

Consolidated Financial Statements

Toronto Hydro Corporation

March 31, 2007

Toronto Hydro Corporation

| INTERIM CONSOLIDATED BALANCE SHEET | | |
|---|--|---|
| [in thousands of dollars, unaudited] | | |
| | As at March 31, 2007 \$ | As at December 31, 2006 \$ |
| ASSETS | | |
| Current | | |
| Cash and cash equivalents | 357,806 | 327,524 |
| Accounts receivable, net of allowance for doubtful accounts | 204,717 | 218,452 |
| Unbilled revenue | 214,319 | 216,857 |
| Inventories | 25,543 | 22,458 |
| Prepaid expenses | 3,359 | 2,277 |
| Future income tax assets | 600 | 791 |
| Assets from discontinued operations <i>[note 13]</i> | - | 12,098 |
| Total current assets | 806,344 | 800,457 |
| Property, plant and equipment, net | 1,665,356 | 1,656,868 |
| Intangible assets, net | 48,077 | 49,266 |
| Regulatory assets <i>[note 4]</i> | 70,767 | 66,528 |
| Other assets | 2,430 | 2,578 |
| Future income tax assets | 15,884 | 16,009 |
| Total assets | 2,608,858 | 2,591,706 |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| Current | | |
| Accounts payable and accrued liabilities | 277,059 | 284,869 |
| Current portion of other liabilities | 16,731 | 16,952 |
| Current portion of deferred revenue | 4,461 | 7,320 |
| Current portion of promissory note payable <i>[note 6]</i> | 245,058 | 245,058 |
| Liabilities from discontinued operations <i>[note 13]</i> | 4,243 | 906 |
| Total current liabilities | 547,552 | 555,105 |
| Long-term liabilities | | |
| Debentures <i>[note 6]</i> | 225,000 | 225,000 |
| Promissory note payable <i>[note 6]</i> | 735,173 | 735,173 |
| Post-employment benefits <i>[note 7]</i> | 136,806 | 134,682 |
| Regulatory liabilities <i>[note 4]</i> | 30,658 | 11,840 |
| Other liabilities | 3,765 | 3,949 |
| Asset retirement obligations | 7,353 | 7,581 |
| Customers' advance deposits | 19,689 | 25,944 |
| Future income tax liabilities | 344 | 368 |
| Total long-term liabilities | 1,158,788 | 1,144,537 |
| Total liabilities | 1,706,340 | 1,699,642 |
| Contingencies <i>[note 12]</i> | | |
| Shareholder's equity | | |
| Share capital <i>[note 8]</i> | 567,817 | 567,817 |
| Retained earnings | 334,701 | 324,247 |
| Total shareholder's equity | 902,518 | 892,064 |
| Total liabilities and shareholder's equity | 2,608,858 | 2,591,706 |

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INTERIM CONSOLIDATED STATEMENT OF INCOME

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

| | Three months ended March 31, | |
|--|---------------------------------|------------|
| | 2007 \$ | 2006 \$ |
| Revenues | 607,327 | 564,009 |
| Costs | | |
| Purchased power and other | 481,634 | 431,652 |
| Operating expenses | 53,814 | 43,423 |
| Depreciation and amortization | 36,039 | 33,827 |
| | 571,487 | 508,902 |
| Income before interest, other and provision for payments in lieu of corporate taxes | 35,840 | 55,107 |
| Interest income | 4,402 | 4,417 |
| Interest expense | | |
| Long-term debt | (18,410) | (20,101) |
| Other interest | (367) | (945) |
| Income before provision for payments in lieu of corporate taxes | 21,465 | 38,478 |
| Provision for payments in lieu of corporate taxes | 8,408 | 16,231 |
| Income from continuing operations | 13,057 | 22,247 |
| Income from discontinued operations - net of tax <i>[note 13]</i> | 24,597 | 312 |
| Net income | 37,654 | 22,559 |
| Basic and fully diluted net income per share from continuing operations | 13,057 | 22,247 |
| Basic and fully diluted net income per share from discontinued operations | 24,597 | 312 |
| Basic and fully diluted net income per share | 37,654 | 22,559 |

