

TORONTO HYDRO CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE INTERIM PERIOD ENDED JUNE 30, 2007

The following discussion and analysis should be read in conjunction with:

- the unaudited interim consolidated financial statements and accompanying notes of Toronto Hydro Corporation (the "Corporation") as at and for the three-month period and the six-month period ended June 30, 2007 (the "Interim Consolidated Financial Statements");
- the audited consolidated financial statements and accompanying notes of the Corporation as at and for the year ended December 31, 2006 (the "Annual Consolidated Financial Statements"); and
- management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2006 (including the sections entitled "Electricity Distribution – Industry Overview", "Liquidity and Capital Resources", "Corporate Developments", "Share Capital", "Services Provided to the City", "Risks and Uncertainties", "Disclosure and Internal Controls" and "Significant Accounting Policies" which remain substantially unchanged as at the date hereof except as noted below or as updated by the Interim Consolidated Financial Statements).

Copies of these documents are available on the System for Electronic Document Analysis and Retrieval ("SEDAR") web site at www.sedar.com.

The Interim Consolidated Financial Statements are prepared in accordance with Canadian generally accepted accounting principles and are presented in Canadian dollars. In preparing the Interim Consolidated Financial Statements, management 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 Interim 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 Ontario Energy Board (the "OEB"), the Minister of Energy or the Minister of Finance. The significant accounting policies of the Corporation are summarized in note 4 to the Annual Consolidated Financial Statements and in note 3 to the Interim Consolidated Financial Statements.

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 provides street lighting and expressway lighting services and develops energy efficiency products and services. In 2006, TH Energy also managed a portfolio of electricity contracts (the last of which expired on December 31, 2006), and operated a water heater rental business (the assets comprising the water heater rental business were sold on February 8, 2007). See notes 1, 4 and 23 to the Annual Consolidated Financial Statements and note 13 to the Interim Consolidated Financial Statements; and
- *Toronto Hydro Telecom Inc.* ("Telecom") - which provides fibre optic cable capacity and manages data communications 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 678,000 customers located in the City of Toronto (the "City"). LDC is the largest municipal electricity distribution company in Canada and distributes approximately 18% 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 Annual Consolidated Financial Statements.

Selected Interim Consolidated Financial Data

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

Interim Consolidated Statement of Income Three months ended June 30 (in thousands of dollars, except for per share amounts, unaudited)				
	2007	2006 ⁽¹⁾	Change	Change
	\$	\$	\$	%
Revenues	560,854	535,421	25,433	4.75%
Costs				
Purchased power and other	435,945	403,044	32,901	8.16%
Operating expenses	54,233	50,494	3,739	7.40%
Depreciation and amortization	36,438	34,218	2,220	6.49%
	<u>526,616</u>	<u>487,756</u>	<u>38,860</u>	<u>7.97%</u>
Income before interest and provision for PILs	34,238	47,665	(13,427)	(28.17)%
Interest income	4,503	4,447	56	1.26%
Interest expense				
Long-term debt	(18,410)	(18,973)	563	2.97%
Other interest	602	(652)	1,254	192.33%
Income before provision for PILs	<u>20,933</u>	<u>32,487</u>	<u>(11,554)</u>	<u>(35.56)%</u>
Provision for PILs	6,041	14,766	(8,725)	(59.09)%
Income from continuing operations	14,892	17,721	(2,829)	(15.96)%
Income from discontinued operations – net of tax ⁽²⁾	17	440	(423)	(96.14)%
Net income	<u>14,909</u>	<u>18,161</u>	<u>(3,252)</u>	<u>(17.91)%</u>
Basic and fully diluted net income per share from continuing operations	14,892	17,721	(2,829)	(15.96)%
Basic and fully diluted net income per share from discontinued operations	17	440	(423)	(96.14)%
Basic and fully diluted net income per share	<u>14,909</u>	<u>18,161</u>	<u>(3,252)</u>	<u>(17.91)%</u>

Notes:

- (1) Amounts reflect reclassification for discontinued operations. See note 23 to the Annual Consolidated Financial Statements.
- (2) Consists of discontinued operations for water heaters. See note 13 to the Interim Consolidated Financial Statements.

