gain on disposal net of tax in 2005.

Net Earnings

Net earnings from consolidated operations increased by $2.9 million from $19.7 million to $22.6 million, primarily due to increased consumption and growth in distribution revenue and decreases in interest expense, offset by increased amortization and taxes.

Assets

Total assets increased by $45.9 million mainly due to a $30.1 million net increase in capital assets and a $15.1 million increase in unbilled revenue.

- Accounts receivable decreased by $1.6 million due to Ontario Price Credit rebates applied to customer accounts at year-end, and lower receivables for work done for others, offset by increased commodity prices and customer growth.
- Unbilled revenue increased by $15.1 million mainly due to an increase in the two-tiered flow-through commodity pricing rate and a spot market price that was 61% higher than in December 2004, offset by reductions in unbilled amounts due to a more efficient billing process.
- Inventory decreased by $1.9 million, primarily due to the sale of the street-lighting business inventory, as well as continued focus on reducing the carrying levels of inventory and just-in-time site delivery.
- Net regulatory assets increased by $1.1 million. The primary reason for the increase was the continued deferral of OEB incremental cost assessment fees and starting in 2005, the deferral of a portion of the Corporation's OMERS pension expense. (See notes 2 and 5 of the December 31, 2005 consolidated financial statements.)
- The net capital assets increase of $30.1 million primarily resulted from capital asset acquisitions of $85.5 million net of contributions in aid of construction of $21.4 million, and reduced by amortization of $34.2 million. (See further detail under Liquidity and Capital Resources.)
- Other assets have increased by $2.6 million due largely to the long-term debt and credit facility restructuring costs, which have been deferred and are being amortized over the remaining term of the associated debt. In addition, a deposit of $1.0 million was made on generation equipment to be delivered in 2006.

Liabilities

Total liabilities increased by $23.3 million. Excluding the $200 million of debt converted from short-term to long-term, current liabilities increased by $9.6 million and long-term liabilities increased by $13.7 million.

Short-term

- Bank indebtedness and banker's acceptances decreased by $18.8 million mainly due to rebate monies received for the Ontario Price Credit that were applied to customers' accounts in December 2005 reducing cash receipts from customers during the next billing period in early 2006.
- Accounts payable and accrued liabilities increased by $29.3 million as a result of the following:
  - a $19.5 million increase largely due to amounts owing to customers as a result of the Ontario Price Credit rebates being applied to customer accounts just prior to year-end;
  - an $8.9 million increase in cost of power due to increased commodity prices and number of customers;
  - a $4.1 million increase in deferred revenue due to recovering CDM revenue in excess of amounts spent during the year that are to be expended during 2006;
  - a $3.9 million increase in interest accrued on notes payable paid February 9, 2006;
  - a $6.1 million decrease in customer deposits mainly due to $3.8 million of the deposits being repaid in accordance with the LDC's revised "Conditions of Service," which includes collection of the maximum security deposit as permitted by the OEB, as well, current deposits were reclassified to long-term to better reflect experience with Hydro Ottawa's new deposit requirements; and
  - a $1.0 million reduction in other liabilities.

Long-term

- Net regulatory liabilities increased $6.7 million due to $4.8 million of Global Adjustment credits received by the LDC from the IESO that had not yet been passed on to customers by year end through the provincial benefit and a further $1.9 million over-collection of transmission costs recovered as a fixed charge from customers.
- Deferred revenue of $1.6 million was recorded representing the recovery of the amount to be spent on CDM in 2007 received through rates from customers in 2005.
- Future income tax liability increased $1.5 million due to Energy Ottawa's temporary differences between the tax basis of assets and liabilities and their carrying amounts.

MANAGEMENT'S DISCUSSION AND ANALYSIS

- Customer deposits increased by $2.8 million, largely due to the reclassification of deposits from short-term, discussed above.

Liquidity and capital resources

Liquidity

The table below shows the debt and liquidity profile of the Corporation as of December 31, 2005 and 2004.

		(In $ millions)
	December 31, 2005	**December 31, 2004**
Debt:		
Notes payable	200.4	200.0
Available credit facilities:		
Revolving term credit facility	150.0	153.0
Operating credit facility	24.9	-
Credit facilities used:		
Bankers acceptances and loans*	10.0	27.4
Letters of credit	22.4	22.5
Liquidity:		
Undrawn bank facilities*	142.5	103.1

*excludes overdraft caused by outstanding cheques

Sources of liquidity

The Corporation's primary sources of liquidity were derived from cash provided by operating activities, banking facilities and debenture proceeds. As at December 31, 2005, the Corporation had $142.5 million of its credit facilities available. Existing financing arrangements are adequate to cover 2006 operations. Renegotiation of the revolving term credit facility will be undertaken for the start of 2007 to increase interim financing until further debentures are issued in the market, anticipated for 2009.

Cash provided by operating activities for the year ended December 31, 2005 was $87.6 million. Net earnings from continuing operations provided $22.1 million of this amount, while non-cash adjustments for amortization and other items mainly related to capital assets accounted for $36.3 million. Cash provided by the working capital decrease of $29.3 million was due mainly to increased accounts payable resulting from the Ontario Price Credit rebates due to customers and to the higher cost of power.

Cash used in financing activities during the year was $1.1 million. $18.8 million was used to repay previous outstanding bank indebtedness, $2.6 million was spent on net debt restructuring costs and a $2-million adjustment was made to long-term customer deposits to better reflect experience with Hydro Ottawa's new deposit requirements. Contributions in aid of construction of $21.4 million, which were much higher than in 2004, mostly as a result of the delays in project closures during the labour disruption, provided the majority of the cash flow from financing activities.

Cash used in investing activities amounted to $86.4 million. The major investment related to the LDC's capital acquisitions of $77.9 million for distribution and general plant, which were higher than in the previous year due to the slowdown in activity as a result of the labour disruption in 2004. The LDC spent $24.7 million on reliability capital on the distribution system including transmission lines, poles, underground cables, and transformer stations for general growth and replacement of aging infrastructure; $30.2 million on demand projects that are normally non-discretionary and driven by new customers being added to the system, city projects impacting the distribution system, and regulatory compliance; $22.3 million on general plant such as the modernization of the control room, CIS and GIS computer programs and Albion, Bank, Maple Grove and Merivale facilities; and $0.7 million on CDM out of the $2.1 million total spend.

The remaining capital of $8.5 million is invested in energy generation and telecommunications to support new customer contracts and is related primarily to expenditures on the refurbishment of Generating Station #4, a deposit on equipment for the Trail Road facility to be delivered in 2006, reliability capital, fibre laterals and backbone projects for specific customer builds.

Financing Facilities. On January 6, 2005, the Corporation arranged a new credit facility in the amount of $350 million. The new facility consisted of two elements: a $150 million, three-year, extendible, revolving loan facility and a $200 million 364-day bridge facility. The bridge facility was not renewed.

An additional credit facility for approximately $47 million to coincide with and facilitate the termination of the previous $153 million credit facility was also arranged in 2005. This facility expired on May 31, 2006 and is in the process of being renewed, subject to a reduction in the amount available for standby letters of credit. (See note 8 of the December 31, 2005 consolidated financial statements.)

On February 9, 2005, the Corporation issued $200 million of senior unsecured debentures, bearing interest at 4.93%. These bonds are rated as follows:

Agency	Credit Rating
Standard & Poor's Rating Services Inc.	**A-**
Dominion Bond Rating Service Inc. (DBRS)	**A (low)**

These bonds have customary covenants normally associated with this type of debt. (See note 10 of the December 31, 2005 consolidated financial statements.) Since the time of the issue, the Corporation has been in compliance with all of the covenants.

Standard & Poor's and DBRS reconfirmed the Corporation's A- level credit ratings.

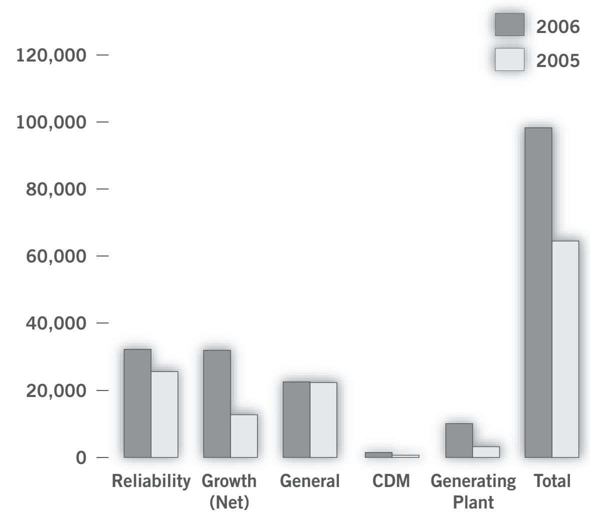
Capital expenditures and other cash requirements

Other cash requirements

The LDC utilized all of its tax loss-carry forwards during 2005 and consequently it expects a $12 million increase in its PILs payments for subsequent years.

2005 Actual and 2006 Planned Capital Expenditures ($ thousands)

The Corporation requires increasing expenditure in its distribution infrastructure.



In August 2004, the City of Ottawa approved the Corporation's dividend policy with a targeted payout ratio equal to 60% of consolidated net income. The first dividend payment of $12 million was made on April 18, 2006 after the Corporation met the solvency and liquidity tests as set out in the *Ontario Business Corporations Act*.

Draft environmental regulatory requirements related to the destruction of PCBs in distribution transformers and other clean-up related to PCBs could result in approximately $11 million being spent over a four-year period from 2006 to 2009. The LDC anticipates spending approximately $5 million in 2006, which has been included in its 2006 budget.

The OMERS pension fund currently has a significant unfunded liability. The main reason for the deficit was the poor equities market performance in 2001 and 2002 and declining interest rates. Contributions from employees and employers have increased to help mitigate the risk. The Corporation represents approximately 0.15% of the OMERS membership. Changes to contributions requirements are not anticipated to have a significant impact on the Corporation's cash requirements.

Energy Ottawa and Telecom Ottawa do not anticipate any future annual cash requirements related to operations or financing activities beyond their capital requirements.

Cash management

The Corporation's capital asset program is flexible enough to permit curtailment of spending to ensure adequate cash resources exist to sustain operations.

Commitments and contractual obligations

These are discussed in note 18 to the December 31, 2005 consolidated financial statements.

Off-Balance Sheet Arrangements are discussed in non-monetary transactions, note 2 to the December 31, 2005 consolidated financial statements.

Enterprise Risk Management

The Corporation's Enterprise Risk Management (ERM) program was strengthened in 2005 with the establishment of a dedicated senior position to manage the program. The Director, ERM, is responsible for developing and implementing an integrated risk management methodology for Hydro Ottawa Holding and its subsidiaries. Working closely with the Board, the President and Chief Executive Officer and executive team, the Director, ERM, will help promote a culture and build processes to keep the enterprise risk focused at all levels of the organization. The Corporation's vision is to integrate ERM into business processes as a discipline, which will enable effective identification and timely management of factors which could impede achievement of corporate goals and objectives.

Consolidated Financial Results

Contractual Obligations	Payments for years ending December 31					($ thousands)	
	Total	2006	2007	2008	2009	2010	2011
Current Purchased Service Commitments*	7,400	7,400	-	-	-	-	-
Long Term Purchased Service Commitments	16,418	3,200	3,259	3,199	3,311	3,449	-
Interest on Notes Payable	59,160	9,860	9,860	9,860	9,860	9,860	9,860
Operating Leases	2,078	724	350	314	285	80	325
Total Contractual Obligations (1)	85,056	21,184	13,469	13,373	13,456	13,389	10,185

* It is anticipated that each year, commitments of a comparable amount will be negotiated.

