Consolidated Financial Statements

Toronto Hydro Corporation

December 31, 2005

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AUDITORS' REPORT

To the Shareholder of
Toronto Hydro Corporation

We have audited the consolidated balance sheets of **Toronto Hydro Corporation** [the "Corporation"] as at December 31, 2005 and 2004 and the consolidated statements of retained earnings, income and cash flows for the years 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 audits.

We conducted our audits 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 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Toronto, Canada,
February 17, 2006 [except as to note 26[a],
which is as of March 2, 2006].

Chartered Accountants

Toronto Hydro Corporation

CONSOLIDATED BALANCE SHEET

[in thousands of dollars]

As at December 31	2005 $	2004 $
ASSETS		
Current		
Cash and cash equivalents	**448,370**	386,625
Accounts receivable, net of allowance for doubtful accounts *[notes 5 and 20]*	**174,499**	183,579
Unbilled revenue	**271,367**	246,122
Inventories	**18,189**	19,908
Prepaid expenses	**2,168**	2,213
Electricity mark-to-market assets *[notes 3[i] and 16]*	**113,297**	26,799
Future income tax assets *[note 18]*	**33,195**	6,698
Total current assets	**1,061,085**	871,944
Property, plant and equipment, net *[note 6]*	**1,624,741**	1,547,557
Intangible assets, net *[note 7]*	**41,926**	47,841
Regulatory assets *[note 8]*	**63,752**	73,883
Electricity mark-to-market assets, long-term *[notes 3[i] and 16]*	**-**	22,313
Other assets *[note 9]*	**5,490**	5,871
Future income tax assets, long-term *[note 18]*	**22,264**	22,325
Total assets	**2,819,258**	2,591,734
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities *[note 5]*	**423,780**	330,797
Current portion of other long-term liabilities *[note 11]*	**39,210**	16,861
Deferred revenue *[note 3[i]]*	**20,423**	-
Current portion of promissory note payable *[note 12]*	**330,000**	330,000
Electricity mark-to-market liabilities *[notes 3[i] and 16]*	**86,875**	14,298
Future income tax liabilities *[note 18]*	**40,923**	9,680
Total current liabilities	**941,211**	701,636
Long-term liabilities		
Long-term debentures *[note 12]*	**225,000**	225,000
Promissory note payable *[note 12]*	**650,231**	650,231
Post-employment benefits *[note 13]*	**125,415**	118,117
Regulatory liabilities *[note 8]*	**13,297**	2,880
Other long-term liabilities *[note 14]*	**7,497**	6,592
Asset retirement obligations *[notes 3[l] and 15]*	**5,691**	4,274
Customers' advance deposits and other deposits	**2,900**	45,967
Long-term deferred revenue *[note 3[i]]*	**1,580**	-
Electricity mark-to-market liabilities, long-term *[notes 3[i] and 16]*	**-**	7,118
Future income tax liabilities, long-term *[note 18]*	**569**	8,497
Total long-term liabilities	**1,032,180**	1,068,676
Total liabilities	**1,973,391**	1,770,312
Commitments and contingencies *[notes 13, 15, 16, 17, 21, and 22]*		
Shareholder's equity		
Share capital *[note 19]*	**567,817**	567,817
Retained earnings	**278,050**	253,605
Total shareholder's equity	**845,867**	821,422
Total liabilities and shareholder's equity	**2,819,258**	2,591,734

ON BEHALF OF THE BOARD:

Clare R. Copeland, Director

L. Ross Cullingworth, Director

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

[in thousands of dollars]

Year ended December 31	2005 $	2004 $
Retained earnings, beginning of year	**253,605**	205,458
Net income	**92,445**	97,347
Dividends *[notes 19 and 26]*	**(68,000)**	(49,200)
Retained earnings, end of year	**278,050**	253,605

CONSOLIDATED STATEMENT OF INCOME

[in thousands of dollars, except for per share amounts]

Year ended December 31	**2005** **$**	**2004** **$**
Revenues *[notes 3[i] and 16]*	**2,612,585**	2,226,159
Costs *[note 20]*		
Purchased power and other	**2,061,542**	1,665,736
Operating expenses	**189,961**	186,004
Depreciation and amortization	**134,978**	134,843
	2,386,481	1,986,583
Income before interest, other and provision for payments in lieu of corporate taxes	**226,104**	239,576
Interest income	**14,086**	12,299
Interest expense		
Long-term debt *[notes 12 and 20]*	**(80,403)**	(80,403)
Other interest	**(2,700)**	(3,381)
Other *[note 3[e]]*	**5,040**	1,043
Income before provision for payments in lieu of corporate taxes	**162,127**	169,134
Provision for payments in lieu of corporate taxes *[note 18]*	**69,682**	71,787
Net income	**92,445**	97,347
Basic and diluted net income per share *[note 23]*	**92,445**	97,347

Toronto Hydro Corporation

CONSOLIDATED STATEMENT OF CASH FLOWS

[in thousands of dollars]

Year ended December 31	**2005** **$**	**2004** **$**
OPERATING ACTIVITIES		
Net income	**92,445**	97,347
Adjustments for non-cash items		
Depreciation and amortization	**134,978**	134,843
Net change in other liabilities and assets	**1,994**	1,386
Electricity mark-to-market assets and liabilities *[notes 3[i] and 16]*	**1,274**	(22,154)
Post-employment benefits *[note 13]*	**7,298**	5,921
Future income taxes	**(3,121)**	5,509
Gains on disposals of property, plant and equipment *[note 3[e]]*	**(5,040)**	(1,043)
Changes in non-cash working capital balances		
Decrease in accounts receivable	**9,080**	7,712
Decrease (increase) in unbilled revenue	**(25,245)**	2,004
Decrease in inventories	**1,719**	3,166
Decrease in prepaid expenses	**45**	129
Increase (decrease) in accounts payable and accrued liabilities	**92,983**	(13,386)
Increase in deferred revenue	**20,423**	-
Increase in current portion of other long-term liabilities	**1,219**	2,021
Net cash provided by operating activities	**330,052**	223,455
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	**(195,879)**	(102,429)
Purchase of intangible assets	**(8,114)**	(7,204)
Net change in regulatory assets and liabilities *[note 8]*	**20,548**	15,029
Proceeds on disposal of property, plant and equipment	**5,085**	5,399
Net cash used in investing activities	**(178,360)**	(89,205)
FINANCING ACTIVITIES		
Increase (decrease) in customers' advance deposits	**(20,081)**	5,795
Repayment of capital lease liability	**(1,866)**	(1,891)
Dividends paid *[note 19]*	**(68,000)**	(49,200)
Net cash used in financing activities	**(89,947)**	(45,296)
Net increase in cash and cash equivalents during the year	**61,745**	88,954
Cash and cash equivalents, beginning of year	**386,625**	297,671
Cash and cash equivalents, end of year	**448,370**	386,625
Supplementary cash flow information		
Total interest paid	**81,657**	81,966
Payments in lieu of corporate taxes	**74,780**	70,878

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2005

1. INCORPORATION

On June 23, 1999, Toronto Hydro Corporation [the "Corporation"] was incorporated under the Business Corporations Act (Ontario) ["BCA"] along with two wholly-owned subsidiary companies, Toronto Hydro-Electric System Limited ["LDC"] and Toronto Hydro Energy Services Inc. ["TH Energy"]. The incorporation was required in accordance with the provincial government's Electricity Act, 1998.

Under the terms of By-law No. 374-1999 of the City of Toronto ["Transfer By-law"] made under section 145 of the Electricity Act, 1998 and in accordance with continuity of interest accounting, the former Toronto Hydro-Electric Commission and the City of Toronto [the "City"] transferred, at book value, their assets and liabilities [effective July 1, 1999] and employees [effective January 1, 2000] associated with:

[a] electricity distribution to LDC in consideration for the issuance of equity securities of LDC and long-term notes payable to the City; and

[b] electricity generation, co-generation and energy services to TH Energy in consideration for the issuance of equity securities of TH Energy.

The equity securities of LDC and TH Energy were subsequently transferred by the City to the Corporation in consideration for the issuance of equity securities of the Corporation to the City.

Certain surplus real property assets and cash funds were excluded from the transfer and were retained by the City. In addition, the long-term debt incurred by the City on behalf of the former Toronto Hydro-Electric Commission was excluded from the liabilities transferred and was retained by the City.

The book value of the assets transferred at July 1, 1999 was $1,548,048,000. The principal amount of the long-term notes payable to the City was $980,231,000 and the value of the common shares of the Corporation received by the City was $567,817,000.

The Corporation supervises the operations of, and provides corporate and management services and strategic direction to, its subsidiary companies [each of which is listed below, incorporated under the BCA and wholly-owned, directly or indirectly, by the Corporation]:

[a] LDC [incorporated June 23, 1999] – which distributes electricity to customers located in the City.