Interim Consolidated Statement of Income
Six months ended June 30
(in thousands of dollars, except for per share amounts, unaudited)

	2007 \$	2006 ⁽¹⁾ \$	Change \$	Change %
Revenues	1,168,181	1,099,430	68,751	6.25%
Costs				
Purchased power and other	917,579	834,696	82,883	9.93%
Operating expenses	108,047	93,917	14,130	15.05%
Depreciation and amortization	72,477	68,045	4,432	6.51%
	<u>1,098,103</u>	<u>996,658</u>	<u>101,445</u>	<u>10.18%</u>
Income before interest and provision for PILs	70,078	102,772	(32,694)	(31.81)%
Interest income	8,905	8,864	41	0.46%
Interest expense				
Long-term debt	(36,820)	(39,074)	2,254	5.77%
Other interest	235	(1,597)	1,832	114.72%
Income before provision for PILs	<u>42,398</u>	<u>70,965</u>	<u>(28,567)</u>	<u>(40.26)%</u>
Provision for PILs	14,449	30,997	(16,548)	(53.39)%
Income from continuing operations	27,949	39,968	(12,019)	(30.07)%
Income from discontinued operations – net of tax ⁽²⁾	24,614	752	23,862	3,173.14%
Net income	<u>52,563</u>	<u>40,720</u>	<u>11,843</u>	<u>29.08%</u>
Basic and fully diluted net income per share from continuing operations	27,949	39,968	(12,019)	(30.07)%
Basic and fully diluted net income per share from discontinued operations	24,614	752	23,862	3,173.14%
Basic and fully diluted net income per share	<u>52,563</u>	<u>40,720</u>	<u>11,843</u>	<u>29.08%</u>

Notes:

- (1) Amounts reflect reclassification for discontinued operations. See note 23 to the Annual Consolidated Financial Statements.
- (2) Consists of discontinued operations for water heaters. See note 13 to the Interim Consolidated Financial Statements.

Interim Consolidated Balance Sheet
(in thousands of dollars, unaudited)

	As at June 30, 2007 \$	As at December 31, 2006 \$
Total assets	2,626,402	2,591,706
Current liabilities	547,865	555,105
Long-term liabilities	1,167,110	1,144,537
Total liabilities	<u>1,714,975</u>	<u>1,699,642</u>
Shareholder's equity	911,427	892,064
Total liabilities and shareholder's equity	<u>2,626,402</u>	<u>2,591,706</u>

Results of Operations

Net Income

Net income for the three months and the six months ended June 30, 2007 was \$14.9 million and \$52.6 million compared to \$18.2 million and \$40.7 million for the comparable periods in 2006.

The decrease in net income for the three months ended June 30, 2007 was primarily due to decreased net revenues (\$7.5 million), increased operating expenses (\$3.7 million) and increased depreciation and amortization expense (\$2.2 million), partially offset by decreased provision for payments in lieu of corporate taxes ("PILs") (\$8.7 million) and decreased net interest expense (\$1.9 million).

The increase in net income for the six months ended June 30, 2007 was primarily due to the gain on the sale of the water heater assets included in income from discontinued operations (\$23.9 million), decreased provision for PILs (\$16.5 million) and decreased net interest expense (\$4.1 million), partially offset by decreased net revenues (\$14.1 million), increased operating expenses (\$14.1 million) and increased depreciation and amortization expense (\$4.4 million).

Net Revenues

Net revenues (revenues minus the cost of purchased power and other) for the three months and the six months ended June 30, 2007 were \$124.9 million and \$250.6 million compared to \$132.4 million and \$264.7 million for the comparable periods in 2006.

The decrease in net revenues for the three months ended June 30, 2007 was primarily due to decreased net revenues at LDC (\$6.0 million) and at TH Energy (\$3.1 million), partially offset by increased net revenues at Telecom (\$1.6 million).

At LDC, the decrease in net revenues for the three months ended June 30, 2007 was primarily due to decreased distribution revenue (\$8.4 million), partially offset by higher non-distribution income (\$2.4 million) from higher customer service charges. The decrease in distribution revenue was mainly related to a decrease in distribution rates mainly arising from the OEB's decision on LDC's 2006 rate application (\$6.9 million) and lower revenue recognition from lower Conservation and Demand Management ("CDM") activities in 2007 (\$3.9 million). LDC's decrease in distribution revenue was partially offset by increased consumption attributable to weather (\$2.2 million) in the second quarter of 2007 compared to 2006 (6,403 GWh compared to 6,314 GWh).