INTERIM CONSOLIDATED STATEMENT OF RETAINED EARNINGS

[in thousands of dollars, unaudited]

| | Three months ended March 31, | |
|---|---------------------------------|------------|
| | 2007 \$ | 2006 \$ |
| Retained earnings, beginning of period | 324,247 | 278,050 |
| Net income | 37,654 | 22,559 |
| Dividends <i>[note 8]</i> | (27,200) | (27,200) |
| Retained earnings, end of period | 334,701 | 273,409 |

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| INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS | | |
|---|---------------------------------|------------------|
| [in thousands of dollars, unaudited] | | |
| | Three months ended March 31, | |
| | 2007 \$ | 2006 \$ |
| OPERATING ACTIVITIES | | |
| Income from continuing operations | 13,057 | 22,247 |
| Adjustments for non-cash items | | |
| Depreciation and amortization | 36,039 | 33,827 |
| Net change in other assets and liabilities | 15 | 7,007 |
| Electricity mark-to-market assets and liabilities | - | 8,201 |
| Post-employment benefits | 2,124 | 2,460 |
| Future income taxes | 292 | (2,849) |
| Gain on disposals of property, plant and equipment | (1,139) | (260) |
| Changes in non-cash working capital balances | | |
| Decrease (increase) in accounts receivable | 13,735 | (75,073) |
| Decrease in unbilled revenue | 2,538 | 50,652 |
| Increase in inventories | (3,085) | (1,320) |
| Increase in prepaid expenses | (1,082) | (1,902) |
| Decrease in accounts payable and accrued liabilities | (7,810) | (72,855) |
| Increase (decrease) in deferred revenue | (2,859) | 175 |
| Increase (decrease) in current portion of other liabilities | (85) | 137 |
| Net cash provided by (used in) operating activities | 51,740 | (29,553) |
| INVESTING ACTIVITIES | | |
| Purchase of property, plant and equipment and intangible assets | (43,659) | (44,282) |
| Net change in regulatory assets and liabilities | 14,579 | (6,876) |
| Proceeds on disposal of property, plant and equipment | 1,195 | 356 |
| Net cash used in investing activities | (27,885) | (50,802) |
| FINANCING ACTIVITIES | | |
| Decrease in customers' advance deposits | (6,245) | (4,827) |
| Repayment of capital lease liability | (160) | (379) |
| Dividends paid <i>[note 8]</i> | (27,200) | (27,200) |
| Net cash used in financing activities | (33,605) | (32,406) |
| Net cash used in continuing operations | (9,750) | (112,761) |
| Net cash provided by (used in) discontinued operations | 40,032 | (515) |
| Net increase (decrease) in cash and cash equivalents during the period | 30,282 | (113,276) |
| Cash and cash equivalents, beginning of period | 327,524 | 448,370 |
| Cash and cash equivalents, end of period | 357,806 | 335,094 |
| Supplementary cash flow information | | |
| Total interest paid | 15,342 | 17,258 |
| Payments in lieu of corporate income taxes | 19,784 | 51,275 |

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

March 31, 2007

1. BASIS OF PRESENTATION

These unaudited interim consolidated financial statements of Toronto Hydro Corporation [the “Corporation”] have been prepared in accordance with Canadian generally accepted accounting principles [“GAAP”] with respect to the preparation of interim financial information. Accordingly, the disclosures in these statements do not conform in all respects to the requirements of Canadian GAAP for annual consolidated financial statements. These statements follow the same accounting policies and methods of application as the audited consolidated financial statements of the Corporation for the year ended December 31, 2006, except as disclosed in note 3, and should be read in conjunction with those statements.

2. REGULATION

Electricity Distribution Rates

In 2006, the Ontario Energy Board [“OEB”] announced the establishment of a multi-year electricity distribution rate-setting plan for Local Distribution Companies for the years 2007 to 2010. To streamline the process for approving distribution rates and charges, the OEB issued guidelines along with an Incentive Regulation Model to be used to calculate 2007 rate adjustments. The guidelines effectively adjusted Base Distribution Rates for inflation less a productivity factor.