[b] TH Energy [incorporated June 23, 1999] – which manages an existing portfolio of electricity contracts and provides energy efficiency products and services.

[c] Toronto Hydro Telecom Inc. [“Telecom”] [incorporated September 26, 2000] – which provides fibre optic cable capacity and manages data communications services.

[d] Toronto Hydro Street Lighting Inc. [“Street Lighting”] [incorporated December 28, 2001] – which provides streetlighting and expressway lighting services *[note 4]*.

[e] 1455948 Ontario Inc. [incorporated December 21, 2000] – which owns a 50% interest in EBT Express Partnership [“EBT Express”], a joint venture with a wholly-owned subsidiary of Ontario Power Generation Inc [“OPG”]. EBT Express owns a 67% controlling interest in The SPi Group [“SPi”], a corporation formed to provide, among other things, centralized electronic data management and transaction services to energy industry participants.

The principal business of the Corporation is the distribution of electricity by LDC.

2. REGULATION

In April 1999, the government of Ontario initiated a restructuring of Ontario’s electricity industry. The restructuring was intended, among other things, to facilitate competition in the generation and sale of electricity, to protect the interests of consumers with respect to prices and the reliability and quality of electricity service and to promote economic efficiency in the generation, transmission and distribution of electricity.

a) Open Access

On May 1, 2002, the Province of Ontario opened Ontario’s wholesale and retail markets to competition by providing generators, retailers and consumers with open access to Ontario’s transmission and distribution network [“Open Access”].

Since the commencement of Open Access, LDC and other electricity distributors have been purchasing their electricity requirements from the wholesale market administered by the Independent Electricity System Operator [the “IESO”] and recovering the cost of electricity and certain other costs at a later date in accordance with procedures mandated by the Ontario Energy Board [the “OEB”].

The OEB has regulatory oversight of electricity matters in the Province of Ontario. The *Ontario Energy Board Act, 1998* sets out the OEB's authority to issue a distribution licence which must be obtained by owners or operators of a distribution system in Ontario. The OEB prescribes licence requirements and conditions including, among other things, specified accounting records, regulatory accounting principles, separation of accounts for separate businesses and filing process requirements for rate-setting purposes.

The OEB's authority and responsibilities include the power to approve and fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity customers and the responsibility for ensuring that electricity distribution companies fulfill obligations to connect and service customers.

LDC is required to charge its customers for the following amounts (all of which, other than the distribution rate, represent a pass through of amounts payable to third parties):

[i] *Electricity Price*. The electricity price represents a pass through of the commodity cost of electricity. See "Price protection and rate caps" below.

[ii] *Distribution Rate*. The distribution rate is designed to recover the costs incurred by LDC in delivering electricity to customers and the OEB allowed rate of return. Distribution rates are regulated by the OEB and typically comprise a fixed charge and a usage-based (consumption) charge.

The volume of electricity consumed by LDC's customers during any period is governed by events largely outside LDC's control (principally sustained periods of hot or cold weather which increase the consumption of electricity and sustained periods of moderate weather which decrease the consumption of electricity).

[iii] *Retail Transmission Rate*. The retail transmission rate represents a pass through of wholesale costs incurred by distributors in respect of the transmission of electricity from generating stations to local areas. Retail transmission rates are regulated by the OEB.

[iv] *Wholesale Market Service Charge*. The wholesale market service charge represents a pass through of various wholesale market support costs. Retail rates for the recovery of wholesale market service charges are regulated by the OEB.

Market participants (including distributors and retailers) are required to satisfy and maintain prudential requirements with the IESO which include credit support with respect to outstanding market obligations in the form of letters of credit, cash deposits or guarantees from third parties with prescribed credit ratings.

b) Price protection and rate caps

In December 2002, the Province passed the *Electricity Pricing, Conservation and Supply Act, 2002* ["Bill 210"] which, among other things:

[i] fixed the price of electricity payable by consumers of electricity who annually utilize less than 250,000 kWh ["Low Volume Consumers"] and consumers comprised principally of municipalities, universities, schools, hospitals, charities, health and community service organizations, consumers with a demand of 50 kW or less and multi-unit residential buildings ["Designated Consumers"] at 4.3¢ per kWh (retroactive to May 1, 2002);

[ii] capped distribution rates at current levels and deferred rate increases and certain cost recoveries by electricity distributors (including scheduled third adjustment for market-based rate of return); and

[iii] deemed certain costs and variance account balances of distributors to be “regulatory assets or liabilities” which are required to be reflected in a distributor’s balance sheet until the manner and timing of disposition is determined by the OEB.

In November 2003, the Province:

[i] announced its intention to increase (effective April 1, 2004) the price of electricity payable by Low Volume Consumers and Designated Consumers from 4.3¢ to 4.7¢ per kWh on the first 750 kWh consumed during a month and 5.5¢ per kWh thereafter;

[ii] directed the OEB to develop new pricing mechanisms for setting the price of electricity payable by Low Volume Consumers and Designated Consumers; and

[iii] announced initiatives with respect to the disposition of regulatory assets and liabilities and the third and final distribution rate adjustments to achieve a market-based rate of return.

During the period that the price protection is in effect, it is expected that electricity distributors and retailers will be compensated by the Ontario Electricity Financial Corporation:

[i] in the case of electricity distributors, for amounts by which the purchase price of the electricity purchased by them in the IESO-administered wholesale market on behalf of Low Volume Consumers and Designated Consumers is greater than the fixed price per kWh charged to customers; and

[ii] in the case of electricity retailers, for amounts by which the retail contract price agreed to between retailers and Low Volume Consumers and Designated Consumers is greater than the fixed price per kWh charged to customers.

c) Market-based rate of return

Before the introduction of rate caps in December 2002, the OEB had authorized electricity distributors to adjust their distribution rates to incorporate a market-based rate of return. The adjustment was being phased in over three adjustment periods (2001, 2002 and 2003) to lessen the rate impact on customers. Effective on each of December 1, 2000 and March 1, 2002, the OEB authorized LDC to increase its distribution rates to allow for the recovery of additional annual revenue of $39.8 million.

In March 2005, LDC received approval from the OEB to increase distribution rates to recover $39.8 million, representing the third and final adjustments necessary to achieve a market-based rate of return. The rate increase was effective as of April 1, 2005 and subjected the LDC to a financial commitment to invest $39.8 million in Conservation and Demand Management [“CDM”] activities by September 2007.

d) Electricity sector reorganization

In December 2004, the Province initiated a further restructuring of Ontario's electricity industry with the passage of the *Electricity Restructuring Act, 2004* ["Bill 100"]. The restructuring was intended, among other things, to ensure efficient and effective management of electricity, promote the expansion of new electricity supply and capacity, encourage electricity conservation and renewable energy and regulate prices in parts of the electricity sector.

Bill 100:

[i] established the Ontario Power Authority [the "OPA"], as an independent, non-profit, self-financed corporation, with a broad mandate to ensure adequate long-term electricity supply in the Province;

[ii] reorganized the Independent Electricity Market Operator as the IESO, a non-share corporation, which will continue to operate the wholesale market and be responsible for the operation and reliability of the integrated power system; and

[iii] established a Conservation Bureau within the OPA responsible for assuming a leadership role in planning and coordinating electricity conservation measures and load management in the Province.

Under Bill 100, the commodity cost of electricity for certain customer classes will be regulated by the OEB. Customers who did not wish to or were not eligible to participate in the regulated plan purchased electricity in the competitive market or through licensed retailers.

Effective January 1, 2005, the IESO implemented, pursuant to Bill 100, a new price adjustment applicable to customers not subject to price protection and rate caps. The new price adjustment, referred to as Global Adjustment, is a variable rate calculated by the IESO based on the difference between electricity market prices and the mix of regulated and contract prices paid to electricity generators. This calculation results in positive or negative bill adjustments depending on prevailing electricity market conditions.

The difference between the amount credited to customers and the amount received from the IESO by LDC is being tracked in variance account and is currently reflected as a settlement variance regulatory liability. The disposition of the variance account balance shall be in accordance with the OEB's guidelines for reviewing variance and deferral accounts.

On February 23, 2005, the Minister of Energy announced a new fixed pricing structure for electricity supplied by OPG. The new pricing structure, effective April 1, 2005 through March 31, 2008, is based on a blended price for electricity supplied by OPG's regulated and unregulated assets.

The new pricing structure had an immediate impact on large industrial and commercial electricity customers who use more than 250,000 kWh per year. While residential, small business and other consumers were not immediately affected by the new pricing structure, the OEB blended the various prices paid to generators into a new fixed price that these consumers now pay under the Regulated Price Plan [“RPP”], which took effect on April 1, 2005.

