

**TORONTO HYDRO CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE YEAR ENDED**  
**DECEMBER 31, 2005**

The following discussion and analysis should be read in conjunction with the audited consolidated financial statements and accompanying notes of Toronto Hydro Corporation (the "Corporation") as at and for the year ended December 31, 2005 (the "Consolidated Financial Statements"). The Consolidated Financial Statements are prepared in accordance with Canadian generally accepted accounting principles, including accounting principles prescribed by the Ontario Energy Board (the "OEB") and are presented in Canadian dollars.

**Business of Toronto Hydro**

The Corporation is a holding company, which wholly-owns the following subsidiaries:

- *Toronto Hydro-Electric System Limited* ("LDC") - which distributes electricity;
- *Toronto Hydro Energy Services Inc.* ("TH Energy") - which manages an existing portfolio of electricity contracts and provides energy efficiency products and services;
- *Toronto Hydro Telecom Inc.* ("Telecom") - which provides fibre optic cable capacity and manages data communications services; and
- *Toronto Hydro Street Lighting Inc.* ("Street Lighting") - which provides street lighting and expressway lighting services.

The principal business of the Corporation and its subsidiaries is the distribution of electricity by LDC. LDC owns and operates an electricity distribution system, which delivers electricity to approximately 677,000 customers located in the City of Toronto. LDC is the largest municipal electricity distribution company in Canada and distributes approximately 19% of the electricity consumed in Ontario. The business of LDC is regulated by the OEB which has broad powers relating to licensing, standards of conduct and service and the regulation of rates charged by LDC and other electricity distributors in Ontario. See note 2 to the Consolidated Financial Statements.

TH Energy is engaged in the sale of energy efficiency products and services to commercial and industrial customers. TH Energy also operates a water heater rental business. In December 2002, TH Energy ceased electricity retailing activities in respect of new customers following the implementation of price protection under the *Electricity Pricing, Conservation and Supply Act, 2002*. Remaining contracts and portfolio obligations are being managed to expiration (currently expected to occur by December 2006).

Telecom is a provider of "dark" fibre optic capacity and "lit" data communications services to telecommunications carriers, business customers and large institutions in the City of Toronto. Telecom owns a network of fibre optic cable located in ducts, on poles and in other parts of the electricity distribution system of LDC. The network is currently connected to over 455 buildings located in the City of Toronto.

Street Lighting owns and operates street lighting and expressway lighting systems located in the City of Toronto.

The sole shareholder of the Corporation is the City of Toronto (the "City").

## Electricity Industry

In April 1999, the Province of Ontario (the “Province”) 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, reliability and quality of electricity service and to promote economic efficiency in the generation, transmission and distribution of electricity.

### *Open Access*

On May 1, 2002, the Province 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 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 fulfil 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):

- *Electricity Price* - The electricity price represents a pass through of the commodity cost of electricity. See “Price Protection and Rate Caps” and “Electricity Restructuring Act, 2004” below.
- *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).

- *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.
- *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.

### ***Price Protection and Rate Caps***

In December 2002, the Province passed the *Electricity Pricing, Conservation and Supply Act, 2002* which, among other things:

- 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);
- capped distribution rates at current levels and deferred rate increases and certain cost recoveries by electricity distributors (including the scheduled third adjustment for a market-based rate of return); and
- deemed certain costs and variance account balances of electricity distributors to be regulatory assets or liabilities which are to be reflected in a distributor’s balance sheet until the manner and timing of disposition is determined by the OEB. See “Regulatory Assets and Liabilities” below.

In November 2003, the Province:

- 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;
- directed the OEB to develop new pricing mechanisms for setting the price of electricity payable by Low Volume Consumers and Designated Consumers; and
- announced initiatives with respect to the disposition of regulatory assets and liabilities (see “Regulatory Assets and Liabilities” below) and the third distribution rate adjustment to achieve a market-based rate of return.

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

- 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
- 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.

### ***Business Protection Plan***

Consumers other than Designated Consumers who annually utilize more than 250,000 kWh were eligible to receive Business Protection Plan (“BPP”) rebates from the IESO to the extent that electricity prices exceeded certain prescribed thresholds. This 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 the BPP rebates through to eligible consumers and other eligible market participants.

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

### ***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 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 adjustment necessary to achieve a market-based rate of return. The rate increase was effective as of April 1, 2005 and subjected LDC to a financial commitment to invest \$39.8 million in CDM activities by September 2007.