The decrease in net revenues for the six months ended June 30, 2007 was primarily due to decreased net revenues at TH Energy (\$8.8 million) and at LDC (\$8.6 million), partially offset by increased net revenues at Telecom (\$3.0 million).

At TH Energy, the decrease in net revenues for the three months and six months ended June 30, 2007 was primarily due to the conclusion of the electricity retail business on December 31, 2006.

At LDC, the decrease in net revenues for the six months ended June 30, 2007 was primarily due to decreased distribution revenue (\$13.5 million), partially offset by higher non-distribution income (\$4.9 million) mainly from higher customer service charges and gains on disposal of assets. The decrease in distribution revenue was mainly related to lower distribution rates mainly arising from the OEB's decision on LDC's 2006 rate application (\$9.0 million), lower revenue recognition from lower CDM activities in 2007 (\$5.7 million) and lower revenue in 2007 due to annual distribution rate adjustment (\$2.9 million). LDC's decrease in distribution revenue was partially offset by increased consumption attributable to weather (\$3.3 million) in the first two quarters of 2007 compared to 2006 (13,282 GWh compared to 13,046 GWh).

At Telecom, the increase in net revenues for the three months and six months ended June 30, 2007 was primarily due to increased sales of data services.

Expenses

Operating expenses for the three months and the six months ended June 30, 2007 were \$54.2 million and \$108.0 million compared to \$50.5 million and \$93.9 million for the comparable periods in 2006.

The increase in operating expenses for the three months ended June 30, 2007 was primarily due to increased business activities at Telecom (\$1.4 million) and TH Energy (\$1.0 million).

The increase in operating expenses for the six months ended June 30, 2007 was primarily due to higher compensation costs at LDC (\$4.9 million) mainly attributable to increased headcount from the hiring of new apprentices and changes in the regulatory treatment of OMERS contribution in May 2006, higher costs for operations and maintenance programs at LDC (\$3.8 million) mainly attributable to aging infrastructure and unfavourable weather, higher costs for facilities at LDC (\$2.2 million) and higher operating costs at Telecom (\$2.6 million) and TH Energy (\$1.1 million) mainly from increased business activities. These variances were partially offset by lower CDM expenditures at LDC for 2007 consistent with lower revenue recognition for such activities as discussed above (\$3.6 million).

Depreciation and amortization expense for the three months and the six months ended June 30, 2007 was \$36.4 million and \$72.5 million compared to \$34.2 million and \$68.0 million for the comparable periods in 2006. The increase in depreciation expense for the three months and six months ended June 30, 2007 was primarily due to a higher net book value for fixed assets and intangible assets in service. The increase in net book value is mainly due to increased investment in electricity distribution assets of LDC over the past two years.

Net interest expense for the three months and the six months ended June 30, 2007 was \$13.3 million and \$27.7 million compared to \$15.2 million and \$31.8 million for the comparable periods in 2006. The decrease in net interest expense was primarily due to higher short-term interest income and lower long-term interest expense following an amendment to the City Promissory Note that reduced long-term interest rate payable on the note from 6.8% to 6.11%, commencing May 1, 2006. See note 6b to the Interim Consolidated Financial Statements.

Provision for PILs

Provision for PILs for the three months and the six months ended June 30, 2007 was \$6.0 million and \$14.4 million compared to \$14.8 million and \$31.0 million for the comparable periods in 2006.

The decrease in the provision for PILs for the three months ended June 30, 2007 was primarily due to a decrease in income (\$4.2 million) and lower temporary differences not benefited in LDC (\$0.7 million).

The decrease in the provision for PILs for the six months ended June 30, 2007 was primarily due to a decrease in income (\$10.3 million), lower temporary differences not benefited in LDC (\$1.5 million) and a decrease in the future tax rate used to value future tax assets in 2006 (\$1.7 million).

Discontinued Operations

On February 8, 2007, TH Energy sold its water heater business to Consumers' Waterheater Income Fund for cash consideration of \$40.8 million subject to post closing adjustments and transaction costs. The results of operations and financial position of the water heater business have been segregated and presented as discontinued operations in the accompanying financial statements. See note 13 to the Interim Consolidated Financial Statements.