The OEB has formulated two pricing plans for RPP-eligible customers, depending on how customers’ electricity consumption is metered – that is, a pricing plan for customers without smart meters, and a pricing plan for customers with smart meters. For both plans, prices were effective April 1, 2005.

The continuing restructuring of Ontario’s electricity industry and other regulatory developments, including current and possible future consultations between the OEB and interested stakeholders, may affect the distribution rates, including payments in lieu of corporate taxes [“PILs”] recoveries, that LDC may charge and the costs that LDC may recover, including the balance of its regulatory assets.

e) 2006 Rate Application

On August 2, 2005, LDC filed with the OEB its Electricity Distribution Rate Application for 2006 distribution rates [the “2006 Rate Application”], for rates to be effective on May 1, 2006. The 2006 Rate Application includes an overall reduction of 6.9% of distribution rates (5.0% including the recovery of regulatory assets). A final decision from the OEB regarding the 2006 Rate Application is expected in April 2006.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Corporation have been prepared in accordance with Canadian generally accepted accounting principles [“GAAP”], including accounting principles prescribed by the OEB in the handbook “Accounting Procedures Handbook for Electric Distribution Utilities” [“AP Handbook”] and reflect the significant accounting policies summarized below.

a) Basis of consolidation

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

b) Regulation

The following regulatory treatments have resulted in accounting treatments which differ from Canadian GAAP for enterprises operating in an unregulated environment:

Regulatory Assets and Liabilities

Effective December 31, 2005, the Corporation adopted Canadian Institute of Chartered Accountants ["CICA"] Accounting Guideline 19 "Disclosures by Entities Subject to Rate Regulation" ["AcG-19"]. Certain costs and variance account balances are deemed to be "regulatory assets" or "regulatory liabilities" and are reflected in LDC's balance sheet until the manner and timing of disposition is determined by the OEB *[note 8]*.

Business Protection Plan ["BPP"]

Consumers other than designated consumers who annually utilize more than 250,000 kWh were eligible to receive BPP rebates from the IESO to the extent that electricity prices exceeded certain prescribed thresholds. The rebate program was terminated on March 31, 2005, with the enactment of Bill 100.

Under this program, LDC and other electricity distributors were required to pass these rebates through to eligible consumers and other market participants (including retailers). LDC included amounts due from the IESO in accounts receivable and included amounts due to eligible consumers and market participants in accounts payable and accrued liabilities.

Depending on the terms of its retail contracts with eligible consumers and other market participants, TH Energy either passed the rebates received from the IESO through LDC and other electricity distributors to its eligible consumers and other market participants or retained the rebates to reduce the cost of purchased power.

Payments in lieu of corporate taxes

The Corporation and its subsidiaries are exempt from tax under the *Income Tax Act (Canada)* and the *Corporations Tax Act (Ontario)*, if not less than 90% of the capital of the Corporation is owned by the City and not more than 10% of the income and each of its subsidiaries is derived from activities carried on outside the municipal geographical boundaries of the City.

The Corporation and each of its subsidiaries is a "municipal electricity utility" ["MEU"] for purposes of the 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)* and the *Corporations Tax Act (Ontario)* is required to make, for each taxation year, a payment in lieu of corporate taxes, to the Ontario Electricity Financial Corporation in an amount equal to the tax that it would be liable to pay under the *Income Tax Act (Canada)* and the *Corporations Tax Act (Ontario)* if it were not exempt from tax.

The PILs regime came into effect on October 1, 2001, at which time the Corporation and each of its subsidiaries were deemed to have commenced a new taxation year for purposes of determining the respective liabilities for PILs. Accordingly, the Corporation and its subsidiaries were deemed to have disposed of their assets at their then fair market value and to have re-acquired such assets at the same amount. The differences between the financial statement carrying value and tax bases of assets and liabilities were accounted for by the Corporation as follows:

[a] in the case of the Corporation's unregulated businesses, the liability method of accounting was applied in accordance with recommendations of the CICA; and

[b] in the case of the Corporation's regulated electricity distribution business, the taxes payable method of accounting was applied in accordance with recommendations of the CICA and the OEB.

The OEB's Electricity Distribution Rate Handbooks, issued in March 2000 and May 2005, provide for the recovery of PILs by LDC through annual distribution rate adjustments as permitted by the OEB. The OEB-approved distribution rate for PILs recoveries is based on estimated consumption volumes. The difference between actual billings that relate to the recovery of PILs and the OEB-approved PILs amount is tracked by the Corporation as a variance amount in accordance with OEB guidelines for regulatory assets and with criteria set out in the AP Handbook.

The Corporation accounts for PILs in the unregulated business using the liability method. The Corporation provides for PILs relating to its regulated business using the taxes payable method as permitted by the CICA and the OEB.

Under the liability method, future income tax assets and liabilities are recognized for the differences between the financial statement carrying values and tax basis of assets and liabilities, known as temporary differences. Future income tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which 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.

Under the taxes payable method, no provisions are made for future income taxes as a result of 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 from the customers of the regulated business at that time.

Contributions in aid of construction

Capital contributions are required contributions received from outside sources used to finance additions to property, plant and equipment. According to the AP Handbook, capital contributions received are treated as a "credit" to property, plant and equipment. The amount is subsequently amortized by a charge to accumulated amortization and a credit to amortization expense at an equivalent rate to that used for the depreciation of the related property, plant and equipment. Canadian GAAP provides no specific guideline on the accounting treatment for this type of contributions.

Spare transformers

Spare transformers are items that are expected to substitute for original distribution plant transformers 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. According to the criteria set out in the AP Handbook, spare transformers are treated as capital assets *[note 6]*, which would be recorded as inventory under Canadian GAAP for unregulated businesses. In the absence of rate regulation, inventory in 2005 would have been $4,767,000 higher [2004 - $4,467,000].

c) Cash and cash equivalents

Cash equivalents are highly liquid investments with terms to maturity of five months or less from their date of acquisition. Temporary investments are accounted for at the lower of cost and market.

d) Inventories

Inventories consist primarily of maintenance and construction materials and are stated at the lower of cost and replacement cost, with cost determined on an average cost basis net of the provision for obsolescence.

e) Property, plant and equipment and depreciation

Property, plant and equipment are stated at cost and are removed from the accounts at the end of their estimated average service lives, except in those instances where specific identification allows their removal at retirement or disposition. Gains or losses at retirement or disposition of such assets are credited or charged to "Other" in the Consolidated Statement of Income.

In the event that facts and circumstances indicate that property, plant and equipment may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the asset are compared to the carrying amount of the asset to determine if a write-down is required. The impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value.

[all tabular amounts in thousands of dollars]

Depreciation is provided on a straight-line basis over the estimated service lives at the following annual rates:

Buildings	1.7% to 10.0%
Distribution stations	2.9% to 5.0%
Distribution lines - overhead and underground	2.5% to 4.0%
Distribution transformers	3.3% to 4.0%
Distribution meters	2.9% to 4.0%
Other capital assets	6.7% to 12.5%
Communications	5.0% to 20.0%
Computer hardware	20.0% to 25.0%
Rolling stock	12.5% to 20.0%
Equipment and tools	10.0%

Construction in progress includes assets not currently in use which are not depreciated.

f) Intangible assets

Intangible assets, which lack physical substance, are stated at cost. Amortization is provided on a straight-line basis over their estimated useful service lives at the following annual rates:

Land rights	2.0%
Computer software	14.0% to 33.0%
Capital contributions paid	4.0%
Leasehold improvements	Over the remaining lease term

Software in development includes assets not currently in use which are not amortized.

g) Deferred debt issue costs

During 2003, the Corporation incurred debt issue costs arising from the Corporation's debenture offering *[notes 9 and 12]*. Deferred debt issue costs are included in "Other assets" and represent the unamortized amounts of debt costs arising from the issuance of debt, and other related costs. Deferred debt issue costs are amortized over the period to maturity of the debt on a straight-line basis.

h) Workplace Safety and Insurance Act

The Corporation is a Schedule 1 employer for workers' compensation under the Workplace Safety and Insurance Act ["WSIA"]. As a Schedule 1 employer, the Corporation is required to pay annual premiums into an insurance fund established under the WSIA and recognizes expenses based on funding requirements.

i) Revenue recognition and accounting for financial derivative instruments

LDC

Revenue from the sale of electricity is recorded on a basis of cyclical billings and also includes unbilled revenue accrued in respect of electricity delivered but not yet billed.

In March 2005, LDC received approval from the OEB to increase distribution rates to recover $39,800,000. The rate increase was effective as of April 1, 2005 and is subject to a financial commitment by LDC to use $39,800,000 in CDM activities by September 2007. The revenue of $39,800,000 is being billed to customers over an approximate 11-month period commencing April 1, 2005. At each reporting date, on a life-to-date basis, to the extent the earned customer revenue exceeds the CDM activity spending, the difference is recorded in the balance sheet as "Deferred revenue".