### ***Regulatory Assets and Liabilities***

Electricity distributors are required to reflect certain prescribed costs on their balance sheet until the manner and timing of disposition is determined by the OEB. These costs are:

- transition costs resulting from the ramp-up to Open Access;
- variances between the cost of electricity purchased by LDC from Ontario Power Generation (“OPG”) and the revenue that LDC was permitted to receive for electricity supplied by it to customers during the period January 1, 2001 to April 30, 2002;
- variances between the amount charged by LDC to customers for the OEB-approved loss adjustment factor and the LDC actual loss adjustment factor, during the period from June 1, 2001 to April 30, 2002;
- settlement variances between amounts charged by LDC to customers (based on regulated rates) and corresponding cost of non-competitive electricity service incurred by it in the wholesale market administered by the IESO after May 1, 2002;
- the deferral of OEB annual cost assessments for the OEB’s fiscal year 2004 and subsequent fiscal years; and
- the deferral of incremental Ontario Municipal Employees Retirement System pension expenditures for fiscal years starting after January 1, 2005.

See note 3 and note 8 to the Consolidated Financial Statements.

### ***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 of the Corporation 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 payment in lieu of corporate taxes (“PILs”) regime contained in the *Electricity Act, 1998*. The *Electricity Act, 1998* provides that a MEU that is exempt from tax under the *Income Tax Act (Canada)* and the *Corporations Tax Act (Ontario)* is required to make, for each taxation year, a PILs 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.

### *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*. 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.

The *Electricity Restructuring Act, 2004*:

- 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;
- reorganized the Independent Electricity Market Operator as the IESO, a non-share corporation, which will continue to administer the wholesale electricity market and be responsible for the operation and reliability of the integrated power system; and
- 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 the *Electricity Restructuring Act, 2004*, the commodity cost of electricity for certain customer classes will be regulated by the OEB. Customers that do not wish to or are not eligible to participate in the regulated plan may purchase electricity in the competitive market or through licensed retailers.

Effective January 1, 2005, the IESO implemented, pursuant to the *Electricity Restructuring Act, 2004*, a new price adjustment applicable to customers not subject to price protection and rate caps. This 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 (\$20.0 million as at December 31, 2005) is being tracked in a 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.

This 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 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 PILs recoveries, that LDC may charge and the costs that LDC may recover, including the balance of its regulatory assets and liabilities.

## Selected Consolidated Financial Data

The selected consolidated financial data presented below should be read in conjunction with the Consolidated Financial Statements.

	<b>Year ended December 31,</b>	
	<b>2005</b>	<b>2004</b>
	<b>\$</b>	<b>\$</b>
	(in thousands of dollars, except for per share amounts)	
<b>Consolidated Statement of Operations Data</b>		
Revenues .....	2,612,585	2,226,159
Costs		
Purchased power and other .....	2,061,542	1,665,736
Operating expenses .....	189,961	186,004
Depreciation and amortization .....	134,978	134,843
	<u>2,386,481</u>	<u>1,986,583</u>
Income before interest, other and provision for PILs .....	226,104	239,576
Interest income .....	14,086	12,299
Interest expense		
Long-term debt .....	(80,403)	(80,403)
Other interest .....	(2,700)	(3,381)
Other .....	5,040	1,043
Income before provision for PILs .....	<u>162,127</u>	<u>169,134</u>
Provision for PILs .....	69,682	71,787
Net income .....	<u>92,445</u>	<u>97,347</u>
Basic and fully diluted net income per share .....	<u>92,445</u>	<u>97,347</u>
	<b>As at December 31,</b>	
	<b>2005</b>	<b>2004</b>
	<b>\$</b>	<b>\$</b>
	(in thousands of dollars)	
<b>Consolidated Balance Sheet Data</b>		
Total assets .....	<u>2,819,258</u>	<u>2,591,734</u>
Current liabilities .....	941,211	701,636
Long-term liabilities .....	1,032,180	1,068,676
Total liabilities .....	<u>1,973,391</u>	<u>1,770,312</u>
Shareholder's equity .....	845,867	821,422
Total liabilities and shareholder's equity .....	<u>2,819,258</u>	<u>2,591,734</u>

## **Results of Operations**

### ***Net Income***

Net income was \$92.4 million in 2005 compared to \$97.3 million in 2004. The decrease was primarily due to decreased net revenues (\$9.4 million) and increased operating expenses (\$4.0 million) offset by gains on disposals of property, plant and equipment (\$4.0 million), decreased net interest expense (\$2.5 million) and decreased provisions for PILs (\$2.1 million).

