London Hydro

October 11, 2006

Kirsten Walli, Board Secretary
Ontario Energy Board
PO Box 2319,
2300 Yonge St, Suite 2700
Toronto, Ontario, M4P 1E4

Re: IN THE MATTER OF a consultation by the Ontario Energy Board on the Cost of Capital and 2nd Generation Incentive Regulation for Electricity Distribution Companies. (EB-2006-0087, EB-2006-0088 and EB-2006-0089)

TECHNICAL CONFERENCE QUESTIONS OF THE SCHOOL ENERGY COALITION

Questions for All Participating LDC's, including Hydro One, all members of CLD, all members of Cornerstone, all members of the ECMI group of LDC's, London Hydro, Chatham-Kent Hydro, Middlesex Power Distribution, Bluewater Power Distribution, Newmarket Hydro, Thunder Bay Hydro, Guelph Hydro, Waterloo North Hydro, and Grimsby Hydro

1. Many parties have raised the issue of whether the proposed changes to cost of capital and to rates will have a negative impact on the financial health of LDC's. Please file your most recent annual audited or unaudited, as the case may be, financial statements. If your LDC represents more than 50% of the assets of a holding company, please file the holding company's most recent annual audited or unaudited, as the case may be, financial statements.

   Response

   We are including the attached PDF file containing London Hydro's audited financial statements for 2005.

2. A number of LDC's have, in their submissions, raised the question of whether the proposed changes in cost of capital are a surprise to LDC's and for that or other reasons will erode the foundation of their current business plans. The PWU has also relied on this proposition in its submissions. Please file your most recent multi-year business plan, if such a document exists and has been reviewed and/or approved by any of your shareholders or your board of directors. If the business plan includes unregulated business activities, please redact all parts of the plan that relate to an unregulated business and don't relate to the regulated utility business. If the business plan includes other confidential information, please file the document in confidence so that the Board's protections for confidential filings can be engaged.

Response

Please refer to our response to OEB question 1.

As we have stated in our response, it is not appropriate to evaluate the Board staff's Proposal based upon the relative degree of financial hardship that such recommendations may or may not inflict on specific utilities. We believe that as a starting point, the Proposal as it stands is inappropriate, inequitable and flawed, for the reasons that we have noted in our submissions and in our responses to the OEB questions. To examine exceptions or to suggest that those adversely affected are limited in occurrence masks the fact that the policy itself is ill-founded.

Was the introduction of a wholesale change to the methodology a surprise? Yes. There was no indication that such a proceeding would occur and that the result would be hard coded into a distribution license resulting in little room for utilities to react or address the impact or understand the process by which exceptions to such broad sweeping policy change could be dealt with.

Does it impact future business plans? Substantially. Is it relevant to examine the business plans? No. We believe that such business plans cannot evolve properly until the uncertainty under this Proposal subsides. Additionally past business plans in this environment have little relevance as the impact of this Proposal is substantial.

SEC has indicated in the Technical Conference that the range of potential impacts of these proposals on a utilities ROE is substantial, and between the high end of the recommendations and the low end of the recommendations, rates would be different by 300 million. Where historical rates of return of utilities have not come close to the regulated notional rates, the introduction of proposals of this magnitude could result in a severe undermining of existing returns and future financial performance. Are current or historical business plans relevant in this context? We suggest not.

3. If your LDC has carried out a merger or acquisition of an LDC since 1999, or has prepared an investment analysis of a proposed merger or acquisition of another LDC, or has prepared an analysis of a potential sale of your LDC to another LDC, please provide that investment analysis, business case, or similar document showing the financial parameters of the deal or proposed deal, including in particular any calculations of expected overall return or return on equity, and advise of the eventual result of the proposed transaction. If any such document contains confidential information, please file the document in confidence so that the Board's protections for confidential filings can be engaged.

   Response

   Please refer to our response to question 2 above and our responses to OEB questions 1 and 2.