(1) Excludes long-term liabilities presented on the balance sheet that have no fixed obligation for payment, including net regulatory liabilities, employee future benefits and long-term customer deposits.

The Board monitors the ERM framework, reviews the Corporation's risk tolerances, risk profile and the status of its internal control framework. While the Corporation's President and Chief Executive Officer has ultimate accountability for risk management, the Chief Executive Officers of its subsidiary companies provide senior management oversight of risk within their respective companies. Each is required to complete a formal risk assessment and develop and implement risk mitigation strategies.

Risks and uncertainties

The financial performance of the Corporation is subject to the risks and uncertainties described below.

Regulatory uncertainty

The continuing restructuring of Ontario's electricity industry and other regulatory developments may affect the distribution rates that the LDC may charge and the costs that the LDC may recover. While the LDC's rates for 2006 were set based on a 2006 forecast cost of service, the OEB will be establishing new performance-based rate-setting mechanisms for future years. This may result in some future costs not being recovered through rates, which would have a negative impact on the company's financial performance.

Costs to the LDC associated with regulatory changes may not be recovered through rate adjustments, either on a timely basis or at all. The LDC will continue to seek approval from the OEB for the recapture of expenses directly incurred as a result of restructuring and/or new regulations.

Potential new requirements for local distribution companies to support CDM programs may not be accompanied by rate changes that allow for the recovery of costs and revenue lost that may be incurred from implementing such programs. Although the Corporation's CDM program and its funding have received final approval from the OEB, there continues to be regulatory risk associated with the Province's proposed smart meter initiative until final guidelines are established.

The recovery of deferral and variance accounts established in 2005 is contingent on approval by the OEB and therefore is not certain.

Energy supply risk

Electricity is a commodity that cannot be stored. All energy in Ontario is exchanged through the IESO, and therefore all energy requirements are met through purchases from the IESO. Energy supply risk exists as a result of potential physical unavailability of electrical energy. In the event demand outstrips supply, the service area could be subject to rotating load curtailments or, in the worst case, a complete blackout of power.

Commodity risk

Energy Ottawa is exposed to the spot price for the electricity commodity in the Ontario wholesale market administered by the IESO. To mitigate this risk the company obtains external pricing forecasts and may engage in hedging this commodity using fixed price contracts. To date, however, no commodity hedges have been entered into. A contract with the Government of Canada pays a premium for green energy, which helps to mitigate some of the exposure to movement in spot market prices.

Long-term energy projects

Energy Ottawa bears a risk related to the premature termination of the green attributes contract by the Government of Canada under the termination-for-convenience provision of the contract. This provision allows the Government of Canada, for any reason other than default, to terminate the contract at any time, although it must reimburse Energy Ottawa for costs that have been reasonably and properly incurred for purposes of performing the contract plus a fair and reasonable profit thereon.

Weather

Severe weather can greatly affect results by increasing the LDC's maintenance expenses as equipment must be repaired and overtime incurred to restore service and ensure the continuing reliability of the distribution system. It can also have a direct impact on customer hydro usage and therefore expected distribution revenue; and affect the amount of electricity produced by Energy Ottawa based upon available water flows, thereby affecting revenues and cash flows.

Aging infrastructure

An Asset Management Plan for the LDC's distribution infrastructure has been developed to maintain reliable service to the Corporation's customers at an optimized cost. This will assist in managing costs to maintain the distribution system throughout its lifecycle.

Credit risk

The LDC is subject to credit risk with respect to customer non-payment. The LDC is responsible for collecting the distribution, transmission, wholesale market services and energy portions of the electricity bill and is exposed to credit risk on the non-payment of these amounts. The LDC is permitted to mitigate the risk of customer non-payment using any means permitted by law, including requiring deposits and other forms of security, charging interest and penalties on late payment and terminating service to delinquent customers. On February 3, 2004, the OEB released amendments to the Distribution System Code with respect to customer security deposits that reduced the amounts allowed to be held. The LDC has adopted a policy to collect the maximum customer security deposit as permitted by the OEB, to mitigate this risk. Credit risk is discussed in note 2 to the December 31, 2005 consolidated financial statements.

Interest rate risk

The Corporation is exposed to fluctuations in interest rates on its short-term borrowings, but has mitigated interest rate risk by locking in long-term debt at a fixed interest rate.

Critical accounting estimates

The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the period, the reported amounts of assets and liabilities, and the disclosure of commitments and contingencies at the date of the financial statements. These estimates are based on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances. Because these estimates involve varying degrees of judgment and uncertainty, the amounts currently reported in the financial statements could, in future, prove to be inaccurate.

The following accounting estimates require management's more significant judgments and estimation in the preparation of financial statements and as such, are considered to be critical.

Regulatory Asset Provision Recovery – The regulatory asset provision recovery is discussed in note 5 to the December 31, 2005 consolidated financial statements.

Employee Future Benefits – The employee future benefits are discussed in note 11 to the December 31, 2005 consolidated financial statements.

Allowance for Doubtful Accounts – The financial statements contain an estimate of bad debt losses arising from uncollectible accounts receivable calculated based on a combination of reviewing specific accounts and taking a specific percentage of balances over 90 days. As a result, the allowance could materially change from period to period based on the composition of accounts receivable. The allowance for doubtful accounts at December 31, 2005 is less than 1% (2004 – less than 1%) of annual revenues.

Customer Deposits – The customer deposits are discussed in note 2 to the December 31, 2005 consolidated financial statements.

Unbilled Revenue – Management establishes period-ending unbilled revenue balances based upon management's estimate of customer electricity consumption up to the end of the period. Customer consumption estimates include instances where the meter reading is not scheduled to take place until the next period. This requires management to make an estimate based on historical usage. In addition, consumption estimates are also necessary when meter readings are not available at the end of a financial reporting period.

Allocation of Overhead Costs – Management uses estimates and its judgment in the allocation of overhead costs. The Corporation uses a comprehensive cost allocation model. This model allocates actual indirect costs across all work types using various identifiable metrics based on historical experience and management's judgment.

Amortization – The estimated useful life for major asset categories is set out in note 2 to the December 31, 2005 consolidated financial statements and is on average approximately 20 to 25 years.

Emerging Accounting Pronouncements

Canadian Accounting Standards Board's Strategic Plan

On January 10, 2006, the Canadian Accounting Standards Board (AcSB) ratified a new strategic plan that will significantly affect the way financial reporting will be carried out in Canada. The plan entails converging Canadian GAAP with International Financial Reporting Standards over an expected five-year transitional period. The AcSB will develop and publish a detailed implementation plan for achieving convergence later in 2006. At this time there is no formal implementation plan and it is difficult to determine the impact this will have on the Corporation. Due to the complexity of implementing this new accounting framework, consideration is being given to what implementation steps will be required to meet this change.

Accounting for Rate Regulated Operations

The AcSB of the Canadian Institute of Chartered Accountants (CICA) has an active project to review GAAP applicable to enterprises with rate-regulated operations. The first phase resulted in the issue of Accounting Guideline AcG-19, ***Disclosures*** by Entities ***Subject to Rate Regulation***. The Corporation's 2005 disclosures reflect these new requirements. In the second phase of its project, the AcSB plans to review whether regulatory accounting treatments, which are commonly applied throughout the industry, meet the definition of an asset or liability as defined by CICA Handbook Section 1000 "Financial Statement Concepts." If the AcSB concludes that they do not, the Corporation would be required to discontinue the application of rate-regulated accounting. Specifically, the Corporation would no longer be able to recognize its net regulatory assets and liabilities, which amounted to $6.6 million and $16.3 million, respectively at December 31, 2005. As well, the Corporation may be required to account for payments in lieu of corporate income taxes related to its regulated business on a liability basis. The net effect of these changes would be charged to either retained earnings or the results of operations once the new accounting standard is in effect, depending on the transition rules. At this time, it is uncertain what decision the AcSB will reach, however, it is not believed that the outcome of the CICA project will have a materially adverse financial impact on the Corporation.

Accounting for Conditional Asset Retirement Obligations

In December 2005, the Emerging Issues Committee (EIC) of the CICA issued EIC-159, *Conditional Asset Retirement Obligations*. This pronouncement governs the accounting for asset retirement obligations where the method or timing of disposal of an asset is conditional on some future event. The new pronouncement is effective for periods ending after March 31, 2006. Upon review of the new EIC pronouncement, the Corporation does not expect that it will have a material impact upon the Corporation.

Financial and other instruments

During 2005, the AcSB completed its project on the recognition and measurement of financial instruments by issuing new recommendations dealing with financial instruments and by introducing the concept of other comprehensive income. Under the new accounting standards, which come into effect for the 2007 fiscal year, all financial instruments, including derivatives, must be included on a company's balance sheet and measured at fair value or, in limited circumstances when fair value may not be the most relevant basis, at cost or amortized cost. The standards also specify when gains and losses resulting from changes in fair value are to be recognized in the Statement of Operations. In addition, certain gains and losses will be reported as other comprehensive income. The overall impact of the new accounting standards is being assessed, but it is not believed that their application will have a material financial impact on the Corporation.

OUTLOOK

Hydro Ottawa Holding

Hydro Ottawa Holding prides itself on being an organization that builds shareholder value through solid business strategy, superior customer service and an excellent employment environment.

The Corporation will continue to focus on three strategic priorities developed to reach this vision:

- Growth – Expand the Corporation's asset base and earn new profitable revenue, improve on core competencies, exit activities where the Corporation cannot compete effectively, and seek alliances and partnerships;
- Customer Excellence – Improve system reliability, increase customer satisfaction and enhance the reputation of the Corporation; and
- Productivity – Improve capital efficiency and operational productivity.

The organization's businesses are capital-intensive, requiring a long-term approach to financing capital assets. A key objective for the Corporation is to operate within a progressive financial structure that features access to long-term debt capital at market rates. A new capital asset management plan and allocation of capital policy was implemented during the year to help address these funding issues.

Hydro Ottawa – the LDC

The LDC has a pivotal role to play as the Ottawa region expands and evolves as a regional economic hub, and as its population base continues to grow. Ottawa is among the fastest-growing and largest metropolitan regions in the country. The number of customers served by the LDC is expected to grow over the period from 2005 to 2009 at an average rate of 1.5% per year.

Like other metropolitan regions, Ottawa faces a complex, long-term infrastructure challenge to improve and replace aging systems and, at the same time, to accommodate the demands of new growth. Just as the City of Ottawa itself has a requirement to re-invest in essential infrastructure – roads, water delivery, and public transit – so too must the LDC reinvest in electricity distribution.

The LDC has made significant strides in recent years to meet the increasing electricity distribution infrastructure needs in its service area. However, there will always be requirements to improve and expand the LDC's assets.

To continue delivering a high standard of reliability and operational excellence, and to provide essential infrastructure and related services in a growing economic region, the LDC's current intention is to invest some $490 million over the next five to seven years to repair, improve, modernize and expand operations. Cash flow, including customer contributions, is expected to fund approximately 65% of the cost of these investments, with the balance funded by external debt.

There are approximately 40,000 customers located within the city of Ottawa boundaries currently served by Hydro One. Since amalgamation it has been Hydro Ottawa's intention to pursue the acquisition of Hydro One's electricity distribution facilities serving these customers – on the condition that the acquisition have no negative rate impact on its current customers. Hydro One has indicated that the provincial government does not expect it to enter into any transactions involving the acquisition or divestment of LDC's or distribution assets. While this acquisition continues to be a priority for Hydro Ottawa, progress appears to be unlikely unless the government of Ontario adopts a policy to facilitate this purchase on commercially acceptable terms.