On January 26, 2007, LDC filed an Annual Rate Adjustment Application for 2007 rates as directed by the OEB. In accordance with the OEB’s Incentive Regulation Model, LDC sought authorization to increase its rates effective May 1, 2007. On April 12, 2007, the OEB approved LDC’s rates which provided for a 0.9% increase in base distribution rates for all customer classes. After adjustment for the removal of the large corporations tax and changes in the smart meter rate riders, the impact on an average residential customer is approximately \$0.35 per month or \$4.20 per year.

On March 23, 2007, Toronto Hydro-Electric System Limited [“LDC”] submitted an Application to the OEB for the disposition of the 2006 balance in the smart meter deferral account, an adjustment to the rate base to reflect smart meter assets and the recovery of the Lost Revenue Adjustment Mechanism and Shared Savings Mechanism amounts related to the 2005 and 2006 Conservation and Demand Management [“CDM”] activities. On March 27, 2007, the OEB advised LDC that it would consider the smart meter deferral account and the adjustment to rate base in a “generic” proceeding that will commence after May 1, 2007. The OEB also advised LDC that it would consider the CDM elements in a separate proceeding.

3. ACCOUNTING POLICIES

a) Financial instruments

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*”, 3865 - “*Hedges*”, 1530 - “*Comprehensive Income*” and the revised

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CICA Handbook Section 3251 – “Equity” [the “Handbook Sections”]. As provided under the standards, the comparative interim consolidated financial statements have not been restated. These new Handbook Sections have lead to changes in the accounting for financial instruments and hedging transactions. All relevant changes are outlined below.

Financial Instruments – Recognition and Measurement - Section 3855

This Section establishes the standards for the recognition and measurement of financial assets and financial liabilities. At inception, all financial instruments which meet the definition of a financial asset or financial liability are to be recorded at fair value, unless fair value cannot be reliably determined. Depending on the nature of the financial instrument, revenues, expenses, gains and losses would be reported in either net income or other comprehensive income. Subsequent measurement of each financial instrument will depend on the balance sheet classification elected by the Corporation. As of January 1, 2007, the Corporation has elected the following balance sheet classifications with respect to its financial assets and financial liabilities:

- ⊘ Cash is classified as “Assets Held-for-Trading” and is measured at fair value.
- ⊘ Cash equivalents, comprising short-term investments, are classified as “Held-to-Maturity Investments” and are measured at amortized cost, which, upon initial recognition, is considered equivalent to fair value.
- ⊘ Accounts receivable are classified as “Loans and Receivables” and are measured at amortized cost, which, upon initial recognition, is considered equivalent to fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method.
- ⊘ Accounts payable and accrued liabilities, long-term debt and the debentures are classified as “Other Financial Liabilities” and are initially measured at their fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. While the Corporation has the option to redeem some or all of the debentures at their discretion, this option has no value and has not been recorded on the financial statements.

Comprehensive Income – Section 1530

This Section describes the recognition and disclosure requirements with respect to comprehensive income. Comprehensive income consists of net income and other comprehensive income. Other comprehensive income represents the changes in the fair value of a financial instrument which have not been included in net income.

As the Corporation had no adjustments to other comprehensive income during the three month period ended March 31, 2007, the adoption of this standard does not have an impact on the March 31, 2007 consolidated financial statements.

Hedges – Section 3865

This Section establishes standards regarding the use of hedge accounting, in particular, the criteria to be met for the application of hedge accounting and the methods of executing various hedging strategies. As the Corporation has not entered into any hedging transactions as at March 31, 2007, the adoption of this standard does not have an impact on the March 31, 2007 consolidated financial statements.

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b) Allowance for funds used during construction

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. The interest rate for capitalization as prescribed by the OEB, for the period from January 1 to March 31, 2007, is 4.7% and is applied to the balance of the construction-in-progress assets on a simple interest basis. Prospectively, AFUDC is included in property, plant and equipment and construction-in-progress for financial reporting purposes, charged to operations through depreciation over the service life of the related assets and recovered through future revenue. For the three months ended March 31, 2007, \$300,000 was capitalized in the construction-in-progress account and is credited to interest expense. As at March 31, 2007, none of the \$300,000 had been capitalized into property, plant and equipment.