TH Energy

TH Energy has entered into contracts to provide electricity at fixed prices. Electricity contracts include full requirement contracts and contracts with fixed notional volumes at fixed prices. These contracts expose TH Energy to changes in market prices of electricity and consumption. To reduce its exposure to these changes, TH Energy purchases wholesale electricity physical bilateral and financial contracts.

TH Energy recognizes revenue on full requirement contracts using the accrual method of accounting and accounts for related designated purchase contracts using hedge accounting. Under the accrual method of accounting, gains and losses on hedging instruments are recognized over the term of the contracts based on the timing of the underlying transactions. TH Energy has assessed the hedging relationship between the full requirement contracts and the designated purchase contracts as effective. The effectiveness of the relationship is assessed periodically. Under the accrual method of accounting, amounts received or paid under the designated purchase contracts are recognized as part of the cost of electricity. Amounts received under the full requirement contracts are recognized as part of electricity revenue.

TH Energy accounts for notional block contracts and non-designated purchase contracts using the mark-to-market method of accounting. Under the mark-to-market method of accounting, TH Energy records the fair value of the contracts, less related reserves, as mark-to-market assets or liabilities at the time of contract execution. All transactions are recognized on a net basis as mark-to-market revenue. Mark-to-market revenue includes gains or losses on new transactions at origination, unrealized gains and losses from changes in the fair value of contracts, net gains or losses from realized transactions and changes in reserves.

TH Energy records reserves for counter-party credit risk and on-going operational expense to reflect uncertainties associated with certain estimates inherent in the determination of the fair value of mark-to-market assets and liabilities. To the extent possible, TH Energy utilizes market-based data together with quantitative methods to determine the level of reserves.

Long-term value-added service contract revenue is accounted for under the percentage of completion method, with revenue recognized proportionately with the degree of completion of the services under contract. Losses on contracts are fully recognized when they become evident.

Telecom and others

Fibre leasing and lit service data communications revenues are recognized over the term of the related customer agreement.

Other Revenues

Other revenues, which include revenues from electricity distribution services, pole attachment, duct and water heater rentals, customer demand work and other miscellaneous revenues, are recognized as the service activity is performed.

j) Employee future benefits

Pension plan

The Corporation provides a pension plan for its full-time employees through Ontario Municipal Employees Retirement System ["OMERS"]. OMERS is a multi-employer, contributory, defined benefit pension plan established in 1962 by the Province for employees of municipalities, local boards and school boards in Ontario. Both participating employers and employees are required to make plan contributions based on participating employees' contributory earnings. The Corporation recognizes the expense related to this plan as contributions are made.

Employee future benefits other than pension

Employee future benefits other than pension provided by the Corporation include medical and life insurance benefits, accumulated sick leave credits and voluntary exit incentive program liability. These plans provide benefits to employees when they are no longer providing active service.

Employee future benefit expense is recognized in the period in which the employees render services on an accrual basis. The accrued benefit obligations and current service cost are calculated using the projected benefit method prorated 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 of benefits attributed to employees' services rendered in the period. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. The excess of the net actuarial gains (losses) over 10% of the accrued benefit obligation are amortized into expense on a straight-line basis over the average remaining service period of active employees to full eligibility. The effects of a curtailment gain or loss are recognized in income in the year of the event giving rise to the curtailment. The effects of a settlement gain or loss are recognized in income for the period in which a settlement occurs.

k) Customers' advance deposits

Customers' advance deposits are cash collections from customers to guarantee the payment of energy bills. The customers' advance deposits liability includes interest credited to the customers' deposit accounts, with the debit charged to interest expense. Deposits expected to be refunded to customers within the next fiscal year are classified as a current liability.

l) Asset retirement obligations

Effective January 1, 2004, the Corporation adopted the new CICA standard for accounting for asset retirement obligations [“ARO”]. The Corporation recognizes a liability for the future environmental remediation of certain properties and for future removal and handling costs for contamination in distribution equipment and in storage. Initially, the liability is measured at present value and the amount of the liability is added to the carrying amount of the related asset. In subsequent periods, the asset is depreciated and the liability is adjusted quarterly for the discount applied upon initial recognition of the liability [“accretion expense”] and for changes in the underlying assumptions. The liability is recognized when the ARO is incurred.

m) Use of estimates

The preparation of the Corporation's consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the year. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Minister of Energy or Minister of Finance.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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December 31, 2005

4. ACQUISITION OF STREET AND EXPRESSWAY LIGHTING ASSETS

On December 31, 2005, Street Lighting purchased the street and expressway lighting assets from the City for cash consideration of $60,000,000. The transaction was recorded at the exchange amount, which is reflective of the fair market value, as an increase in property, plant and equipment. The acquisition of these assets was recorded at the exchange amount since the carrying value of the assets in the City's records was not determinable. The purchase price was supported by an independent valuation of the fair market value of the acquired assets. The valuation will be used to support the tax carrying value of the assets. The tax carrying value will be finalized in 2006. The acquired assets will be depreciated over their estimated remaining service lives.

Concurrently with the transaction, the Corporation entered into a service agreement with the City to provide street and expressway lighting services to the City for a period of 30 years commencing January 1, 2006 *[note 20]*.

5. BUSINESS PROTECTION PLAN REBATES

At December 31, 2005, the "Accounts receivable, net of allowance for doubtful accounts" include $nil [December 31, 2004 - $44,647,000] receivable from the IESO and other electricity distributors and "Accounts payable and accrued liabilities" include $6,872,000 [December 31, 2004 - $51,373,000] payable to customers and electricity retailers in connection with BPP rebates.

For the year ended December 31, 2005, TH Energy recognized $1,733,000 [2004 - $13,685,000] as a reduction of the cost of purchased power in connection with BPP rebates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2005

6. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consist of the following:

	2005			2004		
	Cost $	Accumulated Depreciation $	Net Book value $	Cost $	Accumulated Depreciation $	Net Book value $
Land	**4,136**	**—**	**4,136**	4,153	—	4,153
Buildings	**144,048**	**43,332**	**100,716**	140,635	40,107	100,528
Distribution stations	**183,155**	**94,179**	**88,976**	177,362	88,364	88,998
Distribution lines – overhead and underground	**1,982,918**	**942,109**	**1,040,809**	1,877,718	868,982	1,008,736
Distribution transformers	**471,562**	**247,102**	**224,460**	451,328	230,665	220,663
Distribution meters	**127,468**	**75,721**	**51,747**	123,007	71,585	51,422
Other capital assets	**57,506**	**41,722**	**15,784**	52,875	36,873	16,002
Communications	**61,241**	**39,290**	**21,951**	54,209	32,933	21,276
Computer hardware	**36,593**	**33,436**	**3,157**	35,575	31,567	4,008
Rolling stock	**51,424**	**40,990**	**10,434**	48,912	38,309	10,603
Equipment and tools	**28,086**	**22,232**	**5,854**	25,603	21,157	4,446
Construction in progress	**56,717**	**—**	**56,717**	16,722	—	16,722
	3,204,854	**1,580,113**	**1,624,741**	3,008,099	1,460,542	1,547,557

At December 31, 2005, spare transformers with carrying amounts of $4,767,000 [2004 - $4,467,000], are included in "Property, plant and equipment, net" *[note 3[b] "Spare transformers"].*

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2005

7. INTANGIBLE ASSETS, NET

Intangible assets consist of the following:

	2005			2004		
	Cost $	Accumulated Amortization $	Net Book value $	Cost $	Accumulated Amortization $	Net Book value $
Land rights	**10,074**	**1,819**	**8,255**	10,074	1,619	8,455
Computer software	**97,590**	**72,840**	**24,750**	94,137	59,209	34,928
Leasehold improvements	**1,239**	**383**	**856**	1,154	235	919
Capital contributions paid	**2,043**	**116**	**1,927**	2,043	34	2,009
Software in development	**6,138**	—	**6,138**	1,530	—	1,530
	117,084	**75,158**	**41,926**	108,938	61,097	47,841

8. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

	2005 $	2004 $
Regulatory assets recovery account	**55,408**	—
Transition costs	—	37,310
Pre-market opening energy electricity variance	—	25,759
Settlement variances	—	9,421
Deferral account for cash pension contributions	**4,785**	—
Deferral account for OEB annual cost assessments	**3,559**	1,393
	63,752	73,883

Regulatory liabilities consist of the following:

	2005 $	2004 $
Pre-market opening line loss variance	**2,880**	2,880
Settlement variances	**10,417**	—
	13,297	2,880

For the year ended December 31, 2005, LDC recovered approved regulatory assets amounts of $24,563,000 through permitted distribution rate adjustments [2004 - $17,701,000]. These recovery amounts are for the recovery of approved regulatory assets recorded in reporting periods prior to January 1, 2004. In the absence of rate regulation, revenue in 2005 would have been $24,563,000 higher [2004 - $17,701,000]. In accordance with the OEB's direction, LDC recorded carrying charges on the recovered amounts of $1,544,000 in 2005 [2004 - $399,000]. In the absence of rate regulation, interest income in 2005 would have been $1,544,000 higher [2004 - $399,000]. The regulatory assets and liabilities balances of the Corporation are defined as follows:

[a] Regulatory assets recovery account:

On March 31, 2005, the OEB ordered that the approved regulatory asset balances be aggregated into a single regulatory account. Approved regulatory assets of $71,465,000 consisted of transition costs of $37,868,000, pre-market opening energy electricity variance of $26,129,000, and settlement variances of $31,852,000, less recoveries of $24,384,000, which were transferred to the "regulatory asset recovery account" ["RARA"]. This approved balance will be recovered over a 3-year period ending March 31, 2008. The RARA is credited with recovery amounts and is debited by the OEB prescribed carrying charges. In the absence of rate regulation, interest income in 2005 would have been $2,539,000 lower [2004 - $nil].