   In those responses we have outlined that the historical financial performance has been unduly constrained for a number of reasons and we suggest therefore that the analysis of any of M&A activity and the related investment analysis is not a relevant indicator of the future, which is what the staff Proposal addresses. We have further suggested that the valuation obsession could be mitigated by introducing sharing mechanisms and other broader ratepayer protections without pursuing and over-analyzing information of this nature. This would reduce regulatory burden for the system and ratepayers. At the present time regulatory costs and burden are increasing dramatically and not reducing.

4. Dr. Yatchew posits, at page 16 of his report, that mergers or acquisitions of LDC's may have been cancelled, repriced, or otherwise materially affected by uncertainty about whether the acquiror would be able to receive the benefit of savings generated by the transaction. If your utility has any documents showing that this was a consideration in any transaction, please file those documents. If any such document contains confidential information, please file the document in confidence so that the Board's protections for confidential filings can be engaged.

   Response

   We do not have any documentation of this nature. However we would agree with the position articulated by Dr Yatchew and we would suggest that the submissions to date are consistent with this position. We have seen that the regulatory environment receives significant consideration by credit rating agencies when evaluating the future expected financial performance of a firm, as it impacts on the certainty and quantum of the returns that a firm may achieve. If that is the case for the credit evaluation it would clearly be the same for any acquirer.

   Again, to pursue specific instances of this particularly in light of the historical constraints on returns and M&A activity since 1999 is not going to shed any light on the matter. Certainly the absence of such specific evidence does not provide the opportunity to infer that there is no impact.

5. Several parties have suggested that the proposed changes in the ROE and capital structure may cause LDC's to be offside on their debt covenants. Please advise whether such changes may cause your utility to be offside on your debt covenants, and if so file the text of such covenants, the amounts of borrowing to which they relate, and whether the lender is an affiliate/shareholder or an arm's length third party.

Response

Please refer to our responses above to questions 2, 3, and 4 as well as to our responses to OEB questions 1, 2, 3, 6 and 7. We do not believe that noted exceptions or lack of those exceptions are evidence of the Proposal being fundamentally appropriate. Future performance will be considerably different than historical performance to date.

6. An important issue in this proceeding is maintaining the creditworthiness of the LDC. If your LDC has been rated by Standard & Poors, DBRS, Moody's, or Dun and Bradstreet within the last 18 months, please file the last full rating from each rating agency, plus any updates since that full rating. If your LDC is rated and you have a public sector shareholder, please also advise the shareholder's debt rating(s) if any.

Response

Please refer to our responses above and to the responses to OEB questions 1, 2, 3, 6 and 7.

Credit ratings issued to date are based upon the existing stratified debt equity structures and allowed ROE. We do not know what the credit rating of London Hydro would be under the Proposal put forward by Board staff, but based upon the comments of BMO Capital Markets and others in this proceeding we can only conclude that it is likely that credit ratings will deteriorate after the implementation of the Proposal.

7. The ability of utilities to attract equity investment has been raised as a critical issue by many parties. Please provide the date, amount, investor identity and terms of the last common equity investment in your utility. If there was an offering or disclosure document, please file that document.

Response

Please refer to our responses above and to our responses to OEB question 1, 2, 3, 6 and 7

London Hydro is a municipally owned utility and to-date, has not made a public offering of common shares.

8. Mr. Camfield believes that inadequate returns will result in lower than required investment in capital assets. Please provide for your utility the opening rate base, capital expenditures, and closing rate base for each year from 2000 to 2005 inclusive, and your current projected numbers for 2006.

   <u>Response</u>

   Please refer to our responses above and to our responses to OEB question 1, 2, 3, 6 and 7

   Detailed information on capital spending and the nature of those expenditures has been provided to the SEC and other stakeholders during the 2006 EDR process.

   Utility capital spending decisions are based upon many factors such as:
   - **the need to replace fully depreciated assets to maintain existing levels of service to existing customers**
   - **the license requirement to service customers in the utilities service territory and to construct facilities to accommodate customer growth**
   - **regulatory obligation to comply with requirements of deregulation and CDM spending**
   - **industry and regulatory requirements to maintain specific safety and performance standards**

   Capital spending decisions are not based solely on the allowed rate of returns, and a review of spending levels over any given time frame will not be representative of the spending levels that may be anticipated under a given rate of return. Future spending and financing will also be dictated by Government policy and regulatory lag making historical information not much of an indicator of future capital requirements.