As the AFUDC includes a non-cash component, the construction-in-progress assets would have been lower by \$300,000 and the interest expense account balances would have been higher by \$300,000 in the absence of rate regulation.

c) Use of estimates

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

4. REGULATORY ASSETS AND LIABILITIES

For the three months ended March 31, 2007, LDC recovered approved regulatory asset amounts of \$7,482,000 through permitted distribution rate adjustments [three months ended March 31, 2006 - \$6,287,000]. These recovery amounts are for the recovery of approved regulatory assets recorded in reporting periods prior to January 1, 2005.

Effective May 1, 2006, the OEB allowed the LDC to defer capital expenditures, operating and depreciation expenses and revenues relating to smart meters. Accordingly, the LDC deferred these items in accordance with the criteria set out in the AP Handbook. At March 31, 2007, smart meter capital expenditures, net of accumulated depreciation, totalling \$43,250,000 [December 31, 2006 - \$30,347,000] have been deferred. These expenditures would otherwise have been recorded as property, plant and equipment under Canadian GAAP for unregulated businesses. In the absence of rate regulation, property, plant and equipment would have been \$43,250,000 higher at March 31, 2007 [December 31, 2006 - \$30,347,000]. The manner and timing of disposition of these smart meter regulatory assets have not been determined by the OEB at this time.

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5. CREDIT FACILITIES

At March 31, 2007, \$80,204,000 [December 31, 2006 - \$81,620,000] had been utilized under the Corporation's revolving credit facility in the form of letters of credit to support the prudential requirements of LDC and Toronto Hydro Energy Services Inc. ["TH Energy"]. At March 31, 2007, no amount had been drawn for working capital purposes [December 31, 2006 - \$nil].

At March 31, 2007, no amount had been drawn on the bilateral demand line of credit [December 31, 2006 - \$nil].

6. LONG-TERM DEBT

Long-term debt consists of the following:

| | March 31 2007 \$ | December 31 2006 \$ |
|--|------------------------|---------------------------|
| Senior unsecured debentures | 225,000 | 225,000 |
| Promissory note payable to the City | 980,231 | 980,231 |
| | 1,205,231 | 1,205,231 |
| Less: Current portion of promissory note payable to the City | 245,058 | 245,058 |
| Long-term debt | 960,173 | 960,173 |
| Comprising: | | |
| Debentures | 225,000 | 225,000 |
| Promissory note payable to the City | 735,173 | 735,173 |

All debt of the Corporation ranks equally.

a) Senior unsecured debentures

The Corporation's 10-year senior unsecured debentures in the amount of \$225,000,000 [December 31, 2006 - \$225,000,000] bear interest at a rate of 6.11% per annum, payable semi-annually in arrears in equal instalments on May 7 and November 7 of each year. The debentures mature on May 7, 2013.

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

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of the Corporation and LDC to create security interests, incur additional indebtedness or dispose of all or substantially all of their assets.

At March 31, 2007, the fair values of the City Note [\$980,231,000] and the senior unsecured debentures [\$225,000,000] were \$1,033,565,000 and \$247,825,000 respectively [December 31, 2006 - \$1,034,640,000 and \$247,515,000, respectively]. These fair values have been calculated by discounting the future cash flow of the respective long-term debt at the estimated yield to maturity of similar debt instruments.

b) Promissory note payable to the City of Toronto

The Corporation's promissory note in the principal amount of \$980,231,000 [December 31, 2006 - \$980,231,000] [the "City Note"] is payable to the City of Toronto [the "City"]. On September 5, 2006, the Corporation announced that it had amended and restated the City Note effective May 1, 2006 by fixing the interest rate at 6.11% and establishing an agreed repayment schedule. The Corporation is required to pay the principal amount of the note as follows: \$245,058,000 on the last business day before each of December 31, 2007, December 31, 2009, December 31, 2011 and on May 6, 2013. Accordingly, \$245,058,000 of the principal amount outstanding under the City Note is classified as a short-term liability, with the remainder being classified as a long-term liability. Interest is calculated and payable quarterly in arrears on the last business day of March, June, September and December of each year.