In 2006, the LDC is forecasting a significant increase in net income due mainly to a one-time $20 million recovery of provision for regulatory assets with the OEB's final approval of the LDC's regulatory assets accumulated up to December 31, 2004, as part of the 2006 rate application. Distribution revenue will increase due mainly to the approval of the LDC's 2006 rate applications as well as revenue recognition of deferred CDM monies to be spent during 2006.

Income from other sources and associated costs will reduce in 2006 as the LDC focuses on its core business and continues to withdraw from low-profit, discretionary work for others. Operations, Maintenance and Administration (OM&A) costs are expected to increase as part of the increased focus on reliability, including expanding the apprenticeship program. Interest on debt will remain relatively constant as the LDC will benefit from a full year of the favourable Hydro Ottawa Holding bond issuance rate of 4.93% while short-term rates are expected to increase slightly. The conversion of short-term borrowings to long-term debt will be reviewed during the year to ensure the maintenance of a proper debt-to-equity ratio.

Capital expenditures of $90 million will be made in 2006. Growth capital requirements will increase while contributed capital from customers is expected to decrease. Investment in reliability capital will see a continued increase with a concerted focus on distribution lines, transformers and station rehabilitation programs as part of the long-term asset management plan. General plant will need increased investment to complete the 2006 phases of the GIS project and fulfill the needs of ongoing fleet and information technology life cycles. Consequently, additional borrowings under the Corporation's credit facilities will be required to meet its capital spending requirements.

Cash flow from operations is forecast to decrease mainly due to anticipated higher levels of billings and unbilled revenue based on higher cost of power charges flowing through to the customers. Large rebate monies received late in 2005 for the 2004 Ontario Price Credit were paid out by the LDC each billing cycle during the first quarter of 2006.

Energy Ottawa

Helping to solve the province's, and therefore the city's, electricity supply/demand issue through innovative conservation and demand reduction initiatives and renewable energy generation will be the focus of Energy Ottawa.

Energy Ottawa will continue to seek opportunities on its own or in partnership with all levels of government to develop and operate viable renewable generation projects.

Energy Ottawa's focus will remain on green energy and renewable resources. The Trail Road methane-powered generating station plant will be completed by the end of 2006, sending another 40,000 MWh of green power to the grid. And the company will continue to explore the feasibility for an estimated $30-40 million 60,000 MWh plant at the former Generating Station #1 on the Ottawa River. The company will also continue to grow its energy management services business through the implementation of energy efficiency/conservation measures in large commercial buildings and the expansion of its pilot demand response program.

Telecom Ottawa

Telecom Ottawa will continue to positively contribute to the municipal and regional economic development strategy, such as the one promoted in the City of Ottawa's Broadband 20/20 plan, by making available additional services to its critical MUSH sector client base. And the company will partner with other carriers to expand its fibre network footprint into more commercial and government buildings in the national capital region helping the City of Ottawa achieve its goal of being the most connected city in the world.

In this way, Telecom Ottawa will continue to be a part of the city's efforts to be sufficient in the critical areas of economic and community infrastructure.

Hydro Ottawa Holding

Hydro Ottawa Holding and its subsidiaries have a clear vision for the future that is focused on the customer. As technology advances and the population grows, the need for the Corporation's services will both increase and change. At the forefront remains the need for outstanding customer service delivery. By building essential infrastructure to support municipal growth, as well as finding environmentally sustainable solutions to energy concerns, the Corporation is on track to carry out its vision for years to come.

GENERAL

This Management's Discussion and Analysis contains forward-looking statements reflecting management's current expectations regarding future operating results, economic performance, financial condition and achievements of the Corporation. Forward-looking statements are subject to certain risks and uncertainties and actual results may differ materially. These risks and uncertainties are described above under "RISKS AND UNCERTAINTIES." The

Corporation undertakes no obligation to update or revise any of these forward-looking statements, whether to reflect new information, future events or otherwise.

MATERIALITY

This MD&A contains matters that the Corporation considers material. Quantitatively, materiality is determined based on 10% of net earnings from continuing operations averaged over a three-year period. Management also took into consideration other qualitative factors that could effect the decision making process for prospective investors. A review was made of financial statement items of the business units where critical accounting estimates were made.

AUDITORS' REPORT

To the Shareholder of
Hydro Ottawa Holding Inc.

We have audited the consolidated balance sheet of Hydro Ottawa Holding Inc. as at December 31, 2005 and the consolidated statements of income and retained earnings and of cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Ottawa, Ontario
March 23, 2006 (except for Note 20 which is at April 13, 2006)

REPORT OF MANAGEMENT

Management is responsible for the integrity of the financial data reported by the Corporation. Fulfilling this responsibility requires the preparation and presentation of consolidated financial statements and other data using management's best judgment, estimates and Canadian generally accepted accounting principles applied on a basis consistent with the preceding year.

Management maintains appropriate systems of internal control and corporate-wide policies and procedures which provide reasonable assurance that the Corporation's assets are safeguarded and that financial records are relevant and reliable.

The Board of Directors, through the Audit Committee, ensures that management fulfills its responsibility for financial reporting and internal control. The Audit Committee consists of outside directors and at regular meetings reviews audit, internal control and financial reporting matters with management and external auditors. The Audit Committee has reviewed the financial statements and submitted its report to the Board of Directors.

On behalf of Management,

Rosemarie T. Leclair
President and
Chief Executive Officer

Shirley Mears
Senior Vice President and
Chief Financial Officer

HYDRO OTTAWA HOLDING INC.
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS
YEAR ENDED DECEMBER 31, 2005
($ thousands)

	2005	2004
REVENUES		
Power recovery	**$ 592,231**	$ 507,838
Distribution sales	**90,884**	85,689
Communication services and products	**11,550**	11,548
Other revenue	**12,783**	10,684
	707,448	615,759
EXPENSES		
Purchased power	**585,175**	503,749
Operating, maintenance and administration	**55,943**	54,677
Amortization of capital and intangible assets	**34,219**	29,760
Restructuring costs	**-**	851
Recovery of transition costs (Note 5)	**(1,798)**	-
Recovery of provision for regulatory assets (Note 5)	**(5,820)**	(7,928)
	667,719	581,109
EARNINGS FROM CONTINUING OPERATIONS BEFORE OTHER (REVENUE) EXPENSES AND PAYMENTS IN LIEU OF CORPORATE INCOME TAXES	**39,729**	34,650
OTHER EXPENSES		
Financing costs (Note 14)	**11,704**	15,673
Payments in lieu of provincial capital tax	**1,709**	1,728
	13,413	17,401
NON-CONTROLLING INTEREST IN POWERTRAIL INC. (NOTE 12)	**7**	-
EARNINGS FROM CONTINUING OPERATIONS BEFORE PAYMENTS IN LIEU OF CORPORATE INCOME TAXES	**26,323**	17,249
PAYMENTS IN LIEU OF CORPORATE INCOME TAXES (NOTE 15)	**4,237**	1,236
NET EARNINGS FROM CONTINUING OPERATIONS	**22,086**	16,013
NET EARNINGS FROM DISCONTINUED OPERATIONS (NOTE 4)	**-**	1,410
GAIN ON DISPOSAL OF ASSETS HELD FOR RESALE, NET OF TAXES (NOTE 4)	**479**	2,277
NET EARNINGS	**22,565**	19,700
RETAINED EARNINGS (DEFICIT), BEGINNING OF PERIOD	**2,804**	(16,896)
RETAINED EARNINGS, END OF PERIOD	**$ 25,369**	$ 2,804

The accompanying notes are an integral part of these consolidated financial statements

HYDRO OTTAWA HOLDING INC.
CONSOLIDATED BALANCE SHEET
AS AT DECEMBER 31, 2005
($ thousands)

	2005	2004
CURRENT ASSETS		
Accounts receivable (Note 3)	**$ 48,192**	$ 49,793
Unbilled revenue	**96,024**	80,960
Inventory	**6,670**	8,606
Assets held for sale (Note 4)	**-**	274
Prepaid expenses	**1,685**	896
	152,571	140,529
NON-CURRENT ASSETS		
Net regulatory assets (Note 5)	**6,610**	5,469
Capital assets (Note 6)	**470,271**	440,141
Other assets (Note 7)	**4,367**	1,770
TOTAL ASSETS	**633,819**	587,909
CURRENT LIABILITIES		
Bank indebtedness and banker's acceptances (Note 8)	**$ 11,092**	$ 29,901
Accounts payable and accrued liabilities (Note 9)	**137,355**	108,047
Notes payable (Note 10)	**-**	200,000
Liabilities related to discontinued operations (Note 4)	**33**	940
	148,480	338,888
NON-CURRENT LIABILITIES		
Deferred revenue	**1,635**	-
Repayable grant	**150**	-
Net regulatory liabilities (Note 5)	**16,300**	9,623
Employee future benefits (Note 11)	**3,740**	3,475
Customer deposits	**6,259**	3,459
Future income tax liability (Note 15)	**2,663**	1,207
Non-controlling interest in PowerTrail Inc. (Note 12)	**410**	-
Notes payable (Note 10)	**200,360**	-
	231,517	17,764
TOTAL LIABILITIES	**379,997**	356,652
CONTINGENT LIABILITIES (NOTE 17)		
COMMITMENTS (NOTE 18)		
SHAREHOLDER'S EQUITY		
Share Capital (Note 13)	**228,453**	228,453
Retained Earnings (Note 20)	**25,369**	2,804
	253,822	231,257
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	**$ 633,819**	$ 587,909

The accompanying notes are an integral part of these consolidated financial statements

ON BEHALF OF THE BOARD

Director

Director

HYDRO OTTAWA HOLDING INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2005
($ thousands)

	2005	2004
NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net earnings from continuing operations	$ 22,086	$ 16,013
Adjustments for non-cash items		
Amortization of capital and intangible assets	34,219	29,760
(Gain) loss on disposal of capital and other assets	701	(95)
Allowance for funds used during construction (Note 6)	(467)	(1,225)
Amortization of debt issue costs (Note 7)	358	-
Other	1,449	334
	58,346	44,787
NET CHANGE IN NON-CASH OPERATING WORKING CAPITAL ITEMS (NOTE 16)	29,260	(7,133)
	87,606	37,654
FINANCING		
Debt issue and other costs	(2,592)	(121)
Issue of common shares to PowerTrail Inc.	417	-
Bank indebtedness and banker's acceptances	(18,809)	21,195
Contributions in aid of construction	21,433	7,536
Notes payable (Note 10)	360	-
Repayable grant	150	-
Customer deposits repaid	(2,031)	(307)
	(1,072)	28,303
INVESTING		
Proceeds from disposition of capital assets	88	203
Acquisition of capital assets	(85,450)	(77,351)
Deposit on equipment	(1,018)	-
Acquisition of businesses	-	(28)
	(86,380)	(77,176)
NET CASH INFLOW (OUTFLOW) FROM CONTINUING OPERATIONS	154	(11,219)
NET CASH INFLOW (OUTFLOW) FROM DISCONTINUED OPERATIONS	(154)	11,219
CASH, BEGINNING OF YEAR	-	-
CASH, END OF YEAR	$ -	$ -
OTHER INFORMATION		
Interest paid	$ 7,314	$ 21,091
Payments in lieu of income taxes	$ 2,611	$ 2,671

The accompanying notes are an integral part of these consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(TABULAR AMOUNTS ARE IN THOUSANDS OF DOLLARS)

1. DESCRIPTION OF BUSINESS

Hydro Ottawa Holding Inc. (Hydro Ottawa Holding or the Corporation) was incorporated on October 3, 2000 pursuant to the *Business Corporations Act* (Ontario) as mandated by the Ontario government's *Electricity Act, 1998*. Hydro Ottawa Holding is wholly owned by the City of Ottawa (the Shareholder).