The transition costs and pre-market opening energy electricity variance are defined as follows:

[i] Transition costs:

The OEB has allowed the Corporation to defer the costs incurred to align systems and practices with the requirements of the competitive electricity market in Ontario in accordance with the *Ontario Energy Board Act, 1998*. Accordingly, the Corporation has deferred these expenditures in accordance with the criteria set out in the OEB's Electricity Distribution Rate Handbook and the AP Handbook.

Under such regulation, expenditures were allowed to be deferred during the period January 1, 2000 to December 31, 2002, which would be capitalized or expensed under Canadian GAAP for unregulated businesses. For the period January 1, 2003 to March 31, 2005, transition costs were increased for carrying charges in accordance with the OEB's direction. In the absence of rate regulation, interest income in 2005 would have been $558,000 lower [2004 - $2,233,000].

[ii] Pre-market opening energy electricity variance:

The OEB has allowed the Corporation to recognize the pre-market opening energy electricity variance for the period January 1, 2001 to April 30, 2002, the date of market opening. The pre-market opening energy variance represented the difference between the LDC's cost of power purchased based upon time-of-use ["TOU"] rates and the amounts billed for the cost of power to non-TOU customers at an average rate for the same period. Accordingly, the Corporation has deferred these expenditures in accordance with the criteria set out in the AP Handbook.

Under such regulations, expenditures were allowed to be deferred which would be expensed under Canadian GAAP for unregulated businesses. For the period January 1, 2001 to March 31, 2005, the pre-market opening energy electricity variance was increased for carrying charges in accordance with the OEB's direction. In the absence of rate regulation, interest income in 2005 would have been $370,000 lower [2004 - $1,479,000].

[b] Deferral account for cash pension contributions:

The OEB has allowed the Corporation to defer the incremental OMERS pension expenditures for the fiscal years starting after January 1, 2005. Accordingly, the Corporation has deferred these expenditures in accordance with the criteria set out in the AP Handbook.

Under such regulations, expenditures are allowed to be deferred which would be expensed under Canadian GAAP for unregulated businesses. The deferred balance continues to be calculated and attract carrying charges in accordance with the OEB's direction. In the absence of rate regulation, operating expenses in 2005 would have been $4,785,000 higher [2004 - $nil]. The OEB has allowed the LDC to apply for the recovery of the deferred amounts beginning in 2006 and the LDC has included such balance in its 2006 Rate Application.

[c] Deferral account for OEB annual cost assessments:

The OEB has allowed the Corporation to defer the OEB annual cost assessments for the fiscal years starting after January 1, 2004. Accordingly, the Corporation has deferred these expenditures in accordance with the criteria set out in the AP Handbook.

Under such regulation, expenditures are allowed to be deferred which would be expensed under Canadian GAAP for unregulated businesses. The deferred balance continues to be calculated and attract carrying charges in accordance with the OEB's direction. In the absence of rate regulation, operating expenses in 2005 would have been $2,166,000 higher [2004 - $1,393,000]. The OEB has allowed the LDC to apply for the recovery of the deferred amounts beginning in 2006 and the LDC has included such balance in its 2006 Rate Application.

[d] Pre-market opening line loss variance:

The OEB has allowed the Corporation to defer the pre-market opening line loss variance for the period June 1, 2001 to April 30, 2002. This balance represents the variance between amounts charged by LDC to customers for the OEB-approved loss adjustment factor and the LDC actual loss adjustment factor. Accordingly, the Corporation has deferred this variance in accordance with the OEB's direction.

Under such direction, the variance is allowed to be deferred which would be recorded as revenue under Canadian GAAP for unregulated businesses. In the absence of rate regulation, there would have been no impact on the Consolidated Statement of Income for 2005 and 2004. The deferred balance does not attract carrying charges. The manner and timing of disposition of the variance has not been determined by the OEB.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

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[e] Settlement variances:

The OEB has allowed the Corporation to defer settlement variances from May 1, 2002 to December 31, 2005. This balance represents the variances between amounts charged by LDC to customers (based on regulated rates) and the corresponding cost of non-competitive electricity service incurred by it in the wholesale market administered by the IESO after May 1, 2002. The settlement variances relate primarily to service charges, non-competitive electricity charges, imported power charges and the global adjustment. Accordingly, the Corporation has deferred these recoveries in accordance with the criteria set out in the AP Handbook.

Settlement variances of $31,852,000, relating to the period from May 1, 2002 to December 31, 2003, were approved for recovery in July 2005 and are included in the RARA balance. The remaining balance, representing settlement variances arising after January 1, 2004, is deferred in a regulatory liability account.

Under such regulation, the variances are allowed to be deferred which would be recorded as revenue when incurred under Canadian GAAP for unregulated businesses. In the absence of rate regulation, revenues in 2005 would have been $5,971,000 higher [2004 - $3,739,000] and interest income in 2005 would have been $1,112,000 lower [2004 - $1,705,000]. The deferred balance for unapproved settlement variances continues to be calculated and attract carrying charges in accordance with the OEB's direction. The manner and timing of disposition of the variance has not been determined by the OEB.

9. OTHER ASSETS

Other assets consist of the following:

	2005 $	2004 $
Deferred debt issue costs, net of accumulated amortization of $1,025,000 [2004 - $639,000]	**2,843**	3,230
Long-term advances and deposits	**1,566**	744
Other	**1,081**	1,897
	5,490	5,871

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[all tabular amounts in thousands of dollars]

December 31, 2005

10. BANK INDEBTEDNESS AND BANKERS' ACCEPTANCES

On May 5, 2005, the Corporation extended its revolving credit facility with a syndicate of Canadian banks [the "Corporation Revolving Credit Facility"] for a three-year period to May 4, 2008. Under the terms of the revolving credit facility, the Corporation may borrow up to $500,000,000, of which:

[a] $500,000,000 less the amount utilized under [b] is available for working capital purposes in the form of prime rate loans in Canadian dollars and bankers' acceptances; and

[b] up to $175,000,000 is available in the form of letters of credit to support the prudential requirements of LDC and TH Energy and general credit requirements of the Corporation and its subsidiaries.

The facility contains a negative pledge, customary covenants and events of default.

At December 31, 2005, $90,174,000 [December 31, 2004 - $105,421,000] had been utilized under the Corporation's revolving credit facility in the form of letters of credit to support the prudential requirements of LDC [$80,000,000] [2004 - $80,000,000], TH Energy [$9,194,000] [2004 - $24,301,000] and Telecom [$980,000] [2004 - $1,120,000]. At December 31, 2005, no amounts had been drawn for working capital purposes [December 31, 2004 - $nil].

The Corporation also has a bilateral demand line of credit for $20,000,000 with a Canadian chartered bank. The line of credit bears interest at the bank's prime rate [December 31, 2005 – 5.0%]. At December 31, 2005, no amounts had been drawn on the line of credit [December 31, 2004 - $nil].