9. Please provide a chart showing your fixed asset age distribution measured by dollar amount (e.g. $120 million at 25-30 years old).

   <u>Response</u>

   Please refer to question 8.

10. For each LDC that has debt traded in the public markets, either directly or indirectly, please provide a chart for the period 2003 to date showing the average yield of your debt (broken down by issue if you had more than one outstanding) each month in the market, and for the same month the average yield of 10 year Canada's.

    <u>Response</u>

    Not applicable to London Hydro.

11. At pages 11 and 17 of his report, Dr. Yatchew notes that utilities already have an "informal yardstick competition" currently going on. Please file any efficiency comparisons between Ontario LDC's in the possession of your utility, including any line item or similar benchmarking, any estimates of "best practices" standards, any formal or informal studies, etc.

    Response

    London Hydro monitors specific metrics such as operating costs per customer, customers per employee, etc. to determine its relative standing in the industry but these comparisons are not extensive enough to draw any conclusions with respect to relative efficiencies or best practices.

    This analysis is readily performed from publicly available information and regulatory filings, and can be readily performed by all parties to this proceeding.

12. At page 12 of his report, Dr. Yatchew discusses the importance of aligning performance compensation plans to incentive regulation plans. Please provide the performance based compensation plan of your utility, if any, together with a list of any changes to that plan between 2000 and today.

    Response

    Please refer to the information provided to the SEC during the 2006 EDR rate application.

13. Please describe any attempts your utility has made in the past to borrow in the market in common or in tandem with other LDC's. If you have proceeded with or proposed any such transaction, please describe the structure, the impact on cost of capital, and the result.

    Response

    Please refer to the Response to OEB question 1

14. If your utility has a holding company of which at least 50% of its consolidated assets are assets of the LDC, please advise whether the debt rating of the holding company is different from the debt rating of the LDC, and if so advise the two ratings.

    Response

    London Hydro does not have a holding company.

15. Please provide the “Bill Impacts” pages of the 2006 EDR Model for your utility and comparable calculations using the year 2000 and 2003 approved distribution rates.

    <u>Response</u>

    Rate impacts for 2006 have been provided to the SEC during the 2006 EDR filing process.

    A historical review and comparison of the distribution rates approved by the Board for the period 2000 to 2006 will reflect the changes and impacts that have occurred over this time frame due to deregulation and unbundling of rates, Bill 210 rate freeze, introduction of PILs, recovery of transitional costs, changes in energy pricing, the three year phase-in of MARR, mandatory CDM spending and the adjustment of 2006 rates to recover inflation and other industry restructuring cost increases that have occurred from 1999 to 2004.

    The Bill Impacts page of the 2006 EDR model does not provide the ability to properly assess and evaluate the rate impacts of the above noted factors, and is not included with this response.

16. Please provide a list of the Tier 1 adjustments sought by your utility in your 2006 rate application, the dollar amount of each, and the total revenue requirement applied for.

    <u>Response</u>

    This information is on the public record and has been provided to the SEC during the 2006 EDR process.

The above include all of London Hydro’s responses to the School Energy Coalitions questions.

If you require any further information, please contact me directly.

Sincerely,

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London Hydro Inc.

Financial Statements
For the Year Ended December 31, 2005

KPMG

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AUDITORS' REPORT

To the Shareholder of London Hydro Inc.

We have examined the balance sheet of London Hydro Inc. as at December 31, 2005 and the statements of earnings and retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company'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 financial statements present fairly, in all material respects, the financial position of London Hydro Inc. 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.

KPMG LLP

Chartered Accountants

London, Canada

February 17, 2006

London Hydro Inc.