The principal business of the Corporation is the oversight of its wholly owned subsidiaries, which include:

Hydro Ottawa Limited (Hydro Ottawa) – A regulated electricity distribution company that owns and operates electricity infrastructure in the City of Ottawa and the Village of Casselman and is responsible for the safe, reliable delivery of electricity to homes and businesses in its licensed service area. In addition to billing for distribution services, it also invoices customers for amounts it is required to pay to other organizations in Ontario's electricity system for providing wholesale generation and transmission services and for debt retirement.

Energy Ottawa Inc. – A power generation company that generates and markets EcoLogo-certified green power. Energy Ottawa also offers a range of expert energy management and procurement services to large energy-consuming organizations and Corporations. Energy Ottawa holds a 60% interest in PowerTrail Inc. (PowerTrail), a development stage company incorporated on August 11, 2005 to construct and operate a generation plant and gas collection system at the Trail Road landfill site in Ottawa, Ontario.

Telecom Ottawa Holding Inc. (Telecom Ottawa) – A broadband data carrier and internet service provider (ISP) based in Ottawa, with operations throughout Eastern Ontario. Telecom Ottawa owns and operates a metropolitan-wide network. This broadband infrastructure enables the provision of bandwidth capacity for data networking, high-speed internet access, e-business applications and multimedia services. In providing services to businesses and public-sector organizations, Telecom Ottawa also delivers an extensive portfolio of ISP capabilities such as email, web hosting, wireless and remote internet access. Telecom Ottawa wholly owns the following subsidiaries: Telecom Ottawa Limited, 2038455 Ontario Inc. and Telecom Ottawa Regional Limited.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) for commercial entities, including principles prescribed by the Ontario Energy Board (OEB) in the Accounting Procedures Handbook (AP Handbook). In the opinion of management, all adjustments necessary for fair presentation are reflected in the consolidated financial statements. The consolidated financial statements reflect the significant accounting policies summarized below.

1) BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of Hydro Ottawa Holding and its subsidiaries: Hydro Ottawa, Energy Ottawa, which includes the accounts of PowerTrail, and Telecom Ottawa, which includes the accounts of Telecom Ottawa Limited, Telecom Ottawa Regional Limited and 2038455 Ontario Inc. All significant intercompany balances and transactions have been eliminated in the consolidated financial statements.

Consolidation of variable interest entities

In June 2003, the Canadian Institute of Chartered Accountants issued Accounting Guideline 15, Consolidation of Variable Interest Entities (AcG-15). AcG-15 requires that a variable interest entity (VIE) be consolidated by a company if that company is subject to a majority of the risk of loss from the VIE's residual returns. The adoption of AcG-15 resulted in the consolidation of PowerTrail in the consolidated financial statements of Hydro Ottawa Holding and Energy Ottawa.

2) MEASUREMENT UNCERTAINTY

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of revenue, expenses, assets, liabilities and the disclosure of contingent assets and liabilities at the financial statement date. Accounts receivable, unbilled revenue and regulatory assets and liabilities are reported net of an appropriate allowance for unrecoverable amounts. Due to the inherent uncertainty involved in making such estimates, actual results could differ from estimates recorded in preparing these financial statements, including changes as a result of future decisions made by the OEB or the provincial government. The financial statements have, in management's opinion, been properly prepared using careful judgment within reasonable limits of materiality and within the framework of the accounting policies.

3) REGULATION

Hydro Ottawa (the company) is regulated by the OEB under the authority of the *Ontario Energy Board Act, 1998*. The OEB is charged with the responsibility of approving or setting rates for the transmission and distribution of electricity and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers. The OEB has the general power to include or exclude costs and revenues in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have applied in an unregulated company. The following regulatory treatments have resulted in accounting treatments that differ from GAAP for enterprises operating in a non-regulated environment:

a) Regulatory assets and liabilities

Regulatory assets primarily represent costs that have been deferred because it is probable that they will be recovered in future rates. Similarly, regulatory liabilities can arise from differences in amounts billed to customers for electricity services and the costs that the company incurs to purchase these services. Hydro Ottawa began recovering its regulatory assets (net of liabilities) on an interim basis starting April 1, 2004. This recovery continued throughout 2005. In June 2005, the OEB provided distributors with filing guidelines for final approval of these regulatory assets. Accordingly, the company filed an application with the OEB for the final recovery of regulatory assets (net of liabilities), accumulated to December 31, 2004, on August 2, 2005 which if approved would result in an increase in rates for the period May 1, 2006 to April 30, 2008.

Regulatory balances are comprised principally as follows:

(i) Transition costs: Hydro Ottawa incurred transition costs in preparing the company for requirements of the competitive electricity market in Ontario. Criteria set out in the OEB's Distribution Rate Handbook and AP Handbook allow certain costs to be deferred that would be expensed when incurred under GAAP for an unregulated business. Hydro Ottawa has not recorded additional transition costs since 2002; however, interest on the recorded transition costs has been accrued as a regulatory asset.

(ii) Pre-market opening electricity variance: At December 31, 2002, Hydro Ottawa recognized the pre-market opening electricity variance for the period January 1, 2001 to April 30, 2002, the date of market opening, in accordance with the AP Handbook. The pre-market opening variance represents the difference between the utility's cost of power purchased based upon time-of-use (TOU) rates and amounts billed for the cost of power to non-TOU customers at an average rate for the same period. Simple interest has been accrued as a regulatory asset as per the AP Handbook.

(iii) Post-market opening variances: Retail services and settlement variances – The retail settlement variances relate to the charges Hydro Ottawa incurred for transmission services, generation (the commodity) and wholesale market operations from the Independent Electricity System Operator (IESO) and Hydro One Networks that were not recovered from customers during the period. The nature of the settlement variances is such that the balance can fluctuate between an asset and a liability over time and are reported at period-end dates in accordance with rules prescribed by the OEB. Hydro Ottawa has also recognized the net cost of providing retailer billing services and service transaction request services as a variance amount. On January 1, 2005, the IESO implemented, pursuant to Bill 100, a new price adjustment applicable to customers who are not eligible for the regulated price plans and therefore pay spot market price. To facilitate this, electricity distributors are given a price adjustment on their invoice from the IESO, called the Global Adjustment, which they pass on to this class of customer via a Provincial Benefit on the customer's bill.

The Global Adjustment represents the difference between market prices and the combined regulated and contract prices paid to electricity generators for electricity. This adjustment may be either positive or negative depending on the prevailing electricity market conditions. The electricity distributor adjusts the customer's invoice for the Provincial Benefit based on rates set monthly by the IESO. The difference between the Global Adjustment provided to electricity distributors, and the Provincial Benefit passed on to this particular class of customer, is tracked in a retail settlement variance account.

Miscellaneous deferred debits – The deferred debits represent one time expenses incurred to issue the 2002 customer rebates arising from Bill 210 which established a price cap of 4.3 cents per kilowatt-hour (kWh) for the electricity commodity for low-volume and designated customers (Eligible Customers) retroactive to May 1, 2002.

Deferred OEB annual cost assessments – The OEB has allowed electricity distributors to record their OEB cost assessments for the OEB's 2004 fiscal and subsequent years in order that these costs may be given consideration for rate recovery in the future. The company has deferred these expenditures in accordance with the directions set out in the AP Handbook.

Deferred cash pension contributions – The OEB has allowed electricity distributors to apply for the recovery of incremental Ontario Municipal Employees Retirement System (OMERS) pension expenditures for the fiscal years starting after January 1, 2005. Accordingly, the company has deferred these expenditures in accordance with the directions set out in the AP Handbook.

Deferred payments in lieu of taxes (PILs) – Variances that result from the difference between OEB approved PILs recoverable in electricity distribution services charges and the actual amount collected from customers that relates to the recovery of PILs are deferred in accordance with the AP Handbook.

Interest on all recorded post-market opening variances has been accrued as a regulatory asset as per the AP Handbook.

b) Contributions in aid of construction

Capital contributions are required contributions received from outside sources used to finance additions to capital assets. Capital contributions received are treated as a contra account and are included in capital assets. The amount is amortized by a charge to accumulated amortization and a credit to amortization expense at an equivalent rate to that used to depreciate the related capital asset.

c) Allowance for funds used during construction (AFUDC)

Commencing January 1, 2000, an allowance for the cost of funds used during the construction period of major capital and development projects has been applied to the related capital assets. The rate applied during the current fiscal period as prescribed in the 2006 Electricity Distribution Rate (EDR) Handbook is equal to the weighted average cost of capital, being 6.6%. In 2004 the rate applied was equal to the rate allowed by the OEB in respect of long-term borrowings, being 6.9%.

d) Payment in lieu of corporate income taxes

Hydro Ottawa Holding, Hydro Ottawa, Energy Ottawa, Telecom Ottawa Holding Inc., Telecom Ottawa Limited and 2038455 Ontario Inc. are considered to be municipal electric utilities (MEUs) for purposes of the payments in lieu of taxes (PILs) regime contained in the *Electricity Act, 1998*. The *Electricity Act, 1998* provides that a MEU that is exempt from tax under the *Income Tax Act* (Canada) (ITA) and the *Corporations Tax Act* (Ontario) (CTA) is required to make, for each taxation year, a PILs payment to the Ontario Electricity Financial Corporation (OEFC) in an amount approximating the tax that it would be liable to pay under the ITA and the CTA if it were not exempt from tax.

These companies are exempt from tax under the ITA, as all of their capital is owned indirectly by the City of Ottawa and not more than 10% of each company's income is from activities carried on outside the municipal boundaries of the City of Ottawa. A company exempt under the ITA is also exempt from tax under the CTA.

Hydro Ottawa has adopted the taxes payable method to account for PILs as outlined in the AP Handbook. Under the taxes payable method, no provision is made for future income taxes as a result of unused tax losses or temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered by the regulated business at that time as the AP Handbook provides for the recovery of PILs by Hydro Ottawa at that time.

Hydro Ottawa Holding, Energy Ottawa, Telecom Ottawa Holding Inc., Telecom Ottawa Limited and 2038455 Ontario Inc. provide for PILs using the liability method. Under the liability method, future income tax assets and liabilities are recognized for unused tax losses and the temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. Future income tax assets and liabilities are measured using substantively enacted rates expected to apply to taxable income in the years those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change is substantively enacted. Future income tax assets are recognized only to the extent that it is more likely than not that these assets will be realized.

Telecom Ottawa Regional Limited is taxable under the ITA and the CTA since more than 10% of the company's income is from activities carried on outside the municipal boundaries of the City of Ottawa. The company provides for corporate income taxes using the liability method.

PowerTrail is taxable under the ITA and the CTA as less than 90% of its capital is indirectly owned by the City of Ottawa. The company provides for corporate income taxes using the liability method.

4) FINANCIAL INSTRUMENTS

The Corporation's financial instruments consist of accounts receivable, unbilled revenue, bank indebtedness and banker's acceptances, accounts payable and accrued liabilities, customer deposits, notes payable and standby letters of credit. Unless otherwise noted, it is management's opinion that the Corporation is not exposed to significant currency, commodity or credit risks arising from these financial instruments. The carrying values of the Corporation's financial instruments approximate their fair values unless otherwise noted.