11. CURRENT PORTION OF OTHER LONG-TERM LIABILITIES

	2005 **$**	**2004** **$**
Current portion of obligations under capital leases *[note 21]*	**1,877**	2,514
Customers' advance deposits	**37,029**	14,043
Other	**304**	304
	39,210	16,861

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
[all tabular amounts in thousands of dollars]

December 31, 2005

12. LONG-TERM DEBT

	2005 $	2004 $
Long-term debt:		
6.11% senior unsecured debentures due 2013	**225,000**	225,000
6.80% promissory note payable to the City	**980,231**	980,231
	1,205,231	1,205,231
Less: Current portion of promissory note payable to the City	**330,000**	330,000
Long-term debt	**875,231**	875,231
Comprising:		
Long-term debentures	**225,000**	225,000
Promissory note payable to the City	**650,231**	650,231

All debt of the Corporation is ranked equal in preference and priority.

a) Senior unsecured debentures

On May 7, 2003, the Corporation issued $225,000,000 10-year senior unsecured debentures. The Corporation's 10-year senior unsecured debentures in the amount of $225,000,000, as at December 31, 2005, [December 31, 2004 - $225,000,000] bear interest at a rate of 6.11% per annum, payable semi-annually in arrears in equal instalments on May 7 and November 7 of each year. The debentures mature on May 7, 2013.

The Corporation may redeem some or all of the debentures at any time prior to maturity at a price equal to the greater of the Canada Yield Price (determined in accordance with the terms of the debentures) and par, plus accrued and unpaid interest up to but excluding the date fixed for redemption. Also, the Corporation may, at any time and from time to time, purchase debentures for cancellation, in the open market, by tender or by private contract, at any price. The debentures have the benefit of certain covenants which, subject to certain exceptions, restrict the ability of the Corporation and LDC to create security interests, incur additional indebtedness or dispose of all or substantially all of their assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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December 31, 2005

b) Promissory note payable to the City of Toronto

LDC issued a promissory note to the City on July 1, 1999 [“Initial Note”] in the principal amount of $947,000,000 in partial consideration for the assets in respect of the electricity distribution system transferred by the Toronto Hydro-Electric Commission and the City to LDC effective July 1, 1999. The Initial Note was non-interest bearing until December 31, 1999 and interest bearing thereafter at the rate of 6% per annum. Pursuant to the Transfer By-law, the principal amount of the Initial Note was adjusted effective January 1, 2000 to $980,231,000 to reflect the deemed debt/common equity structure of LDC [65:35] permitted by the OEB. At the same time, the Initial Note was replaced by a promissory note [“Replacement Note”] issued by LDC, which was interest bearing at the rate of 6.8% per annum. At December 31, 2002, the Replacement Note was payable on the earlier of demand and December 31, 2003.

Concurrent with the closing of the debenture offering on May 7, 2003, the City transferred the Replacement Note to the Corporation in consideration for the issue by the Corporation to the City of a new promissory note in the principal amount of $980,231,000 [2004 – $980,231,000] [the “City Note”]. The principal amount of the City Note, together with accrued interest thereon, is payable [see “Subsequent Events” *note 26[b]]*:

[a] on demand on not less than 90 days written notice until May 7, 2006; and

[b] in accordance with a payment schedule to be delivered by the City at least 90 days before May 7, 2006;

provided that the Corporation will not be required to pay more than $330,000,000 of the principal amount of the City Note during any twelve-month period. Accordingly, $330,000,000 of the principal amount outstanding under the City Note is classified as a current liability. The maximum term of the City Note is ten years.

The rate of interest payable on the City Note is the Debt Cost Rate [“DCR”], which is 6.8% per annum. The DCR is a rate of interest per annum equal to the debt cost rate prescribed by the OEB in the Electricity Distribution Rate Handbook for utilities in the same rate class as LDC at the time of issuance of the City Note. Interest is calculated and payable quarterly in arrears on the last business day of March, June, September and December of each year.

13. EMPLOYEE FUTURE BENEFITS

Pension

For the year ended December 31, 2005, the Corporation’s current service pension costs payable to OMERS were $8,965,000 [2004 - $8,503,000].

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Employee future benefits other than pension

The Corporation has a number of unfunded benefit plans providing retirement and post-employment benefits [excluding pension] to most of its employees. The Corporation pays certain medical and life insurance benefits under unfunded defined benefit plans on behalf of its retired employees. The Corporation pays accumulated sick leave credits, up to certain established limits based on service, in the event of retirement, termination or death of certain employees.

In October 1994, the former Toronto Hydro-Electric Commission introduced a voluntary exit incentive program for eligible employees. Under the terms of the program, certain employees receive a retirement supplement payment over the term of their retirement and the life of any surviving spouse.

The Corporation measures its accrued benefits obligation for accounting purposes as at December 31 of each year. The latest actuarial valuation was performed as at January 1, 2005.

[a] Accrued benefit obligation:

	2005 $	2004 $
Balance at beginning of year	**139,468**	121,787
Experience gain at beginning of year	**(1,446)**	—
Current service cost	**3,152**	2,398
Interest cost	**8,178**	7,897
Benefits paid	**(4,988)**	(5,276)
Actuarial losses	**22,649**	12,662
Balance at end of year	**167,013**	139,468

[b] Reconciliation of the accrued benefit obligation to the balance sheet accrued benefits liability:

	2005 $	2004 $
Accrued benefit obligation	**167,013**	139,468
Unamortized net actuarial loss	**(34,427)**	(13,197)
Unamortized past service costs	**(7,171)**	(8,154)
Post-employment benefits liability	**125,415**	118,117

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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December 31, 2005

[c] Components for net periodic defined benefit costs:

	2005 $	2004 $
Current service cost	**3,152**	2,398
Interest cost	**8,178**	7,897
Actuarial losses	**21,203**	12,662
Cost incurred in the period	**32,533**	22,957
Differences between costs incurred and costs recognized in the period in respect of:		
Actuarial gain	**(21,230)**	(12,745)
Past service costs	**983**	985
	(20,247)	(11,760)
Defined benefit costs recognized	**12,286**	11,197
Capitalized as part of property, plant and equipment	**3,672**	2,985
Charged to operations	**8,614**	8,212

[d[Significant assumptions:

	2005 %	2004 %
Accrued benefit obligation as of December 31:		
Discount rate	**5.0**	5.9
Rate of compensation increase	**4.0**	3.3
Benefit costs for years ended December 31:		
Discount rate	**5.9**	6.5
Rate of compensation increase	**4.0**	3.3
Assumed health care cost trend rates at December 31:		
Rate of increase in dental costs	**4.5**	4.5

For December 31, 2005, medical costs are assumed to increase at 10.5% graded down by 1.0% annual decrements to 4.5% in 2011 and thereafter.

For December 31, 2004, medical costs are assumed to increase at 10.5% graded down by 1.0% annual decrements to 4.5% in 2009 and thereafter.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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[e] Sensitivity analysis:

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage-point change in assumed health care cost trend rates have the following effects for 2005:

	Increase $	Decrease $
Net periodic benefit cost (at 5.9%)	**1,896**	**(1,436)**
Accrued benefit obligation at December 31, 2005 (at 5.0%)	**27,152**	**(20,704)**

14. OTHER LONG-TERM LIABILITIES

	2005 $	2004 $
Obligations under capital leases *[note 21]*	**2,063**	3,802
Security deposits	**3,277**	—
Lease liability – long-term	**285**	1,901
Other	**1,872**	889
	7,497	6,592

During 2005, the Corporation acquired "Property, plant and equipment" through capital lease transactions totaling $43,000 [2004 - $1,615,000]. These non-cash transactions have been excluded from the Consolidated Statement of Cash Flows.

15. ASSET RETIREMENT OBLIGATIONS

Effective January 1, 2004, the Corporation adopted the new CICA standard for accounting for ARO *[note 3[l]]*. A reconciliation between the opening and closing ARO liability balances is provided below:

	2005 $	2004 $
Balance, beginning of year	**4,274**	**4,040**
ARO liabilities incurred in the year	**1,525**	**139**
ARO liabilities settled in the year	**(351)**	**(140)**
Accretion expense	**243**	**235**
Balance, end of year	**5,691**	**4,274**

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At December 31, 2005, the Corporation estimates the undiscounted amount of cash flows required over the next ten years to settle the ARO is $6,836,000 [December 31, 2004 - $5,278,000]. Discount rates ranging from 4.35% to 5.93% were used to calculate the carrying value of the ARO liabilities. No assets have been legally restricted for settlement of the liability.

16. RETAIL COMMITMENTS AND FINANCIAL INSTRUMENTS

Electricity retailing

In December 2002, TH Energy ceased new electricity retailing activities in respect of new customers as a result of the price freeze implemented under Bill 210. TH Energy currently manages the remaining portfolio of electricity contracts comprised primarily of fixed notional volume contracts, wholesale financial fixed notional volume fixed-for-floating and floating-for-fixed swaps and fixed notional volume physical bilateral contracts. The contracts are derivative contracts for accounting purposes. The electricity contracts have varying maturity dates throughout the period ending December 31, 2006.

At December 31, 2005, TH Energy has floating-for-fixed electricity contracts that have an aggregate expected contract volume and value of 3,124,000 MWh and $171,270,000 [2004 – 6,753,000 MWh and $364,719,000].