Balance Sheet
(in thousands of dollars)
As at December 31, 2005

	2005	2004
ASSETS		
Current assets		
Cash and equivalents	$ 24,347	$ 17,771
Accounts receivable (Notes 4, 9 and 11)	38,118	41,276
Regulatory assets (Note 5)	5,631	6,466
Inventories	3,452	3,330
Prepaid expenses	957	913
	72,505	69,756
Regulatory assets (Note 5)	11,926	12,030
Capital assets (Note 6)	167,224	166,252
Future income tax assets (Note 13)	5,992	3,212
	$ 257,647	$ 251,250
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities (Note 7)		
Accounts payable and accrued liabilities -		
Due to Independent Electricity System Operator	$ 23,394	$ 19,233
Other	10,647	10,763
Income taxes payable	1,642	1,895
Customer and other deposits (Note 8)	5,208	8,812
Due to shareholder (Note 9)	6,312	5,009
Regulatory liabilities (Note 5)	1,240	-
Future income tax liabilities (Note 13)	1,193	967
	49,636	46,679
Long-term liabilities		
Customer and other deposits (Note 8)	9,567	9,667
Due to shareholder (Note 9)	70,000	70,000
Employee future benefits (Note 14)	7,720	7,355
	87,287	87,022
Shareholder's equity		
Share capital (Note 10)	96,116	96,116
Retained earnings	24,608	21,433
	120,724	117,549
	$ 257,647	$ 251,250

Subsequent event (Note 16)

On behalf of the Board:

Director

Director

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Earnings and Retained Earnings
(in thousands of dollars)
For the Year Ended December 31, 2005

	2005	2004
Distribution revenue (Note 11)	$ 42,262	$ 40,015
Operating expenses		
Plant operating and maintenance	8,596	8,485
General and administrative	17,774	17,033
Amortization of capital assets	12,848	12,578
	39,218	38,096
Less: Costs recovered (Note 9)	(3,259)	(3,895)
	35,959	34,201
Operating income	6,303	5,814
Other Income (expense)		
Interest and other revenue (Note 12)	5,277	4,399
Interest expense (Note 9)	(4,496)	(4,473)
	781	(74)
Earnings before the following	7,084	5,740
Recovery of regulatory amounts	-	6,498
Earnings before income taxes	7,084	12,238
Income taxes (Note 13)	1,909	4,130
Net earnings for the year	5,175	8,108
Retained earnings, beginning of year	21,433	13,325
Dividends	(2,000)	-
Retained earnings, end of year	$ 24,608	$ 21,433

London Hydro Inc.

Statement of Cashflows
(in thousands of dollars)
For the Year Ended December 31, 2005

	2005	2004
Operating activities		
Net earnings for the year	$ 5,175	$ 8,108
Charges to operations not affecting cash		
Amortization of capital assets	12,848	12,578
Gain on disposal of capital assets	(44)	(19)
Future income taxes	(2,554)	860
	15,425	21,527
Net decrease in non-cash working capital balances related to operations	8,087	5,335
Increase in employee future benefits	365	178
Increase (decrease) in customer and other deposits	(3,704)	2,159
Cash provided by operating activities	20,173	29,199
Financing activities		
Dividends	(2,000)	-
Developer contributions to capital asset costs	2,772	1,627
Cash provided by financing activities	772	1,627
Investing activities		
Additions to capital assets	(16,712)	(16,633)
Proceeds on disposal of capital assets	164	69
Decrease (increase) in regulatory assets and liabilities	2,179	(4,320)
Cash used in investing activities	(14,369)	(20,884)
Increase in cash and equivalents during the year	6,576	9,942
Cash and equivalents, beginning of the year	17,771	7,829
Cash and equivalents, end of the year	$ 24,347	$ 17,771
Cash and equivalents are comprised of		
Cash	$ 9,390	$ 17,771
Banker's Acceptance at 3.25%	14,957	-
	$ 24,347	$ 17,771
Supplemental cashflow information		
Interest paid	$ 4,296	$ 4,218
Income taxes paid	$ 5,316	$ 2,250

See accompanying notes to the financial statements

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

1. Regulated Business Operations and Distribution Rates

The Company is a wholly owned subsidiary company of the Corporation of the City of London and provides regulated electrical distribution services to the inhabitants of the City of London.