Concentration of credit risk in accounts receivable and unbilled revenue is limited, due to the large number of customers the Corporation services. The Corporation performs ongoing credit evaluations on its customers and requires collateral to support customer accounts receivable on specific accounts to mitigate significant losses. The Corporation establishes an allowance for doubtful accounts based on the credit risk applicable to particular customers, and historical and other information.

The Corporation is exposed to interest rate risk on its short-term borrowings. Under the Corporation's credit facilities (Note 9), any advances on its operating credit line would expose the Corporation to fluctuations in short-term interest rates related to prime-rate loans and banker's acceptances.

5) INVENTORY

Inventory consists primarily of parts and supplies acquired for internal construction or consumption and are stated at the lower of cost and replacement cost, with cost determined on a weighted moving average basis. A comprehensive review of the utilization of inventory is conducted each year to identify stock items with an impaired value that have become obsolete.

6) SPARE TRANSFORMERS AND METERS

Spare transformers and meters are items that are expected to be substituted for original distribution plant transformers and meters when these original plant assets are being repaired and are held and dedicated for the specific purpose of backing up plant-in-service as opposed to assets available for other uses. Spare transformers and meters are treated as capital assets.

7) CAPITAL ASSETS

Capital assets include generation plants, distribution equipment, fibre-optic equipment, facilities and buildings, as well as construction and operating equipment.

Capital assets are recorded at cost and include contracted services, materials, labour, engineering costs, overheads, an allowance for the cost of funds used during construction and interest on funds used to financing construction of fibre-optic equipment. Certain assets may be acquired or constructed with financial assistance in the form of contributions from customers.

Significant renewals and enhancements to existing assets are capitalized only if the service life of the asset is increased; reliability is improved above original design standards or operating costs are reduced by a substantial and quantifiable amount.

Maintenance and repair costs are expensed as incurred.

Amortization is recorded on a straight-line basis over the estimated service life of the related asset.

Estimated service lives for capital asset classes are as follows:

Distribution system	25 to 40 years
General plant	4 to 50 years
Fibre-optic equipment	1 to 20 years
Generating plant equipment	4 to 60 years

Effective January 1, 2005, there has been a change in the estimated useful life of a portion of fibre-optic laterals. These laterals have now been classified as part of the backbone fibre and therefore are amortized over 20 years rather than over the term of the contract (which is generally 1 to 10 years).

Assets under construction are not subject to amortization.

The Corporation reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable, the Corporation will estimate the future cash flows expected to result from the use of the asset group and their eventual disposition, and record an impairment loss if required.

8) DEFERRED COSTS

Deferred Debt Issue Costs

During 2004 and 2005, the Corporation incurred debt issue costs that are external, direct and incremental in nature arising from the Corporation's debenture offering (See Note 8) and credit facility restructuring. Bond issue costs are amortized over the ten-year term of the debentures issued (See Note 10). Credit facility restructuring costs are amortized over the three-year term of the revolving term credit facility (See Note 8).

Deferred Contract Costs

The Corporation accumulates costs directly associated with securing long-term energy contracts where the recovery of such is probable. Deferred costs include legal, professional and engineering fees that are external, direct and incremental in nature. Deferred costs are amortized on a straight-line basis over the term of the underlying contract.

Deferred Royalty Costs

Deferred royalty costs consist of royalties paid under a long-term contract for the utilization of landfill gas used to generate electricity at the Trail Road landfill site in Ottawa, Ontario. Deferred royalty costs are amortized on a straight-line basis over the term of the contract.

Deferred Development Costs

The Corporation accumulates costs associated with development activities. These costs are external, direct and incremental in nature and are incurred for the completion of a potential construction project. Development costs are included in operating expenses until the construction of a plant is likely to occur and there is a reasonable expectation of commercial success. Costs associated with successful projects are reclassified from long-term assets to capital assets and amortized over the useful life of the related assets. Costs of unsuccessful projects are written off in the year the project is abandoned.

9) EMPLOYEE FUTURE BENEFITS

i. Pension plan

The Corporation provides pension benefits for its employees through the Ontario Municipal Employees Retirement System ("OMERS"). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund (the Fund), and provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards. The Fund is a contributory defined benefit pension plan, which is financed by equal contributions from participating employers and employees and by the investment earnings of the Fund. The Corporation recognizes the expense related to this plan as contributions are made.

Telecom Ottawa has a defined contribution plan whereby the company matches employee contributions made to a retirement savings plan. The company recognizes the expense related to this plan as contributions are made.

ii. Employee future benefits other than pension plan

Employee future benefits other than pensions provided by the Corporation include medical and life insurance benefits, supplemental pensions and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service.

Employee future benefit expense is recognized in the period in which the employees render services.

Employee future benefits are recorded on an accrual basis. The accrued benefit obligation and current service costs are calculated using the projected benefit method pro-rated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

of benefits attributed to employees' services rendered in the period. Actuarial gains and losses resulting from experience different from that assumed or from changes in actuarial assumptions are amortized based on the excess of unamortized net actuarial gains and losses over the 10% corridor calculated in the aggregate for all groups. The expected average remaining service life as at December 31, 2005 is 16 years.

10) CUSTOMER DEPOSITS

Customer deposits are cash collections from customers to guarantee the payment of energy bills and fulfillment of construction obligations. Deposits estimated to be refundable to customers within the next fiscal year are classified as a current liability.

On February 3, 2004, the OEB released amendments to the Distribution System Code (DSC) with respect to customer security deposits. The DSC now sets out the maximum customer security deposits permitted, the length of time that deposits can be held, how customers can seek exemption for part or all of the deposit and the interest that distributors must pay on these deposits. The new DSC requirements came into effect on August 3, 2004; however as permitted by the OEB, the Corporation did not return customer security deposits under the new rules until 2005.

11) NON-MONETARY TRANSACTIONS

The Corporation enters into transactions with other providers of telecommunication services that involve swapping and/or exchanging capacity, conduit and fiber to complete and complement their network. Based upon the terms of the agreement, these transactions are accounted for as non-monetary transactions with no revenue and no cost recognition as these exchanges are not considered to be the culmination of an earnings process.

12) REVENUE RECOGNITION

a) Power recovery: Power recovery revenue is the pass through of all purchased power costs to the consumer.

b) Distribution sales: Electricity distribution sales are recorded on the basis of regular meter readings and estimates of current usage from the last meter reading to the end of the fiscal period.

c) Communications services and products: Telecommunication revenue is recognized on a straight-line basis over the term of the customer contract. Indefeasible right of use contracts (IRUs) are treated as sales-type or direct financing leases. For IRU contracts meeting the criteria as a sales-type lease, revenues are recognized at the time of the transaction, net of cost of sales and any unearned finance revenue is deferred and taken into income over the term of the contract.

d) Other revenue: Other revenue related to sales of other services is recognized as services are rendered. Contract revenue is accounted for using the percentage of completion method, whereby revenue is recognized proportionately with the degree of completion of the services under contract. Losses on contracts are fully recognized when they become evident.

e) Unbilled revenue: Unbilled revenue represents distribution sales, along with accrued revenue from electricity consumed by customers since the date of each customer's last meter reading that has not yet been billed.

f) Deferred revenue: In 2005, Hydro Ottawa began collecting the third instalment (third tranche) of its regulated rate of return, on the condition that an equivalent amount would be invested in conservation and demand management (CDM) activities by September 2007. The CDM recoveries in 2005 exceeded the cumulative amount spent on CDM activities. The excess recoveries are treated as deferred revenue as the company has billed the customer but has yet to discharge its obligation relating to the investment of these funds. The CDM required capital expenditures and operating expenses are recorded from July 1, 2004 to September 30, 2007 while the recovery is received over the twelve-month period from March 1, 2005 to February 28, 2006.

Lump sum payments made by telecommunication customers at the beginning of a contract are deferred and recognized as revenue on a straight-line basis over the term of the contract.

3. ACCOUNTS RECEIVABLE

	2005	2004
Trade receivables net of allowance for doubtful accounts of $2,520,000 (2004 – $3,170,000)	$ 40,666	$ 40,922
Other receivables	7,526	8,871
	$ 48,192	$ 49,793

4. DISCONTINUED OPERATIONS

Assets related to discontinued operations	2005	2004
Unbilled revenue	$ -	$ 3
Payments in lieu of future corporate income tax assets	-	271
	$ -	$ 274
Liabilities related to discontinued operations		
Accounts payable and accrued liabilities	$ 33	$ 940

On November 12, 2004, the Corporation completed the sale of its water heater rental business for $11,250,000 in cash, subject to contingent post closing adjustments of up to $750,000. An after-tax gain of $479,000 was recognized in 2005, as a result of a favourable final resolution to the contingent post closing adjustments.

5. REGULATORY ASSETS AND LIABILITIES

In accordance with the AP Handbook, the Corporation has accounted for regulatory variances during the year. All pre-market opening electricity variances and post-market opening variances have been recorded as regulatory assets, with the exception of the variances related to the transmission connection costs and global adjustments that have been recorded as regulatory liabilities. Interest has been accrued on the regulatory assets and regulatory liabilities as per the AP Handbook. Transition costs have been recorded as capital assets, but the related accrued interest has been treated as a regulatory asset.

Information about the Corporation's net regulatory assets and liabilities is as follows:

	2005	2004
Transition costs:		
Capital assets net of recovery of $1,798,000 (2004 – $nil)	$ 2,268	$ 6,431
Interest on transition costs net of recovery of $1,122,000 (2004 - $611,000)	71	421
Provision for doubtful recovery	(71)	(421)
Total transition costs	2,268	6,431
Pre-market opening electricity variance:		
Regulatory assets net of recovery of $10,123,000 (2004 - $2,293,000)	17,257	23,633
Provision for doubtful recovery	(17,257)	(23,633)
Total pre-market opening electricity variance	-	-
Post-market opening variances:		
Retail settlement variance account assets net of recovery of $10,338,000 (2004 - $5,995,000)	$ 7,931	$ 5,920
Provision for doubtful recovery	(5,099)	(3,496)
	2,832	2,424
Other regulatory assets net of recovery of $456,000 (2004 - $498,000)	4,747	4,889
Provision for doubtful recovery	(969)	(1,844)
	3,778	3,045
Retail settlement variance account liabilities net of disposition of $6,261,000 (2004 - $2,277,000)	(16,300)	(9,623)
Total post-market opening variances	(9,690)	(4,154)
Total regulatory assets and liabilities	$ (7,422)	$ 2,277

Regulatory assets and liabilities are recorded as:

	2005	2004
Net regulatory assets	$ 6,610	$ 5,469
Net regulatory liabilities	(16,300)	(9,623)
Capital assets	2,268	6,431
	$ (7,422)	$ 2,277

The Corporation expects to recover or dispose of these regulatory assets and liabilities by April 30, 2008.