To hedge the volume and price risk inherent in retailing electricity, TH Energy has entered into financial fixed notional volume fixed-for-floating swaps and fixed notional physical bilateral contracts with generators and marketers. At December 31, 2005, the aggregate notional volume and value of these contracts are 3,614,000 MWh and $154,396,000 [2004 – 7,985,000 MWh and $344,048,000].

On April 30, 2004, TH Energy extended an existing retail electricity contract with the City from May 1, 2005 to December 31, 2006. Under the remaining term of the current agreement, TH Energy will sell a fixed notional volume of electricity of 1,917,000 MWh for a total expected settlement of $101,467,000 to the City.

For the year ended December 31, 2005, "Revenues" include $34,309,000 of TH Energy electricity mark-to-market revenues [2004 - $50,684,000].

Credit risk

Financial instruments result in exposure to credit risk stemming from the risk of the counter-party defaulting on its obligations. TH Energy monitors and limits its exposure to counter-parties with lower credit ratings and evaluates its counter-party credit exposure on a continuous basis. TH Energy obtains collateral from some counter-parties and seeks to deal only with counter-parties with investment-grade credit ratings. TH Energy had four wholesale counter-parties as at December 31, 2005 for its electricity supply portfolio. In addition, TH Energy provides reserves for credit risks based on the financial condition and short and long-term exposures to counter-parties. The largest single credit exposure at December 31, 2005 is estimated at $137,170,000, which is the estimated replacement cost of wholesale purchase contracts with one counter-party.

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For retail customers, credit losses are generally low across the sector. LDC and TH Energy provide for an allowance for doubtful accounts to absorb credit losses. At December 31, 2005, there were no significant concentrations of credit risk with respect to any class of financial assets other than the wholesale risk mentioned above.

Interest rate risk

The Corporation is exposed to interest rate risk for certain of its financial assets and liabilities. Under the Corporation's Revolving Credit Facility *[note 10]*, the Corporation may have short-term borrowings for working capital purposes. These borrowings would expose the Corporation to fluctuations in short-term interest rates [borrowings in the form of prime rate loans in Canadian dollars and bankers' acceptances and letters of credit]. The fee payable for bankers' acceptances and letters of credit is based on a margin determined by reference to the Corporation's credit rating.

Cash of the Corporation is invested in Canadian money market instruments, with terms of one day to five months, exposing the Corporation to fluctuations in short-term interest rates. These fluctuations could impact the level of interest income earned by the Corporation.

Fair value of financial instruments

The fair value of hedging derivative financial instruments is the estimated amount the Corporation would receive (pay) to terminate the contracts. The value is based on market prices or management's best estimates if there is no organized market and/or if the market is illiquid.

Mark-to-market energy assets and liabilities

All retail fixed notional volume fixed price contracts and all undesignated wholesale fixed notional volume fixed-for-floating swaps and fixed notional volume physical bilateral contracts are accounted for using the mark-to-market method of accounting. The following are the primary sources of the change in the net mark-to-market assets:

	2005 **$**	**2004** **$**
Net mark-to-market assets		
Fair value, beginning of year	**27,696**	5,542
Unrealized change in fair value during the period	**16,342**	27,596
Realization of contracts for the period	**(17,616)**	(5,442)
Fair value of net mark-to-market assets, end of year	**26,422**	27,696

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Other assets and liabilities

The carrying value of cash and cash equivalents, accounts receivable, unbilled revenue, and accounts payable and accrued liabilities approximates their fair value due to the immediate or short-term maturity of these financial instruments**.**

At December 31, 2005, the fair values of the City Note [$980,231,000] and the senior unsecured debentures [$225,000,000] are $1,120,405,000 and $251,415,000, respectively [2004 - $1,067,782,000 and $247,080,000, respectively]. These fair values have been calculated by discounting the future cash flow of the respective long-term debt at the estimated yield to maturity of similar debt instruments *[note 12]*.

17. FINANCIAL GUARANTEES

Participants [including LDC and TH Energy] in the wholesale market for electricity that is administered by the IESO are required to satisfy prescribed prudential requirements. In addition, counter-parties under contracts for the purchase and sale of electricity and customers under purchase contracts may require parental financial guarantees or other forms of credit support.

The City has authorized the Corporation to provide up to $500,000,000 in financial support [including guarantees] with respect to prudential requirements and as security for obligations under third party contracts.

At December 31, 2005, the Corporation's board of directors had approved $386,000,000 in parental guarantees on behalf of TH Energy, of which $86,500,000 has been issued [2004 - $74,500,000].

The Corporation has issued a parental guarantee to the City as part of an agreement to purchase electricity at a fixed price from TH Energy. The fair value of the parental guarantee was $56,417,000 at December 31, 2005 [2004 - $11,426,000].

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18. PAYMENTS IN LIEU OF CORPORATE TAXES

The provision for PILs differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rate. Reconciliation between the statutory and effective tax rates is set out below:

Statement of income

	2005 $	2004 $
Rate reconciliation		
Income before PILs	**162,127**	169,134
Statutory Canadian federal and provincial income tax rate	**36.12%**	36.12%
Expected provision for PILs	**58,560**	61,091
Increase (decrease) in income taxes resulting from		
Large corporations tax net of surtax	**1,655**	2,882
Utilization of temporary differences previously not benefited	**10,630**	(96)
Valuation allowance	**(1,938)**	(2,239)
Other	**775**	10,149
Provision for PILs	**69,682**	71,787
Effective tax rate	**42.98%**	42.44%
Components of provision for PILs		
Current tax provision	**72,803**	66,278
Future income tax provision (recovery) related to the origination and reversal of temporary differences	**(3,121)**	5,509
Provision for PILs	**69,682**	71,787

Consolidated Balance sheet

Significant components of the Corporation's future income tax assets and liabilities are as follows:

	2005 $	2004 $
Non-capital loss carryforwards	**2,785**	1,455
Property, plant and equipment and intangible assets	**33,119**	34,800
Other taxable temporary differences	**(4,998)**	(6,315)
Valuation allowance	**(16,939)**	(19,094)
	13,967	10,846

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Presented on the consolidated balance sheet as follows:

	2005 $	2004 $
Future income tax assets, current	**33,195**	6,698
Future income tax assets, long-term	**22,264**	22,325
Future income tax liabilities, current	**(40,923)**	(9,680)
Future income tax liabilities, long-term	**(569)**	(8,497)
	13,967	10,846

Under the taxes payable method, no adjustments are made for differences between the financial statement carrying values and the tax basis of assets and liabilities. As at December 31, 2005, future income tax assets of $251,704,000 [2004 - $243,841,000], based on substantively enacted income tax rates, have not been recorded. In the absence of rate regulated accounting, the Corporation's provision for PILs would have been recognized using the liability method rather than the taxes payable method. As a result, the provision for PILs in 2005 would have been $7,863,000 lower [2004 – $4,962,000 higher]. See *note 3[b]* ["Regulation - Payments in lieu of corporate taxes"].

As at December 31, 2005, the Corporation has accumulated tax losses for PILs purposes of approximately $7,711,000, which are available to reduce future years' taxable income. Of these losses, $6,282,000 relates to Street Lighting. These loss carryforwards begin to expire in 2008.

As at December 31, 2005, the Corporation has accumulated a deferred PILs amount, representing the difference between actual billings that relate to the recovery of PILs and the OEB-approved PILs, totaling an under-recovery of $4,948,000 [2004 -$13,489,000]. Cumulative interest included in the amount was calculated following OEB direction and totaled $2,858,000 [2004 - $2,313,000].

19. SHARE CAPITAL

Share capital consists of the following:

	2005 $	2004 $
Authorized		
The authorized share capital of the Corporation consists of an unlimited number of common shares		
Issued and outstanding		
1,000 common shares	**567,817**	567,817

Dividends

The shareholder direction adopted by the City with respect to the Corporation provided that the Corporation's board of directors would use its best efforts to ensure that the Corporation met certain financial performance standards, including those relating to credit rating and dividends. Subject to applicable law, the shareholder direction provided that the Corporation would pay dividends to the City each year.

Subject to applicable law and the shareholder direction, the amount of the annual dividends payable by the Corporation to the City is to be the greater of $25,000,000 or 50% of the Corporation's annual consolidated net income. The dividends are not cumulative and are payable as follows:

[a] $6,000,000 on the last day of each of the first three fiscal quarters in each year;

[b] $7,000,000 on the last day of the fourth fiscal quarter in each year; and

[c] the amount, if any, by which 50% of the Corporation's annual consolidated net income for the year exceeds $25,000,000 within ten days after the board of directors of the Corporation approves the Corporation's audited consolidated financial statements for the year.

During 2005, the board of directors of the Corporation declared and paid dividends totaling $68,000,000 to the City [2004 - $49,200,000].