### ***Net Revenues***

Net revenues (revenues minus the cost of purchased power and other) were \$551.0 million in 2005 compared to \$560.4 million in 2004. The decrease was primarily due to decreased net revenues at TH Energy (\$38.0 million) partially offset by increased net revenues at LDC (\$22.4 million) and at Telecom (\$6.4 million).

At TH Energy, the decrease in net revenues was primarily due to the net gain recognized in 2004 related to the exercise of a wholesale electricity purchase contract (\$27.1 million) and decreased net revenues from expired retail contracts (\$26.2 million) partially offset by a higher mark-to-market gain from the change in future value of the existing portfolio (\$16.3 million).

At LDC, the increase in net revenues was primarily due to the net effect of the third adjustment to achieve a market-based rate of return after deferral for CDM programs (\$15.5 million) and higher distribution revenue from increased consumption attributable to weather (\$10.1 million).

At Telecom, the increase in net revenues was primarily due to lower costs for network support structure.

### ***Expenses***

Operating expenses were \$190.0 million in 2005 compared to \$186.0 million in 2004. The increase was primarily due to higher costs for operations at Telecom and Street Lighting. At LDC, operating expenses were flat in 2005 compared to 2006, due to management's ability to achieve operational savings to mitigate incremental labour cost.

Depreciation and amortization expense was \$135.0 million in 2005 compared to \$134.8 million in 2004. The increase was primarily due to investments made in the electricity distribution system of LDC.

Net interest expense was \$69.0 million in 2005 compared to \$71.5 million in 2004. The decrease resulted from higher cash balances and higher short-term interest income earned from investing cash balances and reduced interest expense incurred on customer deposits at LDC.

### ***Other***

Included in Other are amounts primarily relating to gains on disposals of property, plant and equipment. Other was \$5.0 million in 2005 compared to \$1.0 million in 2004. The increase was due to increased gains on disposals of property, plant and equipment at Telecom (\$2.1 million) and at LDC (\$1.9 million).

### ***Provision for PILs***

Provision for PILs was \$69.7 million in 2005 compared to \$71.8 million in 2004. The decrease in the provision for PILs was primarily due to a decrease in income.

## Quarterly Results of Operations

The tables below present unaudited quarterly consolidated financial information of the Corporation for 2005 and 2004.

	2005 quarter ended,			
	December 31	September 30	June 30	March 31
	\$	\$	\$	\$
	(in thousands of dollars)			
Revenues .....	636,463	774,295	589,001	612,826
Costs .....	591,275	714,350	522,256	558,600
Net income .....	22,501	19,354	29,754	20,836

  

	2004 quarter ended,			
	December 31	September 30	June 30	March 31
	\$	\$	\$	\$
	(in thousands of dollars)			
Revenues .....	545,481	542,972	539,486	598,220
Costs .....	500,822	488,186	456,582	540,993
Net income .....	10,300	22,104	40,674	24,269

## Liquidity and Capital Resources

### *Sources of Liquidity and Capital Resources*

The Corporation's primary sources of liquidity and capital resources are from cash provided by operating activities, short-term bank financing, interest income and debt capital market borrowings.

The Corporation does not believe that equity contributions from the City, its sole shareholder, will constitute a source of capital. In addition, the Corporation is not aware of any plan or decision by the City to permit the Corporation to sell equity to the public or other investors.

### *Cash Provided by Operating Activities*

Cash provided by operating activities was \$330.1 million in 2005 compared to \$223.5 million in 2004. The increase was primarily due to increased variance for accounts payable and accrued liabilities (\$106.4 million) and increased variance for mark-to-market assets and liabilities (\$23.4 million), offset by increased variance for unbilled revenue (\$27.2 million).

### *Revolving Credit Facility*

The Corporation is a party to a credit agreement with respect to a revolving credit facility dated May 5, 2005 pursuant to which the Corporation may borrow up to \$500 million, of which up to \$175 million is available in the form of letters of credit. As at December 31, 2005, no borrowings for working capital were outstanding and letters of credit in the amount of \$90.2 million had been issued. See note 10 to the Consolidated Financial Statements.