The Company is regulated by the Ontario Energy Board ("OEB"), under the authority granted by the Ontario Energy Board Act (1998). The OEB has responsibility to set reasonable distribution rates and thereby approves all of the Company's distribution and ancillary rates. The Company's distribution revenue is determined by applying those regulated rates to customers and their consumption of electricity in the Company's distribution territory, as established by its distribution license granted by the OEB.

In January 2000, the OEB established that distribution rates would be subject to Performance Based Regulation ("PBR"), a method of regulation whereby distribution rates are reduced annually to reflect productivity improvements required of the Company. Under this rate methodology, rates also include regulated amounts for return on Company equity and debt, which were initially determined by the OEB to be 9.88% and 7%, respectively. While the initial PBR regulatory framework provided for those regulatory rates of return, subsequent regulation and Provincial Government initiatives have yet to allow distribution companies to fully achieve those returns. Commencing sometime in fiscal 2006, it is expected that the full amount for regulated return will be included in distribution rates.

2. Financial Effects of Distribution Rate Regulation

The financial results presented are in accordance with generally accepted accounting principles and within that framework the Company accounts for the impact of regulatory actions in the following manner:

a) Regulatory Decisions to Adjust Distribution Rates

In the event that a regulatory decision is rendered, providing regulatory approval and certainty to the recognition of an asset, or creation of a liability, and culminating in an adjustment to Company distribution rates, such occurrences are immediately reflected in the Company's accounts.

b) Regulatory Direction and Practice

In the absence of a regulatory decision impacting rates, and where the Company is required by regulatory accounting practice or direction to accumulate balances for future rate recovery or create liabilities for future discharge, those amounts are recorded in accordance with that regulatory direction. Management assesses the future uncertainty with respect to the final regulatory disposition of those amounts, and to the extent required, makes accounting provisions to reduce the deferred balances accumulated or to increase the recorded liabilities. Upon rendering of the final regulatory decision adjusting distribution rates, the provisions are adjusted to reflect the final impact of that decision, and such adjustment is reflected in net earnings for the period.

Amounts currently confirmed by final regulatory decision, and amounts currently accounted for in the absence of final regulatory decision together with related provisions for future uncertainty, are more fully described in note 5 to the financial statements.

(tabular amounts in thousands of dollars)

3. Summary of Significant Accounting Policies

a) Revenue recognition

In accordance with Ontario Energy Board regulations, the Company recognizes as revenue the regulated distribution tariffs associated with energy distributed, and variances between energy purchase costs and energy billed are recorded as regulatory assets or liabilities for future rate application consideration.

The Company follows the practice of cycle billing customers' accounts and revenue is recognized in the period billed. An accrual is made in the accounts at December 31 for distribution revenue earned on power supplied but not billed to customers between the date the meters were last read and the end of the year.

b) Inventories

Inventories of materials and supplies are valued at the lower of laid down cost on the average cost basis and net realizable value.

c) Capital assets

Capital assets are amortized over their estimated useful lives using the straight-line method over the following periods:

Buildings	50 to 60 years
Other construction	25 to 30 years
Substation equipment	30 years
Distribution lines, transformers and meters	25 years
System supervisory equipment	15 to 25 years
Service, office and other equipment	8 to 10 years
Automotive equipment	4 to 8 years
Computer equipment	5 years

When a capital asset is sold or otherwise disposed of, the related cost and accumulated amortization are removed from the respective accounts and any gain or loss on disposition is recognized in earnings.

Capital assets that by their nature are not readily identifiable as individual assets are grouped together. Under this method, the related cost and accumulated amortization are removed from their respective grouping account at the end of the asset's estimated useful life, regardless of actual service life. Any proceeds on disposition are recognized in earnings in the year of disposition.

d) Contributions to capital costs

Contributions are received from developers and contractors for capital costs incurred by the Company. These contributions are included as a reduction to the cost of the related capital assets when those assets are placed in service.