The water heater sale agreement includes a six-month purchase price adjustment period commencing April 2, 2007. At the end of the adjustment period, the purchase price will be adjusted to reflect an increase or decrease in the number of active customers used in the purchase price calculation.

Income from discontinued operations for the three months and six months ended June 30, 2007 was \$nil million and \$24.6 million compared to \$0.4 million and \$0.8 million for the comparable periods in 2006. The increase for the six months ended June 30, 2007 was primarily due to the sale of the water heater business.

Quarterly Results of Operations

The tables below present unaudited quarterly consolidated financial information of the Corporation for the eight quarters from September 30, 2005 to June 30, 2007 and reflect discontinued operations relating to the water heater business. See note 23 to the Annual Consolidated Financial Statements.

Quarterly Results (in thousands of dollars, unaudited)				
	Jun. 30, 2007	Mar. 31, 2007	Dec. 31, 2006	Sept. 30, 2006
	\$	\$	\$	\$
Revenues	560,854	607,327	548,518	599,041
Costs	526,616	571,487	498,402	542,326
Income from continuing operations	14,892	13,057	22,054	28,197
Net income.....	14,909	37,654	22,783	28,894

Quarterly Results (in thousands of dollars, unaudited)				
	Jun. 30, 2006	Mar. 31, 2006	Dec. 31, 2005	Sept. 30, 2005
	\$	\$	\$	\$
Revenues	535,421	564,009	634,763	772,619
Costs	487,756	508,902	590,126	713,529
Income from continuing operations	17,721	22,247	22,153	18,842
Net income.....	18,161	22,559	22,501	19,354

Liquidity and Capital Resources

The Corporation's primary sources of liquidity and capital resources are cash provided by operating activities, short-term bank financing, interest income and borrowings from debt capital markets. The Corporation's liquidity and capital resource requirements are mainly for capital expenditures to maintain and improve the electricity distribution system of LDC, cost of power, interest expense and prudential requirements and third party credit support.

The Corporation holds R1 High-rated \$88.0 million in asset-backed commercial paper notes: \$66.0 million which matured on August 13, 2007 and remain unpaid; \$8.6 million which matured on August 20, 2007 and remain unpaid and \$13.4 million which will mature on August 31, 2007. The Corporation has sufficient cash to fund all of its ongoing liquidity and capital resources requirements. The Corporation is currently working with the sponsors, the noteholders and other market participants to resolve this issue.

Capital Resources and Liquidity (in thousands of dollars, unaudited)				
	Three months		Six months	
	Ended June 30		Ended June 30	
	2007	2006	2007	2006
	\$	\$	\$	\$
Cash and cash equivalents, beginning of period	357,806	335,094	327,524	448,370
Net cash provided by (used in) operating activities	69,215	29,366	120,955	(187)
Net cash used in investing activities	(70,612)	(44,614)	(98,497)	(95,416)
Net cash used in financing activities	(2,819)	(3,466)	(36,424)	(35,872)
Net cash provided by (used in) discontinued operations ⁽¹⁾	(841)	416	39,191	(99)
Cash and cash equivalents, end of period	<u>352,749</u>	<u>316,796</u>	<u>352,749</u>	<u>316,796</u>

Note:

- (1) Consists of discontinued operations for water heaters. See note 13 to the Interim Consolidated Financial Statements.

Cash Provided by (Used in) Operating Activities

Cash provided by operating activities for the three months and the six months ended June 30, 2007 was

\$69.2 million and \$121.0 million compared to \$29.4 million and (\$0.2) million for the comparable periods in 2006.

The increase in cash provided by operating activities for the three months ended June 30, 2007 was primarily due to the payment of electricity rebates in 2006 at LDC (\$65.0 million) and increased electricity payables at LDC (\$18.5 million), partially offset by an unfavorable variance in the aggregate of accounts receivable and unbilled revenue due to the timing of billing and collection activities at LDC (\$38.0 million) and an unfavorable variance in TH Energy (\$12.7 million) principally attributable to the conclusion of the electricity retail activities.