### *Medium Term Note Program*

The Corporation has established a medium term note program under which it may offer and issue from time to time unsecured debentures in one or more series in an aggregate principal amount of up to \$1 billion. See "Corporate Developments – Medium Term Note Program" below.

### *Operating Liquidity and Capital Resource Requirements*

The Corporation's primary liquidity and capital resource requirements are for capital expenditures to maintain and improve the electricity distribution system of LDC, interest expense and prudential requirements and third party credit support.

#### *Cash Used in Investing Activities*

Cash used in investing activities was \$178.4 million in 2005 compared to \$89.2 million in 2004. The increase was primarily due to higher capital expenditures at Street Lighting (\$60.0 million) following the purchase of the street and expressway lighting assets from the City (see "Corporate Developments – Acquisition" below) and higher capital expenditures at LDC (\$32.5 million) primarily due to increased investments in distribution system assets and technology assets.

#### *Capital Expenditures*

The following table summarizes the Corporation's capital expenditures in respect of continuing operations for the years indicated.

	<b>Year ended December 31,</b>	
	<b>2005</b>	<b>2004</b>
	<b>\$</b>	<b>\$</b>
	<b>(in millions of dollars)</b>	
LDC		
Distribution system .....	113,333	85,273
Technology assets .....	10,119	5,799
Other <sup>(1)</sup> .....	8,808	8,617
	<u>132,260</u>	<u>99,689</u>
Other <sup>(2)</sup> .....	71,733	9,944
Total Capital Expenditures .....	<u>203,993</u>	<u>109,633</u>

Notes:

- (1) Consists of vehicles, other work-related equipment, furniture and office equipment.
- (2) Includes capital expenditures relating to TH Energy, Street Lighting and Telecom.

#### *Cash Used in Financing Activities*

Cash used in financing activities was \$90.0 million in 2005 compared to \$45.3 million in 2004. The increase was primarily due to decreased customer deposits following a new OEB directive (\$25.9 million) and increased dividends paid to the City (\$18.8 million).

#### *Prudential Requirements and Third Party Credit Support*

In order to mitigate the risk of payment default, wholesale market participants are required to provide credit support for their obligations to the IESO in the form of letters of credit, cash deposits or guarantees from third parties with prescribed credit ratings. A market participant's prudential requirements are determined by the IESO based on the participant's "maximum net exposure", subject to permitted reductions resulting from, among other things, good payment history, credit rating or, in the case of distributors, prudential support collected from retailers or customers.

In addition to prudential requirements, counterparties under bilateral contracts for the purchase and sale of electricity contracts may require parental guarantees or other forms of credit support. Also, electricity distributors may require retailers to maintain security arrangements (including letters of credit, surety bonds, cash deposits or lock-box arrangements) under terms prescribed by the OEB to protect against credit risk.

The City has authorized the Corporation to provide financial assistance to its subsidiaries, and LDC to provide financial assistance to other subsidiaries of the Corporation, in the form of letters of credit and guarantees, for the purposes of enabling them to carry on their businesses up to an aggregate amount of \$500 million.

As at December 31, 2005, the Corporation had issued \$86.5 million of parental guarantees on behalf of TH Energy in support of prudential requirements and obligations under bilateral contracts for the purchase and sale of electricity and had issued \$56.4 million of parental guarantees to the City as part of an agreement by the City to purchase electricity at a fixed price from TH Energy. See note 17 to the Consolidated Financial Statements.

### ***Dividends***

The shareholder direction adopted by the City with respect to the Corporation provides that the board of directors of the Corporation will use its best efforts to ensure the Corporation meets certain financial performance standards, including those relating to credit rating and dividends. Subject to applicable law, the shareholder direction provides that the Corporation will pay dividends to the City each year equal to the greater of \$25 million or 50% of the Corporation's net income for the year. The dividends are not cumulative and are payable as follows:

- \$6 million on the last business day of each of the first three fiscal quarters during the year;
- \$7 million on the last business day of the fiscal year; and
- the amount, if any, by which 50% of the Corporation's net income for the year exceeds \$25 million, within ten calendar days after the board of directors of the Corporation approves the Corporation's Consolidated Financial Statements for the year.

The board of directors of the Corporation did not declare or pay any dividends prior to November 2003.

The board of directors of the Corporation declared and paid dividends totalling \$49.2 million in 2004 and \$68.0 million in 2005.