3. Summary of Significant Accounting Policies, continued

e) Cash and equivalents

Cash on hand and on deposit with banks, and short-term investments with maturity of three months or less, are considered cash and equivalents.

f) Income taxes

The Company follows the liability method for accounting for income taxes whereby future income tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities and their respective values for income tax purposes. These differences are measured using substantively enacted tax rates in effect in the period in which those differences are expected to be recovered or settled. To the extent that there is uncertainty regarding the recovery of a future income tax asset a valuation allowance reducing the future income tax asset is recorded.

g) Measurement uncertainty

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities at the date of the financial statements. Certain estimates are also required as regulations, which will ultimately determine the actual results, have yet to be finalized and are dependent on the completion of regulatory proceedings or decisions. Due to these uncertainties, actual results might differ from those estimates and the impact will be recorded in the current period when the actual results are known.

h) Employee future benefits

The Company has adopted the following policies for future benefits provided to both active and retired employees:

(i) Pension benefits

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer contributory defined benefit plan. Company contributions to the plan are recognized as pension expense in the period that they are incurred.

(ii) Other Post-Retirement and Post-Employment benefits

The Company provides other benefits to active and retired employees including group life insurance and health-care benefits. Recognition of these benefits are actuarially determined using the projected benefit method pro rated on service using management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

(tabular amounts in thousands of dollars)

4. Accounts Receivable

	2005	2004
Accounts receivable -		
Energy and water	$ 38,137	$ 41,407
Sundry	1,365	1,572
	39,502	42,979
Less: Allowance for doubtful accounts	1,384	1,703
	$ 38,118	$ 41,276

Included in accounts receivable is approximately $3.8 million (2004 - $4.7 million) of customer receivables for water consumption that the Company bills and collects on behalf of the Corporation of the City of London. As the Company does not assume liability for collection of these amounts, no allowance for doubtful collection has been provided for these accounts.

5. Regulatory Assets and Liabilities

	2005	2004
Regulatory assets		
Amounts approved and included in distribution rates	$ 14,534	$ 20,094
Less: Current portion	5,631	6,466
	8,903	13,628
Amounts to be submitted for future rate approval:		
Ontario Energy Board annual assessment costs	340	106
Purchased power cost variances	3,103	896
	12,346	14,630
Provision for regulatory rate adjustments	(420)	(2,600)
	$ 11,926	$ 12,030
Regulatory liabilities		
Conservation and Demand Management - recoveries	$ 2,122	$ -
Conservation and Demand Management - expenditures	(882)	-
	$ 1,240	$ -

a) Amounts approved and included in distribution rates

The regulatory decision of December 9, 2004 affirmed the recovery of these amounts in rates which are being recovered through a distribution rate rider over a three-year period ending March 31, 2008.

b) Ontario Energy Board annual assessment costs

In December of 2004, electric distribution companies were allowed to establish a deferral account to record the annual costs assessed by the regulator. The amounts recorded as deferred costs are the amounts by which the annual OEB assessment costs for the period January 1, 2004 to April 30, 2006, exceed the amounts being recovered through distribution rates. It is anticipated that these costs will be reviewed by the regulator for final approval in 2006, and if approved, recovery would commence in 2007.

5. Regulatory Amounts Recoverable, continued

b) Ontario Energy Board annual assessment costs, continued

In the absence of rate regulation, generally accepted accounting principles would require the Company to record such costs in the operating results of the year in which they are incurred and reported earnings before income taxes would be $0.2 million (2004 - $0.1 million lower) lower than reported.

c) Purchased power cost variances

As a regulated distributor of electricity, the Company is obligated to provide default energy supply to those consumers who elect not to purchase their energy from an energy retailer. The regulatory framework requires that all default energy commodity costs be billed to the consumer at regulated rates. Variances between purchase costs and amounts billed are required to be captured in a Retail Settlement Variance Account for future rate recovery. The Company has accumulated in the Retail Settlement Variance Accounts amounts that have accumulated since January 1, 2004 in the amount of $3.1 million (2004 - $0.9 million). Variances are eligible for recovery in future rates based upon a quarterly review process established by the regulator which determines when the balances are material enough to warrant an adjustment to rates.