The increase in cash provided by operating activities for the six months ended June 30, 2007 was primarily due to the payment of electricity rebates and PILs liabilities in 2006 at LDC (\$109.9 million) and increased electricity payables at LDC (\$70.0 million), partially offset by an unfavorable variance in the aggregate of accounts receivable and unbilled revenue due to the timing of billing and collection activities at LDC (\$15.1 million), an unfavorable variance at TH Energy (\$18.3 million) mainly attributable to the conclusion of the electricity retail activities, an unfavorable variance in net income at LDC (\$9.6 million) and an unfavorable variance at Telecom (\$7.7 million).

Cash Used in Investing Activities

Cash used in investing activities for the three months and the six months ended June 30, 2007 was \$70.6 million and \$98.5 million compared to \$44.6 million and \$95.4 million for the comparable periods in 2006.

The increase in cash used in investing activities for the three months ended June 30, 2007 was primarily due to an increase in the purchase of property, plant and equipment and intangible assets at LDC (\$32.5 million), partially offset by a decrease in regulatory assets at LDC (\$8.3 million).

The increase in cash used in investing activities for the six months ended June 30, 2007 was primarily due to an increase in the purchase of property, plant and equipment at LDC (\$29.6 million), TH Energy (\$2.7 million) and Telecom (\$1.9 million), partially offset by a decrease in regulatory assets at LDC (\$29.8 million) primarily due to lower government rebate variances.

The increase in property, plant and equipment at LDC for the three months and six months ended June 30, 2007 is related to the planned increased investment in infrastructure. The increase is mainly related to core electricity distribution assets along with improvement in facilities.

The following table summarizes the Corporation's capital expenditures for the periods indicated:

Capital Expenditures (in thousands of dollars, unaudited)				
	Three months		Six months	
	Ended June 30		Ended June 30	
	2007	2006	2007	2006
	\$	\$	\$	\$
Capital Expenditures from Continuing Operations				
LDC				
Distribution System	53,612	31,030	86,137	64,939
Technology assets	7,465	4,503	10,594	10,138
Other ⁽¹⁾	8,718	1,778	12,914	4,981
	<u>69,795</u>	<u>37,311</u>	<u>109,645</u>	<u>80,058</u>
Other ⁽²⁾	5,118	3,264	8,927	4,799
Total Capital Expenditures	<u>74,913</u>	<u>40,575</u>	<u>118,572</u>	<u>84,857</u>
Capital Expenditures from Discontinued Operations				
Water Heaters	-	820	286	1,787

Notes:

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

Cash Used in Financing Activities

Cash used in financing activities for the three months and the six months ended June 30, 2007 was \$2.8 million and \$36.4 million compared to \$3.5 million and \$35.9 million for the comparable periods in 2006.

The variances in cash used in financing activities for the three months and the six months ended June 30, 2007 were primarily due to variances in customer deposits.

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 \$500.0 million, of which up to \$175.0 million is available in the form of letters of credit. As at June 30, 2007, no borrowings for working capital were outstanding and letters of credit in the amount of \$80.1 million had been issued. See note 5 to the Interim Consolidated Financial Statements.

Dividends

On March 1, 2007, 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 2006 net income, which was paid on March 9, 2007 and a \$6.0 million payment in respect of the first quarter of 2007, which was paid on March 30, 2007.

On May 28, 2007, the board of directors of the Corporation declared a dividend in the amount of \$6.0 million in respect of the second quarter of 2007, which was paid on June 29, 2007.

On August 23, 2007, the board of directors of the Corporation declared a dividend in the amount of \$6.0 million in respect of the third quarter of 2007. The dividend is payable on September 28, 2007.

Corporate Developments

Changes in Business

TH Energy operated a water heater rental business until February 8, 2007, at which time the business was sold to The Consumers' Waterheater Income Fund. See note 13 to the Interim Consolidated Financial Statements.

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 were managed to expiration on December 31, 2006. See note 15 to the Annual Consolidated Financial Statements.

Distribution Rates for LDC

On April 12, 2007, the OEB approved an increase in LDC's distribution rates for the period May 1, 2007 to April 30, 2008 representing an estimated revenue increase of approximately \$1.9 million.

On August 2, 2007, LDC filed a rate application with the OEB seeking approval of separate and successive revenue requirements and corresponding rates for the rate years commencing May 1, 2008, 2009, and 2010. The requested base distribution revenue requirements for these rate years are \$498.4 million, \$534.0 million and \$562.4 million respectively.