On March 2, 2006, the board of directors of the Corporation declared dividends in the amount of \$27.2 million. The dividends are comprised of a \$21.2 million payment for 2005 net income, payable to the City on March 10, 2006, and a \$6.0 million payment in connection with the first quarter of 2006, payable to the City on March 31, 2006.

### **Corporate Developments**

#### ***Appointment***

On March 2, 2006, the board of directors of the Corporation appointed Eduardo Bresani as Chief Information Officer of the Corporation, effective January 23, 2006.

#### ***Extension of Maturity Date under City Note***

The City holds a \$980.2 million promissory note (the "City Note") issued to the City by the Corporation in May 2003. See note 12(b) to the Consolidated Financial Statements. 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 million of the principal amount of the City Note during any twelve-month period.

#### ***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, unsecured debentures in one or more series in an aggregate principal amount of up to \$1 billion during the twenty-five months following the date of the prospectus. The

debentures issuable under the MTN Program have been assigned a rating of “A” with a stable trend by DBRS and a preliminary rating of “A-” by S&P. As at March 2, 2006, no debentures have been issued under the MTN Program.

### ***Acquisition***

On December 31, 2005, Street Lighting purchased the street and expressway lighting assets from the City for cash consideration of \$60.0 million. 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 acquired assets will be depreciated over their estimated remaining service lives.

Concurrently, 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. See note 4 to the Consolidated Financial Statements.

### ***Labour Agreement***

On December 20, 2005, CUPE One ratified collective agreements governing inside and outside employees for a three-year period expiring January 31, 2009. The collective agreements implemented an immediate wage increase of 3.5% on rates in effect on December 16, 2005 and provide for general wage increases of 3.25%, effective February 1, 2007 and 2008 on rates in effect on January 31, 2007 and 2008, respectively.

### ***2006 Rate Application***

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

### **Consumer’s 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 ruled that The Consumers’ Gas Company (“Consumers’ Gas”) was required to repay that 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.

The Corporation is not a party to the Consumers’ Gas class action. It is, however, subject to the two class actions described below and in the Corporation’s annual information form.

The first is an action commenced against a predecessor of LDC and other Ontario MEU’s under the Class Proceedings Act, 1992 seeking \$500.0 million 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 \$64.0 million 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 a 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 reasonably quantify the effect, if any, of the Consumers' Gas decision on these actions or of these actions on the financial performance of the Corporation.

### **Share Capital**

The authorized capital of the Corporation consists of an unlimited number of common shares of which 1,000 common shares are issued and outstanding as at the date hereof.

### **Services Provided to the City**

Subsidiaries of the Corporation provide certain services to the City at commercial rates, including street lighting and maintenance services. In addition, the City and its agencies have entered into retail electricity purchase contracts and energy management contracts with TH Energy. See note 16 and note 20 to the Consolidated Financial Statements.

### **Risks and Uncertainties**

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

#### ***Regulatory Uncertainty***

The continuing restructuring of Ontario's electricity industry and other regulatory developments, including current and possible future consultations between the OEB and interested stakeholders, may affect the distribution rates that LDC may charge and the costs that LDC may recover. This may in turn have a material adverse effect on the financial performance of the Corporation.

#### ***Commodity Risk***

TH Energy is subject to commodity risk in connection with its existing portfolio of electricity contracts. TH Energy's approach to managing commodity risk is to match the estimated requirements of its customers under retail contracts with the volumes of electricity purchased from suppliers. Since electricity consumption from retail contracts cannot always be matched perfectly with electricity purchased from the supplier, TH Energy might have to settle its open positions in a manner, which could adversely affect the consolidated net income of the Corporation. All retail contracts with variable volume have expired and the remaining retail contracts are for fixed volume.

The introduction of price protection has reduced liquidity in the wholesale electricity market and thereby makes it more difficult for TH Energy to implement hedging activities to allow active management of its commodity risk in connection with its portfolio of electricity retail and supply contracts.

#### ***Credit Risk***

LDC is subject to credit risk with respect to customer non-payment. LDC is permitted to mitigate the risk of customer non-payment using any means permitted by law, including security deposits (under terms prescribed by the OEB), late payment penalties, prepayment, pre-authorized payment, load limiters or disconnection. LDC is also subject to credit risk with respect to retailer non-payment under the billing and settlement services that it is required

to provide. LDC is permitted to require retailers to maintain security arrangements, including letters of credit, surety bonds, cash deposits or lock-box arrangements, under terms prescribed by the OEB, to protect against the risk of payment default by retailers.