Variances accumulated prior to January 1, 2004 in the amount of $9.9 million plus allowed interest are included in the regulatory assets that were approved for rate recovery in December 2004.

d) Provision for regulatory rate adjustments

With the implementation of Bill 210 in December of 2002, distribution rates were frozen at their existing levels, which included a one-time adjustment for the recovery of 2001 income taxes. Due to the rate freeze, this adjustment was not removed from the rates until April 1, 2004. To-date, the regulator has not issued a formal decision on whether amounts collected during 2003 and 2004 for the 2001 tax component in rates, will be adjusted for in a future rate proceeding, but sufficient information was provided by the regulator during 2005 to indicate that these amounts will not be fully refundable. During 2005, this provision was reduced by $2.2 million, and it is anticipated that final resolution on the remaining balance will be made in 2006 pending further clarification on this matter by the regulator.

e) Conservation and Demand Management expenditures and recoveries

In May of 2004, the Minister of Energy granted approval to all distributors to apply to the regulator for an increase in their 2005 distribution rates, conditional on a commitment by the Company to reinvest an equivalent amount in conservation and demand management initiatives. The Company received approval to collect approximately $2.8 million to be spent on conservation and demand management programs over the period ending September 30, 2007. Until such amounts are fully expended, the Company has reflected these amounts as liabilities in keeping with the obligation to spend all amounts received on qualifying activities, as approved by the regulator.

(tabular amounts in thousands of dollars)

6. Capital Assets

	2005			2004
	Cost	Accumulated Amortization	Net	Net
Land and land rights	$ 968	$ 357	$ 611	$ 649
Buildings	17,746	7,499	10,247	10,670
Plant and equipment	35,876	20,795	15,081	15,526
Distribution system	241,251	102,740	138,511	136,450
Work in progress	2,774	-	2,774	2,957
	$ 298,615	$ 131,391	$ 167,224	$ 166,252

7. Bank Indebtedness

The Company has utilized $13.2 million in bank standby letters of credit issued to the Independent Electricity System Operator, as required by regulation.

8. Customer and Other Deposits

Customer and other deposits include security deposits for energy consumption bearing interest at a rate of prime less 2% per annum and developer deposits held in accordance with regulation.

9. Related Party Balances and Transactions

	2005	2004
Non-interest bearing trade balances due to shareholder, without stated repayment terms	$ 6,312	$ 5,009
Unsecured promissory note, bearing interest at 6% per annum, payable in interest only, maturing July 1, 2008	70,000	70,000
	76,312	75,009
Less: Current portion	6,312	5,009
	$ 70,000	$ 70,000

Included in the accounts receivable is $0.2 million (2004 - $1.0 million) of energy, water, and sundry receivables due from the Corporation of the City of London.

(tabular amounts in thousands of dollars)

9. Related Party Balances and Transactions, continued

During the year and within the course of normal operations, the Company provided services to the City of London on an estimated cost recovery basis at an amount of $3.3 million (2004 - $3.9 million), and paid interest to the City in the amount of $4.2 million (2004 - $4.2 million).

10. Share Capital

Authorized

An unlimited number of common shares

An unlimited number of non-voting, non-cumulative preference shares, redeemable at the paid-up amount

Issued	2005	2004
1,001 common shares	$ 96,116	$ 96,116

11. Distribution Revenue

In addition to distribution revenues of $42.3 million (2004 - $40.0 million), by regulation the Company is responsible for billing, collecting and settling energy purchase costs in the amount of $297.4 million (2004 - $245.9 million).

12. Interest and Other Revenue

	2005	2004
Interest	$ 1,420	$ 1,490
Late payment charges	982	978
Sundry	946	1,018
Customer billing service fees	598	601
Rentals	1,195	204
Scrap sales and other	136	108
	$ 5,277	$ 4,399

13. Income Taxes

a) Income tax status

As a wholly owned subsidiary Company of the Corporation of the City of London, the Company is exempt from income taxes under the Income Tax Act (Canada). Pursuant to the Electricity Act (1998)(Ontario) the Company is required to make payments in lieu of tax to the Ontario Electricity Financial Corporation. The amount of payments in lieu of tax will be approximately equivalent to the income and capital taxes that would have to be paid if the Company was a taxable corporation under the Income Tax Act (Canada).