Information about the Corporation's recovery of provision for regulatory assets is as follows:

	2005 (Recapture of) Provision for Doubtful Recovery	2004 (Recapture of) Provision for Doubtful Recovery
Recovery of regulatory assets through rate approval	$ (11,384)	$ (8,388)
Disposition of regulatory liabilities through rate approval	1,797	1
Regulatory assets provision	3,767	459
Total recovery of provision for regulatory assets	$ (5,820)	$ (7,928)

The impact of accounting for regulatory assets and liabilities in the absence of rate regulation considerations under GAAP in the current period are:

1) The opening of the restructured electricity market on May 1, 2002 separated the purchase of power into several components such as the cost of the commodity or power, and non-competitive charges being transmission connection

and network costs, and wholesale market service costs. These costs are to be passed on to the customer. The difference between actual costs incurred and the amounts recovered through rates are held as regulatory assets or liabilities, with final disposition subject to OEB approval.

a) Retail settlement variances of $2,832,000 (2004 - $2,424,000) for non-competitive electricity charges and power charges such as the cost of imported power, excluding the transmission connection costs variance and global adjustment variance, are recorded as regulatory assets. In the absence of rate regulation considerations, actual non-competitive electricity charges and power costs could be expensed as incurred. Consequently, operating results for 2005 would be $408,000 lower.

b) Retail settlement transmission connection costs and global adjustment variances of $16,300,000 (2004 - $9,623,000) are recorded as regulatory liabilities. They represent the over recovery of transmission connection charges and the difference between the Provincial Benefit provided to customers and the Global Adjustment received from the IESO. In the absence of rate regulation considerations, actual transmission connection costs and global adjustment variances would be recognized as revenue when billed to the customer, and as an expense when charged by the IESO. Consequently, operating results for 2005 would be $6,677,000 higher.

2) Other regulatory assets of $2,200,000 (2004 - $760,000) include costs that the OEB has allowed electricity distributors to record, such as OEB cost assessments, incremental OMERS pension expenditures, retail service costs and miscellaneous deferred debits, in order that these costs may be given consideration for rate recovery in the future. Also included in other regulatory assets are deferred PILs of $1,578,000 (2004 - $2,285,000) that represent variances resulting from the difference between OEB approved PILs recoverable in electricity distribution services charges and the actual amount collected from customers related to the recovery of PILs. In the absence of rate regulation considerations, the operating results for 2005 would be $733,000 lower.

Final approval of regulatory assets and liabilities:

The Corporation reviews all regulatory assets for likelihood of recovery. The absence of final approval of recovery is a consideration in this evaluation. The Corporation has recorded a net provision of $23,396,000 (2004 - $29,394,000) against regulatory assets. The Corporation continues to assess the likelihood of full recovery of regulatory assets, net of liabilities. If future recovery becomes assured, the Corporation would recognize the recovery in the results of operations in the period such a decision is made.

In 2005, Hydro Ottawa filed an application with the OEB to obtain final approval to recover $4,066,000 in transition costs included in general plant capital assets. Hydro Ottawa has received interim approval to begin recovering these costs. Hydro Ottawa has recovered $2,920,000 (2004 – $611,000) in regulatory assets through rates of which $1,798,000 (2004 – $nil) represented transition costs and $1,122,000 (2004 – $611,000) represented interest accrued on these costs. Included in general plant cost is $2,268,000 (2004 - $6,431,000) of capital assets still recoverable.

6. CAPITAL ASSETS

	2005			2004
	Cost	Accumulated amortization	Net book value	Net book value
Distribution system	$ 743,678	$ 351,928	$ 391,750	$ 351,843
General plant	140,805	57,806	82,999	78,634
Fibre-optic equipment	40,815	9,383	31,432	29,959
Generating plant and equipment	34,869	6,456	28,413	25,705
	960,167	425,573	534,594	486,141
Contributions in aid of construction	(76,017)	(11,694)	(64,323)	(46,000)
	$ 884,150	$ 413,879	$ 470,271	$ 440,141

Included in capital assets is $18,598,000 (2004 - $23,888,000) of assets under construction not subject to amortization.

During the year, the Corporation capitalized interest of approximately $24,360 (2004 – $138,000) and an allowance for funds used during construction of $467,000 (2004 – $1,225,000).

Included in the cost of generating plant and equipment is $791,000 (2004 – $547,000) related to Energy Ottawa's interest in the Chaudière dam (Note 19).

The OEB permits an allowance for funds used during construction (AFUDC), based on Hydro Ottawa's weighted average cost of capital, to be included in the rate base. AFUDC is also included in the cost of capital assets for financial reporting purposes, and is depreciated over future periods as part of the total cost of the related asset, based on the expectation that depreciation expense, including the AFUDC component, will be approved for inclusion in future rates. Since AFUDC includes an interest component, and a cost-of-equity component, it exceeds the company's weighted average cost of debt. In the absence of rate regulation considerations under GAAP, the operating results for 2005 would be $113,000 lower.

7. OTHER ASSETS

	2005	2004
Deferred debt issue costs (net of accumulated amortization of $342,000 (2004 - $nil))	$ 2,235	$ 121
Deferred contract and royalty costs	191	71
Deposits on equipment	1,018	-
Goodwill and customer lists	532	1,187
Other assets	391	391
	$ 4,367	$ 1,770

On May 16, 2005, Energy Ottawa entered into an agreement to purchase gas engine generators to be used in the generation plant at the Trail Road landfill site in Ottawa, Ontario. The value of the contract is approximately $2,000,000. This contract has been assigned to PowerTrail. As at December 31, 2005, PowerTrail has placed deposits of approximately $1,018,000 on the equipment. PowerTrail expects to take possession of the equipment in early 2006 at which point the remaining balance of the contract will become due.

Customer lists are recorded at cost less accumulated amortization and are amortized over 5 to 8 years. Goodwill is not amortized.

In 2004, the Corporation sold a server valued at $541,000. The sale of the server did not result in any gain or loss on disposal. Consideration for the server consisted of credits to be applied against fees payable under the maintenance agreement with $150,000 applied in 2004 and the remaining to be applied as follows:

2008	$130,000
2009	130,000
2010	131,000
	$391,000

8. BANK INDEBTEDNESS AND BANKER'S ACCEPTANCES

	2005	2004
Bank indebtedness and banker's acceptances	**$ 11,092**	$ 29,901

On January 6, 2005, the Corporation arranged a new credit facility in the amount of $350,000,000 with a syndicate of Canadian banks. The new facility consisted of two elements, a $150,000,000 three-year extendible revolving term credit facility that expires January 6, 2008 and a $200,000,000 364-day bridge facility.

The bridge facility was fully drawn on January 6, 2005 to repay the $200,000,000 promissory note held by the City. This loan, including interest, was subsequently repaid with the proceeds of the bond offering of February 9, 2005 (See Note 11) and drawings under the $150,000,000 revolving term credit facility.

Amounts drawn under the revolving term credit facility as banker's acceptances are calculated using a discount rate that is 0.1% below the average posted rate for Banker's Acceptances (3.33% at December 31, 2005). Prime rate advances under this facility bear interest at the bank's prime rate (5% at December 31, 2005). The fee payable for banker's acceptances and standby letters of credit is based on a rate determined by reference to the Corporation's credit rating. This facility contains a requirement to maintain the consolidated debt to capitalization ratio at or below 75% and to use no more than $75,000,000 of the facility to fund capital expenditures, customary covenants and events of default. At December 31, 2005, the Corporation and its subsidiaries had drawn $22,165,000 in letters of credit and a $10,000,000 banker's acceptance that matured January 4, 2006 for a total of $32,165,000 drawn against this facility. The Corporation incurred total debt issue costs of $434,176 in 2005 (See Note 7).

On January 5, 2005 the existing unsecured $152,000,000, credit facility with a Canadian chartered bank was terminated and replaced with a new facility, amended on May 20, 2005, in the amount of $47,284,782. This facility expires May 20, 2006. It is management's intention to renew this facility, amended for a reduction to the amount for standby letters of credit, for another year. This facility consists of a $24,850,000, 364-day revolving term operating credit line, $22,284,782 in standby letter of credits and a $150,000 corporate Visa facility. Direct advances under the 364-day operating credit line bear interest at prime less 0.35% per annum. This facility contains customary covenants and events of default, including a covenant to maintain the consolidated tangible net worth in excess of $55,000,000 at all times. At December 31, 2005, the Corporation and its subsidiaries had drawn $1,092,000 (2004 - $29,901,000) on the operating credit line, including outstanding cheques and $211,000 in standby letter of credits (2004 - $22,284,782).

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2005	2004
Purchased power payable	**$ 57,953**	$ 49,083
Rebates payable to eligible customers	**4,518**	2,433
Customer credit balances	**28,636**	11,115
Collateral funds held	**14,068**	20,149
Deferred revenue	**5,350**	1,288
Other accounts payable and accrued liabilities	**22,954**	23,979
Accrued interest on notes payable (Note 10)	**3,876**	-
	$ 137,355	$ 108,047

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. NOTES PAYABLE

	2005	2004
Current:		
6.9% Promissory Note payable to the City of Ottawa	**$ -**	$ 200,000
Long-term:		
4.93% Senior Unsecured Debentures, Series 2005-1, due February 9, 2015	**200,000**	-
Integrated Gas Recovery Services Inc., non-interest bearing note	**360**	-
	200,360	-
	$ 200,360	$ 200,000

On December 31, 2004, the Corporation issued a promissory note to the City of Ottawa in the amount of $200,000,000. On January 6, 2005 the Corporation repaid this promissory note and accrued interest with proceeds from a 364-day bridge loan.

On February 9, 2005, the Corporation issued 4.93% Senior Unsecured Debentures, Series 2005-1 due February 9, 2015. The debentures bear interest at a rate of 4.93% per annum, payable semi-annually in arrears in equal installments on August 9 and February 9 commencing August 9, 2005. The debentures mature on February 9, 2015. The debentures were purchased at 99.961% of their principal amount. After deducting underwriters' fees of $1,500,000, the net proceeds to the Corporation were $198,422,000. The funds, together with a draw from the credit facility, were used to repay the $200,000,000 bridge loan. The Corporation incurred total debt issue costs of $2,142,902 with $2,021,501 incurred in 2005 and $121,401 in 2004 (See Note 7).

The Corporation estimated the fair value of these debentures at December 31, 2005 at $206,691,688. The fair value has been determined based on discounting all future payments of interest and the principal repayment on February 15, 2015 at the estimated interest rate of 4.75% that would be available to the Corporation on December 31, 2005.

Effective November 18, 2005, PowerTrail issued a demand promissory note to Integrated Gas Recovery Services Inc. (IGRS), in the amount of $360,000 to fund the construction of the gas collection and generation plant at the Trail Road landfill site. The Corporation cannot determine the fair value of the note payable as the amount is due to a related party, is non-interest bearing and has no specific repayment terms. Pursuant to the Shareholder Agreement dated November 3, 2005 among Energy Ottawa, IGRS and PowerTrail and subject to certain conditions stipulated in this agreement, the note is non-interest bearing.

11. EMPLOYEE FUTURE BENEFITS

(i) Pension plan

The Corporation's participating employer contributions under OMERS and other defined contribution plans for the year ended December 31, 2005 were approximately $2,685,000 (December 31, 2004 - $2,437,000).

(ii) Employee future benefits other than pension plan

Employee future benefits are calculated using an annual compensation rate increase of 3% (2004 - 2.5% to 3%), an inflation rate of 2.0% (2004 - 1.75%), and a discount rate of 5.25% (2004- 6.0%) to calculate the liabilities.

Information about the Corporation's defined benefits plans is as follows:

2005			
	Accumulated liability	**Expense for the year**	**Benefits paid**
Life insurance	**$ 4,021**	**$ 601**	**$ 325**
Supplemental pensions	**28**	**3**	**3**
Sick leave	**16**	**-**	**-**
	$ 4,065	**$ 604**	**$ 328**
Projected benefit obligation	**$ 7,724**		
Actuarial deficit	**$ (3,659)**		

2004			
	Accumulated liability	Expense for the year	Benefits paid
Life insurance	$ 3,744	$ 502	$ 331
Supplemental pensions	28	3	3
Sick leave	16	(42)	-
	$ 3,788	$ 463	$ 334
Projected benefit obligation	$ 6,700		
Actuarial deficit	$ (2,912)		

The last actuarial valuation was performed January 1, 2004. The actuary has updated the assumptions and estimates at December 31, 2005. As a result of this exercise, the Corporation increased the projected benefit obligation by $1,024,000. The excess over the 10% corridor will be charged to earnings over the average remaining service life of current employees of 16 years, beginning January 1, 2006.