TH Energy is subject to credit risk with respect to counterparty default under electricity supply contracts. See note 16 to the Consolidated Financial Statements.

### ***Additional Debt Financing***

The Corporation expects to borrow to repay the Note payable to the City when required to do so under its terms or otherwise. See note 12 (b) to the Consolidated Financial Statements.

The Corporation's ability to arrange sufficient and cost-effective debt financing to repay the Note could be adversely affected by a number of factors, including the regulatory environment in Ontario, the Corporation's results of operations and financial condition, financial market conditions, the ratings assigned to the Corporation, and its debt securities by credit rating agencies, the current timing of debt maturities, and general economic conditions.

### **Risk Management**

TH Energy has established a governance structure for risk management that includes the boards of directors of the Corporation and TH Energy, Risk Oversight and Management Committees and key senior management personnel of the Corporation and TH Energy, to oversee the operational aspects of the transactional portfolio of commodity and non-commodity risks. TH Energy's approach to risk management also requires the reporting of weekly reports summarizing open positions and mark-to-market values of all forward positions and weekly risk compliance reports. TH Energy has established credit risk guidelines which include the utilization of a credit approval process, the establishment of credit limits for authorized counterparties and the monitoring of counterparty credit limits.

TH Energy has organized commodity risk management activities in terms of core strategies, risk limits and hedging activities. The core strategy of TH Energy is to match the estimated requirements of its customers to volumes of electricity purchased from suppliers. Market and credit risks are managed under approved limits. TH Energy engages in hedging activities only to the extent required to manage open positions. In the regard, TH Energy's risk management approach establishes prescribed limits (including mark-to-market portfolio limits and volumetric limits) and approved products and restricts activities to the Ontario marketplace.

### **Significant Accounting Policies**

The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles, including accounting principles prescribed by the OEB, and are presented in Canadian dollars. In preparing the Consolidated Financial Statements, management of the Corporation makes estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the Consolidated Financial Statements and the reported amounts of revenues and expenses for the periods covered thereby. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Minister of Energy or the Minister of Finance. The significant accounting policies of the Corporation are summarized in note 3 to the Consolidated Financial Statements.

In May 2005, the Canadian Institute of Chartered Accountants (CICA) issued Accounting Guideline AcG-19, *Disclosures by Entities Subject to Rate Regulation*, which applies to all entities subject to rate regulation in effect for fiscal years ending on or after December 31, 2005. This guideline presents the views of the CICA on certain aspects of the disclosure and presentation of information in the financial statements of entities providing services or products for which customer rates are established or, subject to approval, by a regulator or a governing body empowered by statute or contract to set rates. The Corporation adopted this standard on December 31, 2005. See note 3 and note 8 to the Consolidated Financial Statements.

In January 2005, the CICA released new Handbook Section 3865, Hedges, effective for annual and interim periods beginning on or after October 1, 2006. This new Section establishes standards from when and how hedge accounting may be applied. The Corporation is currently evaluating the impact of this standard on its financial statements.

### **Forward-Looking Information**

Certain information included herein constitutes “forward-looking information”. Forward-looking information means disclosure regarding possible events, conditions or results that is based on assumptions about future economic conditions and courses of action. In some cases, forward looking information can be identified by terminology such as “may”, “will”, “should”, “expect”, “anticipate”, “believe”, “estimate”, “predict”, “potential”, “budget”, “continue” or the negative of these terms or other comparable terminology. In addition, certain information included herein may contain forward-looking information attributable to third parties. Although the Corporation believes that it has a reasonable basis for the forward-looking information included herein, such information is subject to a number of risks and uncertainties that may cause actual events, conditions or results to differ materially from those contemplated by the forward-looking information. Some of the factors that could cause such differences include legislative or regulatory developments, financial market conditions, the ratings assigned to the Corporation and its debt securities by rating agencies, general economic conditions and weather. The Corporation does not undertake any obligation to update publicly or to revise any of the forward-looking information included herein after the date hereof, whether as a result of new information, future events or otherwise.

### **Additional Information**

The information included herein reflects material events up to March 2, 2006, the date on which Consolidated Financial Statements of the Corporation were approved by the Corporation’s board of directors.

Additional information with respect to the Corporation (including its annual information form and annual report) is available on the Canadian Securities Administrators’ web-site at [www.sedar.com](http://www.sedar.com).

Toronto, Canada

March 2, 2006