7. EMPLOYEE FUTURE BENEFITS

a) Pension

For the three months ended March 31, 2007, the Corporation's current service pension costs payable to Ontario Municipal Employees Retirement System were \$2,854,000 [three months ended March 31, 2006 - \$2,585,000].

b) Employee future benefits other than pension

For the three months ended March 31, 2007, the Corporation recognized periodic benefit costs of \$3,621,000 [three months ended March 31, 2006 - \$3,656,000] of which \$1,385,000 [three months ended March 31, 2006 - \$1,733,000] was capitalized as part of property, plant and equipment, resulting in \$2,236,000 [three months ended March 31, 2006 - \$1,923,000] charged to operations.

8. SHARE CAPITAL

At March 31, 2007, the Corporation had 1,000 [December 31, 2006 - 1,000] common shares issued and outstanding at a stated value of \$567,817,000 [December 31, 2006 - \$567,817,000]. The Corporation is authorized to issue an unlimited number of common shares.

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Dividends

On March 1, 2007, the board of directors of the Corporation declared dividends in the amount of \$27,200,000. The dividends are comprised of a \$21,200,000 payment for 2006 net income, which was paid on March 9, 2007 and a \$6,000,000 payment in connection with the first quarter of 2007, which was paid on March 30, 2007.

9. FINANCIAL INSTRUMENTS

a) Risk Management Process

The Corporation risk management process is intended to assist in the decision-making process in order to minimize potential losses and improve the management of existing risks. The process provides the Corporation with a method of managing and ranking risks. On an annual basis, risks are identified and measured in terms of their likelihood of occurrence, their impact on the organization and management's effectiveness in dealing with the risks. The risk management process is intended to ensure that key risks that could affect the budget, business performance and decision-making are identified, and that these risks are communicated across the organization and mitigated in a timely manner.

b) Credit risk

For customers, credit losses are generally low across the sector. LDC, TH Energy and Toronto Hydro Telecom Inc. ["Telecom"] provide for an allowance for doubtful accounts to absorb credit losses. At March 31, 2007, there were no significant concentrations of credit risk with respect to any class of financial assets.

c) Interest rate risk

The Corporation is exposed to interest rate risk for certain of its financial assets and liabilities. Under the Corporation's Revolving Credit Facility [note 5], the Corporation may have short-term borrowings for working capital purposes. These borrowings, when drawn upon, may expose the Corporation to fluctuations in short-term interest rates [borrowings in the form of prime rate loans in Canadian dollars and bankers' acceptances and letters of credit]. The fee payable for bankers' acceptances and letters of credit is based on a margin determined by reference to the Corporation's credit rating.

Cash balances not required to meet day-to-day obligations of the Corporation are invested in Canadian money market instruments, with terms of one day to 90 days, exposing the Corporation to fluctuations in short-term interest rates. These fluctuations could impact the level of interest income earned by the Corporation.

10. FINANCIAL GUARANTEES

At March 31, 2007, the Corporation's board of directors had approved \$386,000,000 in parental guarantees on behalf of TH Energy, of which none had been issued to unrelated parties [December 31, 2006 - \$56,500,000].

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11. RELATED PARTIES

For the Corporation, transactions with related parties include transactions with the City. All transactions with the City are conducted at prevailing market prices and normal trade terms.

For the three months ended March 31, 2007, LDC provided street lighting electricity to the City in the amount of \$2,787,000 [March 31, 2006 - \$2,578,000].

For the three months ended March 31, 2007, TH Energy invoiced the City for electricity for \$27,570,000 [March 31, 2006 - \$26,828,000]. At March 31, 2007, included in "Accounts receivable, net of allowance for doubtful accounts" is \$1,439,000 [December 31, 2006 - \$5,905,000] receivable from the City related to electricity billing activities.

For the three months ended March 31, 2007, TH Energy provided energy efficiency products and services to the City amounting to \$335,000 [March 31, 2006 - \$254,000].

For the three months ended March 31, 2007, TH Energy provided street and expressway lighting services to the City totalling \$3,470,000 [March 31, 2006 - \$3,400,000].