At December 31, 2005, the current liability portion of the accrued employee future benefits included in other accounts payable is $325,000 (2004 - $313,000) and the non-current portion of $3,740,000 (2004 - $3,475,000) is included in long-term liabilities.

12. NON-CONTROLLING INTEREST IN POWERTRAIL INC.

The non-controlling interest at December 31, 2005 consists of IGRS' non-controlling interest in the assets of PowerTrail.

PowerTrail was incorporated on August 10, 2005 pursuant to the *Business Corporations Act* (Ontario). Since inception PowerTrail has been engaged in the construction of its gas collection and generation plant at the Trail Road land-fill site in Ottawa, Ontario. PowerTrail is expected to commence operations in late 2006.

As at December 31, 2005, PowerTrail was a development stage company. Successful completion of PowerTrail's gas collection and generation plant, and ultimately, the attainment of profitable operations is dependent upon future events, including the successful commissioning of the gas collection and generation plants and obtaining adequate financing to fulfill its development activities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The adoption of AcG-15 has resulted in the consolidation of PowerTrail for the period commencing August 10, 2005 and ending December 31, 2005.

13. SHARE CAPITAL

Authorized
Unlimited voting first preferred shares, redeemable at $1 per share
Unlimited non-voting second preferred shares, redeemable at $10 per share
Unlimited non-voting third preferred shares, redeemable at $100 per share
Unlimited voting (10 votes per share) fourth preferred shares, redeemable at $100 per share
Unlimited voting Class A common shares
Unlimited non-voting Class B common shares
Unlimited non-voting Class C common shares

The above shares are without nominal or par value.

The Corporation may, at any time, purchase for cancellation the whole or part of the Class C common shares at the price at which such shares were issued.

Holders of second preferred shares, fourth preferred shares and common shares are entitled to receive dividends as and when declared by the board of directors at their discretion. (See Note 20).

	2005	2004
Issued 214,901,003 (2004 - 214,901,003) Class A common shares	**$ 228,453**	$ 228,453

On August 25, 2004, the Shareholder passed a resolution approving a target dividend policy for Hydro Ottawa Holding of 60% of annual consolidated net income. No dividends were declared in 2004 or 2005.

Any invitation to the public to subscribe for shares of the Corporation is prohibited by shareholder resolution.

14. FINANCING COSTS

	2005	2004
Short-term interest (net)	**$ 2,060**	$ 603
Interest on notes payable	**8,807**	16,410
Amortization of debt issue costs	**342**	-
Other	**986**	171
Less: Allowance for funds used during construction	**(467)**	(1,225)
Interest included in discontinued operations	**-**	(148)
Interest capitalized on construction of fibre-optic equipment	**(24)**	(138)
	$ 11,704	$ 15,673

15. PAYMENTS IN LIEU OF CORPORATE INCOME TAXES

The provision for PILs differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rates.

A reconciliation between the statutory and effective tax rates is provided as follows:

	2005	2004
Federal and Ontario statutory income tax rate	**36.12%**	36.12%
Income before provision for PILs	**$ 27,073**	$ 21,685
Provision for PILs at statutory rate	**9,779**	7,833
Increase (decrease) resulting from:		
Permanent differences	**39**	(391)
Tax effect of non-capital losses for which no benefit has been recorded	**(6,240)**	(6,522)
Large corporations tax (LCT)	**745**	885
Corporate minimum tax	**185**	180
Provision for PILs	**$ 4,508**	$ 1,985
Consists of:		
Current PILs corporate income tax expense	**$ 2,781**	$ 1,049
Future PILs corporate income tax expense	**1,727**	936
	$ 4,508	$ 1,985
Effective income tax rate	**16.67%**	9.10%
Reported as:		
Payments in lieu of corporate income taxes	**$ 4,237**	$ 1,236
Net of gain on disposal of discontinued operations	**271**	749
	$ 4,508	$ 1,985

Hydro Ottawa, as a rate regulated utility, does not recognize future income taxes to the extent they are expected to be included in future approved rates charged to customers and recovered from them. Hydro Ottawa has applied all unused tax losses (2004 - $16,131,000) to offset taxable income in the current year. Hydro Ottawa has deductible temporary differences between the tax basis of assets and their carrying amount for accounting purposes of approximately $79,725,000 (2004 - $82,192,000). These amounts translate into an unrecognized future tax asset of approximately $28,982,000 (2004 - $29,688,000) that can be used to reduce payments in lieu of taxes of Hydro Ottawa calculated in future periods.

As prescribed by a regulatory rate order, income tax expense is recovered through customer rates based on the taxes payable method. Therefore, rates do not include the recovery of future income taxes related to unused tax losses or temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. Hydro Ottawa has not recognized future income taxes, as it is expected that when these amounts become payable, they will be recovered through future rate revenues. GAAP for unregulated businesses require the recognition of future income tax liabilities and future income tax assets. In the absence of rate regulation considerations under GAAP operating results in 2005 would be $706,000 lower.

The Corporation, excluding Hydro Ottawa has unused tax losses that have not been reflected on the financial statements, of approximately $14,047,000 (2004 - $12,643,000) of which $5,489,000 have been used to reduce the future PILs liability. These companies have taxable temporary differences between the tax basis of assets and their carrying amount for accounting purposes of approximately $3,709,000 (2004 – $2,600,000). These amounts translate into an unrecognized future tax asset of approximately $1,751,000 (2004 – $1,056,000) which can be used to reduce payments in lieu of taxes calculated in future periods. The losses expire between 2009 and 2015.

Losses are available to offset taxable income in future years for purposes of the PILs regime. The Companies are subject to PILs as long as they are exempt from federal taxation under paragraph 149(1)(d.6) of the ITA. These tax losses will not be available to offset taxable income of the Companies if the Companies are no longer exempt for federal and provincial tax purposes.

16. NET CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS

	2005	2004
(Increase) decrease in accounts receivable	**$ 1,601**	$ (3,150)
(Increase) in unbilled revenue	**(15,064)**	(3,994)
Increase in accounts payable and accrued liabilities	**30,944**	986
Decrease in regulatory assets net of liabilities	**5,536**	2,976
(Increase) decrease in other	**6,243**	(3,951)
(Increase) decrease in non-cash operating working capital	**$ 29,260**	$ (7,133)

17. CONTINGENT LIABILITIES

(i) A class action claiming $500,000,000 in restitutionary payments plus interest was served on the former Toronto Hydro-Electric Commission on November 18, 1998. The action was initiated against the former Toronto Hydro-Electric Commission as the representative of the Defendant Class consisting of all municipal electric utilities in Ontario, including Hydro Ottawa, which have charged late payment charges on overdue utility bills at any time after April 1, 1981.

The claim is that late payment penalties result in electric utilities receiving interest at effective rates in excess of what is allowed under Section 347(1)(b) of the Criminal Code. This action has not yet been certified as a class action and no discoveries have been held, as parties were awaiting the outcome of a similar proceedings brought against The Consumers Gas Company Limited (now Enbridge Gas Distribution Inc.).

On April 22, 2004, the Supreme Court of Canada released a decision in the Enbridge Gas Distribution Inc. (EGD) case with respect to late payment penalties. The Court rejected all the defences which had been raised by EGD, however the Court did not permit the plaintiff class to recover damages for any period prior to the issuance of the Statement of Claim in 1994. At this time, it is not possible to quantify the effect, if any, and no amount has been accrued, in the financial statements of the Corporation.

(ii) Purchasers of electricity in Ontario, through the IESO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IESO could draw on these guarantees if the Corporation fails to make a payment required by a default notice issued by the IESO. A prudential support obligation is calculated based upon a default protection amount and the distributor's trading limit less a reduction for the distributor's credit rating. At December 31, 2005, the Corporation had drawn standby letters of credit of $22,000,000 against its credit facility to cover its prudential support obligation. In addition, the Corporation provided standby letters of credit of $376,000 to the City of Ottawa and Ontario Power Authority as security for construction projects.

(iii) Various lawsuits have been filed against the Corporation for incidents that arose in the ordinary course of business. In the opinion of management, the outcomes of the lawsuits, now pending, are neither determinable nor material. Should any loss result from the resolution of these claims, such loss will be charged to operations in the year of resolution.

(iv) The Corporation participates with other electrical utilities in Ontario in an agreement to exchange reciprocal contracts of indemnity through the Municipal Electrical Association Reciprocal Insurance Exchange. The Corporation is liable for additional assessments to the extent premiums collected and reserves established are not sufficient to cover the cost of claims and costs incurred. If any additional assessments were required in the future, their cost would be charged to operations in the year in which they occur.

(v) The Corporation may be subject to environmental regulatory requirements related to the destruction of PCBs in distribution transformers and other clean up related to PCBs if draft federal legislation in its current form is ultimately passed. Proposed revisions to the Federal PCB Regulatory Framework under the *Canadian Environmental Protection Act, 1999* recommends that certain equipment containing PCBs be removed from service by December 31, 2009 with final removal of PCB equipment expected by December 31, 2014. This legislation could result in approximately $10,000,000 to $11,000,000 being spent over the 4-year period from 2006 to 2009. No amount has been recorded in these financial statements.

(vi) The Corporation has posted a performance guarantee to the Ottawa-Carleton District School Board (OCDSB) related to a wide area network service agreement between Telecom Ottawa Limited and the OCDSB. The guarantee is limited to an amount not to exceed $1,500,000 and expires on or about June 30, 2009.

18. COMMITMENTS

(i) Hydro Ottawa has $9,600,000 in open commitments for 2006. This includes $3,200,000 for its customer information system application services agreement and beginning in 2005, an arrangement to provide call centre services, with IBM Canada Limited. The minimum billable value of the agreement over its term is $16,418,000 and is set to expire December 31, 2010.

(ii) Hydro Ottawa has committed to provide support for a community park in the Village of Casselman. The total amount of the commitment remaining is $27,000, which will be paid in 2006.

(iii) Energy Ottawa and Telecom Ottawa have future minimum annual lease payments related to property and computer hardware operating leases with remaining lease terms between 3 to 11 years as follows:

	Minimum Lease Payments
2006	724
2007	350
2008	314
2009	285
2010	80
Thereafter	325
Total minimum lease payments	$ 2,078

(iv) The Corporation was awarded a $70,000,000, twenty-year contract to supply the Government of Ontario with renewable energy. This contract was subsequently assigned to PowerTrail. Under the terms of the contract, PowerTrail will construct a $10,000,000 - $12,000,000 generation plant and gas collection system at the Trail Road landfill site in Ottawa, Ontario. The plant is expected to be operational by January 31, 2007. The Corporation has a standby letter of credit, expiring on November 14th, 2006, related to this contract, in the amount of $165,000 of the total $376,000 outstanding letters of credit (Note 17 (ii)).

(v) The Corporation entered a Gas Utilization License of Occupation Agreement with the City of Ottawa. This agreement was subsequently assigned to PowerTrail. Under this agreement the City of Ottawa is to provide facilities for the collection and use of the gas generated by the Trail Road and Nepean landfill sites in consideration for a royalty of 5.5% percent of PowerTrail's gross annual receipts derived from the sale of electricity associated with the use of gas from the landfill and a one-time royalty of up to $2,000,000 payable over the term of the agreement represented by initial repairs to the gas collection system.