Smart Meters

On June 13, 2006, the Province issued draft regulations clarifying the technical details of advanced metering infrastructure and data management. In support of the Province's decision to install smart meters throughout Ontario by 2010, LDC launched its smart meter project in 2006. The project objective is to install 711,000 smart meters and the supporting infrastructure by the end of 2010. LDC had installed over 311,000 meters at June 30, 2007.

Consistent with the OEB's direction, LDC has deferred capital expenditures, operating and depreciation expenses and revenues relating to smart meters in regulatory asset accounts. On May 1, 2006, LDC implemented new distribution rates which included charges for smart meters of \$0.47 per 30 days for each residential customer and \$1.04 per 30 days for all other customers. Effective May 1, 2007, the OEB-approved charges for smart meters were changed to \$0.68 per 30 days for all metered customers.

On March 23, 2007, LDC submitted an application to the OEB for disposition of the 2006 balance in the smart meter deferral account and an adjustment to rate base to reflect smart meter assets.

On August 8, 2007, the OEB issued its decision approving costs associated with smart metering activities incurred by LDC for minimum smart meter infrastructure functionality. LDC is currently reviewing the impacts of the decision on Regulatory Assets, Fixed Assets, Distribution Revenue and Depreciation and Amortization. The financial outcome of the decision will be recorded in the third quarter of 2007 upon completion of the review.

Shared Savings Mechanism and Lost Revenue Adjustment Mechanism

On March 23, 2007, LDC submitted an application to the OEB for recovery of \$10.4 million associated with LDC's CDM programs for 2005 and 2006. Authorization to apply for recovery of these amounts was granted by the OEB in its decision on CDM programs funding on May 11, 2005. The evidentiary examination was held by way of oral hearing on June 21, 2007. Final arguments were submitted to the OEB on July 20, 2007. This matter is now awaiting a final decision by the OEB.

OEB Proposals for Multi-Year Electricity Rate Setting Plan

In June 2006, the OEB began a generic licence amendment proceeding that was intended to effect changes to the allowable cost of capital and was intended to effect a multi-year electricity distribution rate setting plan via incentive regulation mechanisms for distributors. LDC responded to the OEB's proposals and participated in technical conferences.

In December 2006, in the interests of implementing distribution rate changes for 2007 in a timely manner, the OEB maintained its current methodology for determining LDC's allowable cost of capital but proceeded with its multi-year incentive regulation mechanism ("IRM") which incorporates changes to LDC's capital structure as well as an incentive mechanism that adjusts distribution rates by inflation less a productivity factor between rebasing periods. The capital structure change will see LDC's current deemed debt-to-equity structure of 65% debt-to-35% equity change to 60% debt-to-40% equity over a two-year period beginning on May 1, 2008. The capital structure change is estimated to increase LDC's return on rate base by about 20 basis points by 2009 representing an estimated revenue increase of approximately \$4.0 million.

CDM Agreements

In May 2007, LDC entered into agreements with Ontario Power Authority ["OPA"] to deliver OPA-funded CDM programs in the amount of approximately \$59.0 million during the years from 2007 to 2010. All programs are fully funded by the OPA with any advance payments recorded on the balance sheet as a deferred liability.

Ministry of Finance Tax Audit

In June 2007, the Ministry of Finance completed its tax audit for tax years 2001 and 2002 on the Corporation and its subsidiaries except for LDC. The impact of the completed audits was not material to the Corporation and has been recorded in the interim financial statements. The Ministry of Finance is continuing its audit of LDC for those tax years. Certain filing positions for PILs taken by LDC may be challenged on the audit. This may result in a material increase in LDC's reported tax obligations upon reassessment. As the audit has not yet been completed, management is not able to determine the impact, if any, of the audit on the interim consolidated financial statements or LDC's tax reserves. The Corporation adjusts its tax reserves when there is sufficient information available, or when an event occurs requiring a change to the reserves.

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 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 parties reached a settlement of this class action. The Ontario Superior Court of Justice has approved this settlement, however the representative plaintiff, Mr. Garland, is appealing the settlement approval order in an attempt to increase the fees to which he is entitled for having acted as representative plaintiff, and to receive lawyer's fees in connection with that effort. Mr. Garland's appeal is pending.

The 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 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. After the release by the Supreme Court of Canada of its 2004 decision in the Consumers' Gas case, the plaintiffs in this proposed class action indicated their intention to proceed with the litigation, but no formal steps have been taken.