20. RELATED PARTIES

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

For the year ended December 31, 2005, LDC and Street Lighting provided street lighting electricity and street lighting maintenance services, respectively, to the City in the amounts of $11,089,000 and $3,363,000, respectively [2004 - $9,590,000 and $4,742,000 respectively].

For the year ended December 31, 2005, TH Energy invoiced the City for electricity for $107,450,000 [2004 - $103,582,000]. At December 31, 2005, included in "Accounts receivable, net of allowance for doubtful accounts" are $1,257,000 [2004 - $2,371,000] receivable from the City related to these electricity billing activities.

For the year ended December 31, 2005, TH Energy provided energy efficiency products and services to the City amounting to $1,927,000 [2004 - $2,072,000].

For the year ended December 31, 2005, the Corporation incurred property taxes payable to the City of $7,030,000 [2004 - $7,825,000].

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At December 31, 2005, a promissory note in the amount of $980,231,000 [2004 - $980,231,000;] was payable to the City. For the year ended December 31, 2005, interest expense of $66,656,000 [2004 - 66,656,000], on the promissory note was paid to the City *[note 12]*.

On December 31, 2005, Street Lighting entered into a purchase agreement to acquire street and expressway lighting assets from the City for cash consideration of $60,000,000, and concurrently entered into a service agreement with the City to provide street and expressway lighting services to the City *[note 4]*.

21. LEASE COMMITMENTS

Operating lease obligations

As at December 31, 2005, the future minimum annual lease payments under property and computer hardware operating leases with remaining lease terms from one to six years are as follows:

	$
2006	1,735
2007	1,451
2008	1,147
2009	1,023
2010	1,017
Thereafter	1,196
Total minimum lease payments	7,569

Capital lease obligations

As at December 31, 2005, the future minimum annual lease payments under vehicle capital leases with remaining lease terms from one to six years are as follows:

	$
2006	1,877
2007	1,481
2008	578
2009	346
Thereafter	106
Total amount of future minimum lease payments	4,388
Less interest	448
	3,940
Current portion *[note 11]*	1,877
Long-term portion *[note 14]*	2,063

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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22. CONTINGENCIES

Consumers' Gas Decision

On April 22, 2004, in a decision in a class action commenced against The Consumers' Gas Company Limited (now Enbridge Gas Distribution Inc.), the Supreme Court of Canada [the "Supreme Court"] ruled that The Consumers' Gas Company ["Consumers' Gas"] was required to repay the portion of certain late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. Although the claim related to charges collected by Consumers' Gas after the enactment of section 347 of the *Criminal Code* in 1981, the Supreme Court limited recovery to charges collected after the action was initiated in 1994. The Supreme Court remitted the matter back to the Ontario Superior Court of Justice for a determination of the plaintiffs' damages. LDC is not a party to the Consumers' Gas class action. It is, however, subject to the two class actions described below in which the issues are analogous.

The first is an action commenced against a predecessor of LDC and other Ontario municipal electric utilities under the Class Proceedings Act, 1992 seeking $500,000,000 in restitution for late payment charges collected by them from their customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. This action is at a preliminary stage. Pleadings have closed but examinations for discovery have not been conducted and the classes have not been certified as the parties were awaiting the outcome of the Consumers' Gas class action.

The second is an action commenced against a predecessor of LDC under the Class Proceedings Act, 1992 seeking $64,000,000 in restitution for late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. This action is also at the preliminary stage. Pleadings have closed and examinations for discovery have been conducted but, as in the first action, the classes have not been certified as the parties were awaiting the outcome of the Consumers' Gas class action.

The claims made against LDC and the definitions of the plaintiff classes are identical in both actions. As a result, any damages payable by LDC in the first action would reduce the damages payable by LDC in the second action, and vice versa.

It is anticipated that the first action will now proceed for determination in light of the reasons of the Supreme Court in the Consumers' Gas class action.

LDC may have defences available to it in these actions that were not disposed of by the Supreme Court in the Consumers' Gas class action.

Also, the determination of whether the late payment charges collected by LDC from its customers were in excess of the interest limit stipulated in section 347 of the *Criminal Code* is fact specific in each circumstance. Accordingly, given the preliminary status of these actions, it is not possible at this time to quantify the effect, if any, of the Consumers' Gas decision on these actions or of these actions on the financial performance of the Corporation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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23. NET INCOME PER SHARE

The weighted daily average numbers of shares outstanding were 1,000 as at December 31, 2005 and 2004, for purposes of determining basic and fully diluted net income per share. Basic and fully diluted net income per share was determined by dividing the net income for the period by the weighted daily average number of shares outstanding.

24. SEGMENT REPORTING

The Corporation has two reportable segments:

[a] Electricity Distribution:
the regulated business which consists of the electricity distribution business; and

[b] Non-regulated:
the non-regulated businesses which consist primarily of the management of an existing portfolio of electricity contracts, the sale of energy management services and the provision of "dark" fibre optic capacity and "lit" data communications services to telecommunications carriers, business customers and large institutions.

The designation of the segments has been based on a combination of the regulatory status and the nature of products and services provided.

Segment information on the above basis is as follows:

	2005 **$**	**2004** **$**
Electricity Distribution		
Revenues	**2,709,819**	2,261,351
Purchased power and other	**2,224,034**	1,798,008
Operating expenses	**167,139**	166,617
Depreciation and amortization	**124,988**	122,526
Income before interest, other and provision for PILs	**193,658**	174,200
Interest income	**10,485**	10,325
Interest expense	**80,620**	81,608
Other	**2,965**	1,043
Income before provision for PILs	**126,488**	103,960
Provision for PILs	**61,114**	43,825
Net income	**65,374**	60,135

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	2005 $	2004 $
Non-regulated		
Revenues	**109,747**	201,813
Purchased power and other	**44,084**	103,608
Operating expenses	**23,227**	20,512
Depreciation and amortization	**9,990**	12,317
Income before interest, other and provision for PILs	**32,446**	65,376
Interest income	**81,835**	80,608
Interest expense	**80,717**	80,810
Other	**2,075**	—
Income before provision for PILs	**35,639**	65,174
Provision for PILs	**8,568**	27,962
Net income	**27,071**	37,212
Intersegment eliminations		
Revenues	**(206,981)**	(237,005)
Purchased power and other	**(206,576)**	(235,880)
Operating expenses	**(405)**	(1,125)
Interest income	**(78,234)**	(78,634)
Interest expense	**(78,234)**	(78,634)
Total		
Revenues	**2,612,585**	2,226,159
Purchased power and other	**2,061,542**	1,665,736
Operating expenses	**189,961**	186,004
Depreciation and amortization	**134,978**	134,843
Income before interest, other and provision for PILs	**226,104**	239,576
Interest income	**14,086**	12,299
Interest expense	**83,103**	83,784
Other	**5,040**	1,043
Income before provision for PILs	**162,127**	169,134
Provision for PILs	**69,682**	71,787
Net income	**92,445**	97,347

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	2005 $	2004 $
Expenditures on property, plant and equipment and intangible assets		
Electricity Distribution	**132,260**	99,742
Non-regulated	**71,733**	9,891
Total	**203,993**	109,633

	2005 $	2004 $
Assets		
Electricity Distribution	**2,393,533**	2,326,181
Non-regulated	**1,619,790**	1,473,573
Intersegment eliminations	**(1,194,065)**	(1,208,020)
Total	**2,819,258**	2,591,734

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

25. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2005 consolidated financial statements.

26. SUBSEQUENT EVENTS

a) Dividends

On March 2, 2006, the board of directors of the Corporation declared a dividend in the amount of $27,223,000. The dividends are comprised of a $21,223,000 payment for 2005 net income, payable to the City on March 10, 2006 and a $6,000,000 payment in connection with the first quarter of 2006, payable to the City on March 31, 2006.

b) Extension of Maturity Date under City Note

The City holds a $980,231,000 promissory note issued to the City (the "City Note") by the Corporation in May 2003. On February 6, 2006, the City exercised its option under the terms of the City Note to extend the maturity date from May 7, 2008 until May 6, 2013. The principal amount of the City Note, together with accrued interest thereon, is payable on May 6, 2013; provided that, under the terms of the City Note, the Corporation will not be required to pay more than $330,000,000 of the principal amount of the City note during any twelve-month period.

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c) Short Form Shelf Prospectus

On January 13, 2006, the Corporation filed a short form base shelf prospectus in connection with the establishment of a medium-term note program ("MTN Program"). Under the terms of the MTN Program, the Corporation may offer and issue, from time to time over the next twenty-five months, unsecured debentures. The net proceeds from the sale of debentures pursuant to the MTN Program will be used for general corporate purposes which may include the repayment of a portion of existing indebtedness outstanding to the City.