For the three months ended March 31, 2007, LDC paid property tax expenses to the City of \$1,139,000 [March 31, 2006 - \$1,479,000]. At March 31, 2007, included in "Trade accounts payable" is \$1,737,000 [December 31, 2006 - \$nil] payable to the City primarily relating to property taxes.

At March 31, 2007, a promissory note in the amount of \$980,231,000 [December 31, 2006 - \$980,231,000] was payable to the City. For the three months ended March 31, 2007, interest of \$14,973,000 [March 31, 2006 - \$16,786,000], on the promissory note was paid to the City [note 6].

12. CONTINGENCIES

a) Ministry of Finance Tax Audit

The Ministry of Finance is currently carrying out a tax audit on the Corporation and its subsidiaries. Certain filing positions for payments in lieu of corporate taxes ["PILs"] taken by the Corporation and its subsidiaries may be challenged on the audit. This may result in a material increase in the Corporation'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 the Corporation'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.

b) Consumers' Gas Decision

On April 22, 2004, in a decision in a class action commenced against The Consumers' Gas Company Limited (now Enbridge Gas Distribution Inc.), the Supreme Court of Canada [the "Supreme Court"] ruled that The Consumers'

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Gas Company ["Consumers' Gas"] was required to repay the portion of certain late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. Although the claim related to charges collected by Consumers' Gas after the enactment of section 347 of the *Criminal Code* in 1981, the Supreme Court limited recovery to charges collected after the action was initiated in 1994. The Supreme Court remitted the matter back to the Ontario Superior Court of Justice for a determination of the plaintiffs' damages. 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.

LDC is not a party to the Consumers' Gas class action. It is, however, subject to the two class actions described below in which the issues are analogous.

The first is an action commenced against a predecessor of LDC and other Ontario municipal electric utilities under the Class Proceedings Act, 1992 seeking \$500,000,000 in restitution for late payment charges collected by them from their customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. This action is at a preliminary stage. Pleadings have closed but examinations for discovery have not been conducted and the classes have not been certified. 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 \$64,000,000 in restitution for late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. This action is also at the preliminary stage. Pleadings have closed and examinations for discovery have been conducted but, as in the first action, the classes have not been certified as the parties were awaiting the outcome of the Consumers' Gas class action.

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

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

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

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

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13. DISCONTINUED OPERATIONS

On February 8, 2007, TH Energy sold its water heater business to Consumers' Waterheater Income Fund for cash consideration of \$40,800,000 subject to post closing adjustments and transaction costs. Accordingly, 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. The net assets from discontinued operations are as follows:

| | March 31 2007 \$ | December 31 2006 \$ |
|---|------------------------|---------------------------|
| Current assets from discontinued operations | | |
| Property, plant and equipment | — | 12,098 |
| Current liabilities from discontinued operations | | |
| Accounts payable and accrued liabilities | 370 | 103 |
| Payments in lieu of corporate taxes payable | 3,873 | 803 |
| | 4,243 | 906 |

For the three month period ended March 31, 2007 and March 31, 2006, the following revenues and expenses of the water heater business have been reclassified from continuing operations to discontinued operations:

| | March 31 2007 \$ | March 31 2006 \$ |
|--|------------------------|------------------------|
| Revenues | 1,758 | 2,094 |
| Expenses | | |
| Purchased power and other | 499 | 454 |
| Operating expenses | 680 | 321 |
| Depreciation and amortization | — | 892 |
| | 1,179 | 1,667 |
| Provision for payments in lieu of corporate taxes | 174 | 115 |
| Gain on sale of water heater business – net of tax | 24,192 | — |
| Income from discontinued operations | 24,597 | 312 |

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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. At this point, management is not able to determine the impact, if any, of an adjustment to the purchase price.

14. SEGMENT REPORTING

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

[a] Electricity Distribution

The regulated business which consists of the electricity distribution business of LDC; and

[b] Non-regulated

The non-regulated business of TH Energy which consist primarily of the delivery of street lighting and expressway lighting services and the sale of energy management services, and up until December 31, 2006, the management of a portfolio of electricity contracts. The non-regulated business of Telecom which consists of the provision of fibre optic capacity and data communications services to telecommunications carriers, business customers and large institutions.