19. RELATED PARTY TRANSACTIONS

The Corporation and its subsidiaries provide certain services to the City of Ottawa in the normal course of business at commercial rates.

For the year ended December 31, 2005, the Corporation earned revenues related to the sale of electricity and telecommunications products and services, the provision of street lighting services, and energy management consulting in the amount of $29,999,000 (2004 - $30,757,000) to the City of Ottawa.

For the year ended December 31, 2005, the Corporation purchased certain services related to water and sewer charges, fuel and permits from the City of Ottawa in the amount of $354,000 (2004 - $852,000); and property taxes in the amount of $1,712,000 (2004 - $1,644,000). By agreement, Energy Ottawa has agreed to repair the City's gas collection system at the Trail Road landfill site in Ottawa, Ontario. Royalties related to this in the amount of $137,000 (2004 - $nil) are included in deferred costs.

Interest in the amount of $189,000 (2004 - $16,410,000) was paid to the City of Ottawa. On December 31, 2004, $37,825,000 of the promissory notes payable to the City of Ottawa totaling $237,825,000 was converted to 37,825,000 Class A common shares of the Corporation. The remaining balance of $200,000,000 assigned to Hydro Ottawa Holding was repaid January 6, 2005 (Note 10).

For the year ended December 31, 2005, the Corporation did not purchase any professional services from Directors and Advisory Board Members of the Corporation, and their spouses and related companies (2004 – $187,000).

The Corporation owns 28.33% of Chaudière Water Power Inc. (CWPI), a company incorporated to act as an agent for the principals of CWPI, with the mandate to control, operate and maintain the Chaudière dam. By agreement, all expenditures incurred by CWPI, including those of a capital nature, are recovered from shareholders based on their pro-rata interest in CWPI. The Corporation's share of these costs included in operating, maintenance and administration expenses and capital assets are as follows:

	2005	2004
Operating and maintenance and administration	**$ 349**	$ 321
Capital assets	**$ 244**	$ 547

The Corporation and IGRS jointly control PowerTrail. By agreement, IGRS provided construction services to PowerTrail in the amount of $121,000 (2004 - $nil). These costs are included in capital assets. At December 31, 2005, non-interest bearing notes payable to IGRS were $360,000 (2004 - $nil) (Note 10).

20. SUBSEQUENT EVENT

Dividends

On April 13, 2006, the Board of Directors of the Corporation declared dividends in the amount of $12,000,000 or $0.055839665 per common share with respect to 2005 consolidated net income. The dividends are payable on April 18, 2006.

21. COMPARATIVE FIGURES

In certain instances, the 2004 information presented for comparative purposes has been reclassified to conform to the financial statement presentation adopted for the current period.

CORPORATE GOVERNANCE

Corporate governance in Canada is constantly evolving and improving. Hydro Ottawa Holding is committed to identifying and implementing best practices in corporate governance to sustain the sound management and successful development of the Corporation and its subsidiaries. That commitment was reflected in a number of important new practices the Corporation's Board of Directors introduced in 2005.

Early in the year, the Board approved a code of conduct for members of the Board and for company employees, and approved and implemented conflict of interest and conduct guidelines for directors. The Corporation also adopted a mandate for the Board of Directors and defined the roles of the Board of Directors, the Chair, individual directors and the President and Chief Executive Officer.

Management reporting responsibilities were also refined to ensure proper due diligence in the oversight of management actions. The Corporation undertook a detailed assessment of the risks and opportunities relating to its subsidiaries and created an enterprise risk management function within the Hydro Ottawa group of companies.

In 2004, the size of the Board of Directors was increased from five to 11 directors to expand the range of insight and perspectives available on the Board. The Advisory Board was disbanded. Eight of the directors are required to be unrelated to any of the Hydro Ottawa group of companies while the remaining three are members of the Council of the City of Ottawa, including the Mayor. There are currently eight Directors. The structure will be revised in 2006 to ensure compliance with the OEB's Affiliate Relationships Code. The Board met 13 times in 2005.

COMMITTEE DESCRIPTIONS

Audit. The Audit Committee reviews financial statements, accounting practices and policies; evaluates the results of external audits and related matters; oversees financial risk management and assesses internal controls. The committee undertook a detailed review of the statements, agreements and other transactions that encompassed the successful private debenture offering completed in February 2005. The committee met six times in 2005.

Compensation. The Compensation Committee reviews overall compensation strategy, objectives and policies; and reviews the Chief Executive Officer's performance against objectives and the performance of the senior executive group against assessments. The committee's mandate includes succession planning for executive positions with the respective companies. The committee met six times in 2005.

Governance. The Governance Committee oversees the relationships between Hydro Ottawa Holding and its operating companies and reviews the information disclosure obligations between their managements, the board of directors, the shareholder and other stakeholders to ensure the company can meet its objectives. The committee reviews codes and guidelines relating to the conduct of directors, officers and employees. The committee also has the responsibility to review the allocation of roles and responsibilities and the accountability for carrying out organizational responsibilities and implementation of risk and compliance management. The Committee met five times in 2005.

Hydro Ottawa – the LDC. The Local Distribution company (LDC) Committee reviews strategic directions, business plans, management, financial performance and legal compliance matters relating to Hydro Ottawa Limited. The Committee met five times in 2005.

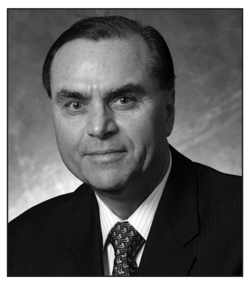
Energy Ottawa. The Energy Committee reviews strategic directions, business plans, management, financial performance and legal compliance matters relating to Energy Ottawa Inc. The committee met six times in 2005.

Telecom Ottawa. The Telecommunications Committee reviews strategic directions, business plans, management, financial performance and legal compliance matters relating to Telecom Ottawa Holding Inc. and its operating subsidiaries. The committee met seven times in 2005.

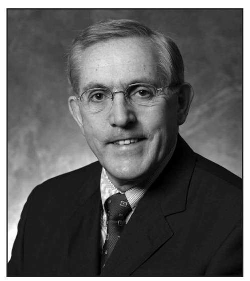
BOARD OF DIRECTORS AND CHIEF EXECUTIVE OFFICERS*

* *as at May 2006*

BOARD OF DIRECTORS



Pierre Richard Q.C., Chair
Senior Partner
Lang Michener LLP

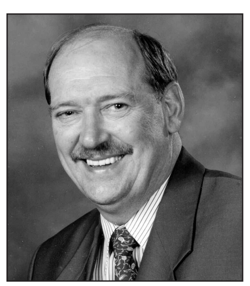


Robert Chiarelli
Mayor
City of Ottawa

Jan Harder
Councillor
City of Ottawa

Manon Harvey
Vice President
Corporate Services
Canada Foundation for Innovation

Peter Hume
Councillor
City of Ottawa

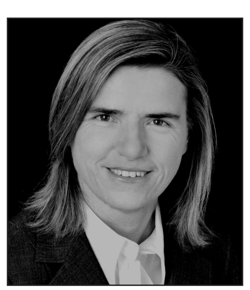


John Kelly
Chair
NexInnovations Inc.

Lisa Stillborn
Senior Vice President
Temple Scott
Associates Inc.

Carole Workman
Executive Director
Canadian Association of
University Business Officers

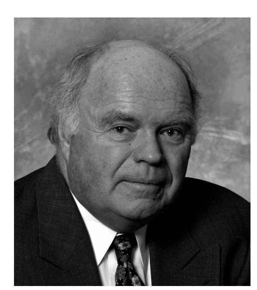
CHIEF EXECUTIVE OFFICERS



Rosemarie T. Leclair
President and Chief
Executive Officer
Hydro Ottawa Holding Inc.

Kim Osmars
Chief Executive Officer
Hydro Ottawa Limited

Marc Brûlé
Chief Executive Officer
Energy Ottawa Inc.



Tom Moss
Chief Executive Officer
Telecom Ottawa
Holding Inc.

KEY TERMS

REVENUES

The Corporation breaks down its revenues into different categories, making it easier to understand how different aspects of the business are performing.

Power Recovery This is pass-through revenue that Hydro Ottawa collects from consumers on behalf of others, including electricity generators, such as Ontario Power Generation, and the company that maintains the provincial grid, Hydro One Networks. It also includes revenue that is applied to manage Ontario's electricity market and to help pay down the debt of the old Ontario Hydro.

Distribution Sales This is the revenue that Hydro Ottawa collects from consumers to pay for the distribution services it provides – maintaining the reliable delivery of electricity in the city of Ottawa.

Communication services and products Telecommunication revenue earned from priority broadband capacity and delivering ISP capabilities such as email, web hosting, wireless and remote Internet access.

Other income This includes premium from sales of green attributes and income earned from work done for others, late payment charges, property rental income and other smaller items.

EARNINGS

There are a number of different ways of looking at how much a company earns. The most common is "net earnings" but other measurements, such as EBITDA, can be useful in judging the company's ability to borrow and to expand its business.

EBITDA This is an acronym for Earnings Before Interest, Taxes, Depreciation and Amortization. It's one measure of financial health that helps to show how much money a company generates to pay for its obligations (such as interest on money borrowed and taxes) and fund its future growth (through depreciation and amortization).

EBIT This is an acronym for Earnings Before Interest and Taxes. This is the same as EBITDA, except that amounts for depreciation and amortization have been deducted in computing EBIT.

Net earnings This is what is left over after the company has met all its expenses and obligations.

CASH SOURCES AND USES

While most companies are concerned about profitability, they also have to ensure that they have enough cash to pay their expenses on a day-to-day basis.

Generated from operations Similar to EBITDA, this is the amount of money that Hydro Ottawa Holding produced during 2005, after all the expenses paid during the year and adding back non-cash "accounting" items such as amortization and depreciation. Essentially, it is net income adjusted for all expenses and revenues that do not include a cash outlay or receipt.

The change in working capital is the change between the company's currents assets (the amounts it is likely to collect in the short-term or which it can easily turn into cash) and current liabilities, the amounts it will likely have to pay out in the short-term.

Capital Assets This is primarily the amount Hydro Ottawa invested across its transmission system in 2005 to improve and expand service and to ensure its reliability. The total also includes expenditures made at Telecom Ottawa and Energy Ottawa.

Financing The process that makes money available for projects and activities. Financing can come from many sources – from existing resources or corporate cash flow or from money raised in financial markets through bank loans or the issuance of bonds, debentures or shares, for instance.

RATIOS

Managers and analysts use a host of ratios to help determine the financial health of the company.

Working Capital This measure compares the company's easy access to funds (through its cash, accounts receivables, inventories and other assets that can be readily turned into cash) versus its immediate liabilities (such as bank debt, accounts payable etc.). Healthy companies have more current assets than liabilities, represented by a ratio greater than 1.0.

Debt to Equity This compares the two sources of investment to support the business. Equity is the money contributed in return for ownership of the company, as well as the accumulation of undistributed earnings, while debt represents the funds provided by financial institutions and investors. Too much debt can burden a business, but good businesses use a certain amount of debt to allow them to do more.

CONSUMPTION

MWH Consumption This refers to the amount of electricity consumed by Hydro Ottawa customers during 2005 as measured in megawatt-hours. The typical Ottawa residential consumer uses an average of 750 kilowatt-hours per month.

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