(tabular amounts in thousands of dollars)

13. Income Taxes, continued

b) Income tax expense

The Company's effective income tax rates differed from the statutory combined federal and provincial rates primarily due to the following:

	2005	2004
Earnings before income taxes	$ 7,084	$ 12,238
Income tax expense based on combined federal and provincial statutory income tax rate of 36.1% (2004 – 36.1%)	$ 2,557	$ 4,420
Federal large corporations tax	144	210
Unrecognized future income tax assets	(500)	(500)
Effect of changes to substantively enacted tax rates	-	-
Other items	(292)	-
Income tax expense recognized	$ 1,909	$ 4,130

Income tax expense is comprised of the following:

	2005	2004
Current income tax	$ 4,463	$ 3,270
Future income tax	(2,554)	860
	$ 1,909	$ 4,130

c) Future income tax balances

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and future income tax liabilities are as follows:

	2005	2004
Future income tax assets (liabilities):		
Capital assets	$ 6,497	$ 6,293
Employee future benefits	1,000	500
Deferred regulatory asset recoveries	(2,767)	(3,684)
Other	69	(864)
	$ 4,799	$ 2,245
Classified in the balance sheet as follows:		
Non-current assets	$ 5,992	$ 3,212
Current liabilities	(1,193)	(967)
	$ 4,799	$ 2,245

(tabular amounts in thousands of dollars)

14. Employee Future Benefits

a) Pension plan

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer plan, on behalf of its employees. The plan is a contributory defined benefit plan which specifies the amount of retirement benefit to be received by the employees based on the length of service and rates of pay. During the year, the Company contributed $1.1 million (2004 - $1.0 million).

b) Medical and life insurance benefits plan

The Company provides medical and life insurance benefit coverage to certain retirees of the Company. Based on a recent actuarial extrapolation of the plan's last valuation of September 30, 2003, the following information has been determined:

	2005	2004
Accrued benefit obligation		
Balance, beginning of year	$ 9,556	$ 9,426
Current service cost	170	163
Interest cost	565	558
Benefits paid	(478)	(591)
Actuarial loss	1,032	-
Balance, end of year	$ 10,845	$ 9,556

	2005	2004
Accrued benefit liability		
Accrued benefit obligation	$ 10,845	$ 9,556
Benefits paid between measurement date of September 30, 2005 and December 31, 2005	(110)	(149)
Unamortized net actuarial loss	(3,015)	(2,052)
Accrued benefit liability, end of year	$ 7,720	$ 7,355

The Company's net periodic benefit cost is comprised of the following:

	2005	2004
Current service cost	$ 170	$ 163
Interest cost	565	558
Amortization of net actuarial loss	68	74
	$ 803	$ 795

The excess of the net actuarial loss in excess of ten percent of the accrued benefit obligation is amortized over the average remaining service life of employees, which is estimated to be 16 years.

(tabular amounts in thousands of dollars)

14. Employee Future Benefits, continued

The significant actuarial assumptions are as follows:

	2005	2004
Discount rate	5.1%	6.0%
Initial medical cost rate	10.0%	11.0%
Ultimate medical cost rate	5.0%	5.0%
Year ultimate rate reached	2011	2011
Dental cost rate	5.0%	5.0%
Rate of compensation increase	4.0%	4.0%

The estimated impact on fiscal 2004 reported pension amounts of a one percent increase or decrease in the health care cost assumptions is as follows:

	Reported	+1.0%	-1.0%
Current service cost	$ 170	$ 210	$ 140
Interest cost	$ 565	$ 615	$ 525
Accrued benefit obligation	$ 10,845	$ 11,906	$ 10,002

15. Financial Instruments and Credit Risk

a) Financial Instruments

Management estimates that the fair values of all financial assets and liabilities are not materially different from their carrying values.

b) Credit Risk

Credit risk is the risk that a counterparty will fail to discharge its obligation to the Company reducing the expected cash inflow from Company assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions. The Company has assessed that there are no significant concentrations of credit risk.

16. Subsequent Event

On March 21, 2006, the Board of Directors declared a $2.0 million dividend payable to the sole shareholder, the Corporation of the City of London.