Segment information on the above basis is as follows:

| Three months ended March 31, 2007 | | | | |
|---|-----------------------------|-------------------|------------------------------|---------|
| | Electricity Distribution | Non- Regulated | Intersegment Eliminations | Total |
| | \$ | \$ | \$ | \$ |
| Revenues | 592,575 | 15,373 | (621) | 607,327 |
| Purchased power and other | 478,346 | 3,899 | (611) | 481,634 |
| Operating expenses | 46,476 | 7,348 | (10) | 53,814 |
| Depreciation and amortization | 32,523 | 3,516 | — | 36,039 |
| Income before interest and provision for payments in lieu of corporate taxes | 35,230 | 610 | — | 35,840 |
| Interest income | 2,439 | 19,852 | (17,889) | 4,402 |
| Interest expense | 18,208 | 18,458 | (17,889) | 18,777 |
| Provision for payments in lieu of corporate taxes | 7,850 | 558 | — | 8,408 |
| Income from continuing operations | 11,611 | 1,446 | — | 13,057 |
| Expenditures on property, plant and equipment and intangible assets | 39,850 | 3,809 | — | 43,659 |

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

March 31, 2007

| Three months ended March 31, 2006 | | | | |
|---|-------------------------------------|---------------------------|--------------------------------------|--------------|
| | Electricity Distribution | Non- Regulated | Intersegment Eliminations | Total |
| | \$ | \$ | \$ | \$ |
| Revenues | 570,044 | 18,754 | (24,789) | 564,009 |
| Purchased power and other | 453,216 | 3,225 | (24,789) | 431,652 |
| Operating expenses | 39,488 | 3,935 | — | 43,423 |
| Depreciation and amortization | 30,754 | 3,073 | — | 33,827 |
| Income before interest and provision for payments in lieu of corporate taxes | 46,586 | 8,521 | — | 55,107 |
| Interest income | 3,272 | 20,665 | (19,520) | 4,417 |
| Interest expense | 20,356 | 20,210 | (19,520) | 21,046 |
| Payments in lieu of corporate taxes | 12,567 | 3,664 | — | 16,231 |
| Income from continuing operations | 16,935 | 5,312 | — | 22,247 |
| Expenditures on property, plant and equipment and intangible assets | 42,747 | 1,535 | — | 44,282 |

| Assets | | |
|---------------------------|--------------------------|-----------------------------|
| | March 31 2007 | December 31 2006 |
| | \$ | \$ |
| Electricity Distribution | 2,324,221 | 2,280,811 |
| Non-Regulated | 1,471,823 | 1,505,987 |
| Intersegment Eliminations | (1,187,186) | (1,207,190) |
| Discontinued Operations | — | 12,098 |
| Total | 2,608,858 | 2,591,706 |

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

15. SEASONAL OPERATIONS

The Corporation's quarterly results are impacted by changes in revenues resulting from variations in seasonal weather conditions. The Corporation's revenues tend to be higher in the first and third quarters of a year as a result of higher energy consumption for winter heating in the first quarter and air conditioning/cooling in the third quarter.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

March 31, 2007

16. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the March 31, 2007 consolidated financial statements.

17. SUBSEQUENT EVENTS

a) Regulatory Affairs

On April 12, 2007, the OEB approved 2007 distribution rates for LDC, with the rate changes to take effect on May 1, 2007. As part of its decision, the OEB approved the 2007 smart meter rate rider at \$0.68 per 30 days per metered customer for all rate classes. This rate rider replaces the \$0.47 per 30 days per metered residential customer, and the \$1.04 per 30 days per metered customer in all other rate classes. The rate rider has been credited to the regulatory asset smart meter account.

b) CDM Agreements

In May 2007, LDC entered into agreements with the Ontario Power Authority ["OPA"] to deliver OPA funded CDM programs in the amount of \$59,000,000 during the years from 2007 to 2010.

c) Dividends

On May 28, 2007, the board of directors of the Corporation declared a dividend in the amount of \$6,000,000 in respect of the second quarter of 2007, payable on June 29, 2007.