The second is an action commenced against a predecessor of LDC under the *Class Proceedings Act, 1992* seeking \$64 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.

Disclosure and Internal Controls

During the quarter ended June 30, 2007, the Corporation evaluated the effectiveness of the Corporation's disclosure controls and procedures as defined in Multilateral Instrument 52-109 pursuant to Canadian regulatory requirements. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

During the quarter ended June 30, 2007, the Corporation evaluated the design of internal controls over financial reporting as required under Multilateral Instrument 52-109. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the design of those controls is effective to provide such reasonable assurance that the Corporation's consolidated financial statements for external purposes in accordance with Canadian GAAP are reliable.

During the quarter ended June 30, 2007 there were no changes to the Corporation's internal controls over financial reporting that would have materially affected these controls.

Significant Accounting Policies

Effective January 1, 2007, the Corporation adopted the Canadian Institute of Chartered Accountants ["CICA"] Handbook Sections 3855 - "Financial Instruments – Recognition and Measurement", 3861 - "Financial

Instruments – Disclosure and Presentation”, 1530 – “Comprehensive Income”, 3865 – “Hedges” and the revised CICA Handbook Section 3251 – “Equity” [the “Handbook Sections”]. These Handbook Sections require that all financial instruments, which meet the definition of an asset or liability, be recognized in the financial statements at their fair value, unless fair value cannot be reliably determined. Although the Corporation has identified financial instruments to be reported at fair value, no amounts have been recorded as the fair value of the related financial instruments has been determined to not be material to the Corporation’s results of operations and financial position. See note 3 to the Interim Consolidated Financial Statements.

Commencing January 1, 2007, LDC prospectively adopted Article 410 of the Accounting Procedures [“AP”] Handbook, which provides for the inclusion of an allowance for funds used during construction [“AFUDC”] when capitalizing construction in progress assets, until such time as the asset is substantially complete. A concurrent credit of the same amount is made to the interest expense account when the allowance is capitalized. For the six months ended June 30, 2007, \$0.9 million was capitalized to property, plant and equipment and was credited to interest expense. See note 3 to the Interim Consolidated Financial Statements.

In December 2006, the Canadian Accounting Standards Board [“AcSB”] announced that as of March 31, 2008, they will be making a final decision on the date in which publicly accountable enterprises will be required to change over to International Financial Reporting Standards (“IFRS”). At this time, the AcSB anticipates a five-year transition period ending around 2011. Some of the converged standards will be implemented in Canada during the transition period with the remaining standards adopted at the change over date. Until the change over is finalized, companies will continue to describe their basis of reporting using Canadian GAAP. Management is currently in the process of evaluating the potential impact of the conversion from Canadian GAAP to IFRS on the Corporation’s financial statements.

In December 2006, the AcSB released CICA Handbook Section 1535 – “Capital Disclosures” effective for fiscal years beginning on or after October 1, 2007. This section establishes new accounting standards regarding capital disclosures. Under Section 1535, an entity is required to disclose information regarding its objectives, policies and processes for managing capital as well as its compliance with any external capital requirements. The Corporation is currently in the process of evaluating the potential impact of this standard on its financial statements.

The AcSB issued two new accounting standards surrounding financial instrument presentation and disclosure. CICA Handbook Sections 3862 – “Financial Instruments – Disclosure” and 3863 – “Financial Instruments – Presentation” are effective for fiscal years beginning on or after October 1, 2007. Both sections improve upon the financial instrument disclosure requirements existing under CICA Handbook Section 3861 – “Financial Instruments – Disclosure and Presentation”. The Corporation is currently in the process of evaluating the potential impact of these standards on its financial statements.

In March 2007, the AcSB approved CICA Handbook Section 3031 – “Inventories”, which will replace the existing CICA Handbook Section 3030. The new Handbook Section will be effective for fiscal periods beginning on or after January 1, 2008. Under the new section, inventories are required to be measured at the lower of cost and net realizable value. The section also provides updated guidance on the appropriate methods of determining cost and the impact of any write-downs to net realizable value. The Corporation is currently in the process of evaluating the potential 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

Additional information with respect to the Corporation (including its annual information form) is available at www.sedar.com.

Toronto, Canada

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