

Consolidated Financial Statements

Toronto Hydro Corporation

September 30, 2007

Toronto Hydro Corporation

INTERIM CONSOLIDATED BALANCE SHEET		
[in thousands of dollars, unaudited]		
	As at September 30, 2007 \$	As at December 31, 2006 \$
ASSETS		
Current		
Cash and cash equivalents	191,691	327,524
Accounts receivable, net of allowance for doubtful accounts	217,554	218,452
Unbilled revenue	234,687	216,857
Inventories	23,500	22,458
Prepaid expenses	3,785	2,277
Future income tax assets	284	791
Assets from discontinued operations <i>[note 14]</i>	-	12,098
Total current assets	671,501	800,457
Investments held to maturity <i>[note 13]</i>	74,941	-
Property, plant and equipment, net	1,742,758	1,656,868
Intangible assets, net	55,336	49,266
Regulatory assets <i>[note 4]</i>	51,503	66,528
Other assets	2,942	2,578
Future income tax assets	17,083	16,009
Total assets	2,616,064	2,591,706
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities	257,637	284,869
Current portion of other liabilities	17,902	16,952
Current portion of deferred revenue	2,141	7,320
Current portion of promissory note payable <i>[note 6]</i>	245,058	245,058
Liabilities from discontinued operations <i>[note 14]</i>	3,408	906
Total current liabilities	526,146	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>	141,436	134,682
Regulatory liabilities <i>[note 4]</i>	33,540	11,840
Other liabilities	6,377	3,949
Asset retirement obligations	7,484	7,581
Customers' advance deposits	24,012	25,944
Future income tax liabilities	424	368
Total long-term liabilities	1,173,446	1,144,537
Total liabilities	1,699,592	1,699,642
Contingencies <i>[note 12]</i>		
Shareholder's equity		
Share capital <i>[note 8]</i>	567,817	567,817
Retained earnings	348,655	324,247
Total shareholder's equity	916,472	892,064
Total liabilities and shareholder's equity	2,616,064	2,591,706

Toronto Hydro Corporation

INTERIM CONSOLIDATED STATEMENT OF INCOME

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
	\$	\$	\$	\$
Revenues	629,090	599,647	1,797,271	1,699,077
Costs				
Purchased power and other	486,790	458,413	1,404,369	1,293,109
Operating expenses	48,907	49,793	156,954	143,710
Depreciation and amortization	38,755	34,120	111,232	102,165
	574,452	542,326	1,672,555	1,538,984
Income before interest and provision for payments in lieu of corporate taxes	54,638	57,321	124,716	160,093
Interest income	1,387	4,440	10,292	13,304
Interest expense				
Long-term debt	(18,410)	(18,410)	(55,230)	(57,484)
Other interest <i>[note 13]</i>	(12,879)	(645)	(12,644)	(2,242)
Income before provision for payments in lieu of corporate taxes	24,736	42,706	67,134	113,671
Provision for payments in lieu of corporate taxes	13,602	14,509	28,051	45,506
Income from continuing operations	11,134	28,197	39,083	68,165
Income (loss) from discontinued operations - net of tax <i>[note 14]</i>	(89)	697	24,525	1,449
Net income	11,045	28,894	63,608	69,614
Basic and fully diluted net income per share from continuing operations	11,134	28,197	39,083	68,165
Basic and fully diluted net income (loss) per share from discontinued operations	(89)	697	24,525	1,449
Basic and fully diluted net income per share	11,045	28,894	63,608	69,614

INTERIM CONSOLIDATED STATEMENT OF RETAINED EARNINGS

[in thousands of dollars, unaudited]

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
	\$	\$	\$	\$
Retained earnings, beginning of period	343,610	285,570	324,247	278,050
Net income	11,045	28,894	63,608	69,614
Dividends <i>[note 8]</i>	(6,000)	(6,000)	(39,200)	(39,200)
Retained earnings, end of period	348,655	308,464	348,655	308,464

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INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS

[in thousands of dollars, unaudited]

	Three months ended September 30,		Nine months ended September 30,	
	2007 \$	2006 \$	2007 \$	2006 \$
OPERATING ACTIVITIES				
Income from continuing operations	11,134	28,197	39,083	68,165
Adjustments for non-cash items				
Depreciation and amortization	38,755	34,120	111,232	102,165
Net change in other assets and liabilities	15,251	(2,547)	15,653	(589)
Electricity mark-to-market assets and liabilities	-	7,072	-	22,429
Post-employment benefits	2,313	2,268	6,754	6,953
Future income taxes	(809)	1,886	(511)	(2,203)
Gain on disposals of property, plant and equipment	(77)	(315)	(1,289)	(582)
Changes in non-cash working capital balances				
Decrease (increase) in accounts receivable	(54,360)	(24,558)	898	(40,512)
Decrease (increase) in unbilled revenue	8,553	26,179	(17,830)	74,367
Decrease (increase) in inventories	338	735	(1,042)	(1,988)
Increase in prepaid expenses	(756)	(1,665)	(1,508)	(2,073)
Decrease in accounts payable and accrued liabilities	(21,299)	(7,009)	(27,232)	(159,692)
Decrease in deferred revenue	(969)	(5,043)	(5,179)	(7,307)
Net cash provided by (used in) operating activities	(1,926)	59,320	119,029	59,133
INVESTING ACTIVITIES				
Purchase of property, plant and equipment	(56,711)	(39,191)	(166,476)	(114,630)
Purchase of intangible assets	(6,996)	(3,095)	(15,803)	(12,513)
Investments held to maturity [note 13]	(88,000)	-	(88,000)	-
Net change in regulatory assets and liabilities	(3,211)	(5,916)	15,596	(16,889)
Proceeds on disposal of property, plant and equipment	138	380	1,406	794
Net cash used in investing activities	(154,780)	(47,822)	(253,277)	(143,238)
FINANCING ACTIVITIES				
Increase (decrease) in customers' advance deposits	1,761	2,004	(1,230)	49
Repayment of capital lease liability	(47)	(272)	(280)	(989)
Dividends paid [note 8]	(6,000)	(6,000)	(39,200)	(39,200)
Net cash used in financing activities	(4,286)	(4,268)	(40,710)	(40,140)
Net cash provided by (used in) continuing operations	(160,992)	7,230	(174,958)	(124,245)
Net cash provided by (used in) discontinued operations	(66)	451	39,125	352
Net increase (decrease) in cash and cash equivalents during the period	(161,058)	7,681	(135,833)	(123,893)
Cash and cash equivalents, beginning of period	352,749	316,796	327,524	448,370
Cash and cash equivalents, end of period	191,691	324,477	191,691	324,477
Supplementary cash flow information				
Total interest paid	15,227	17,091	52,713	55,277
Payments in lieu of corporate income taxes	11,362	17,994	50,852	88,777

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

September 30, 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 April 12, 2007, the OEB approved an increase in Toronto Hydro-Electric System Limited’s [“LDC”] distribution rates for the period May 1, 2007 to April 30, 2008 representing an estimated revenue increase of approximately \$1,900,000.

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 \$498,400,000, \$534,000,000 and \$562,400,000, 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 369,000 meters at September 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.

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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. Hearings related to the recovery of the smart meter expenditures were held from May 30, 2007 to July 12, 2007.

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. In its decision, the OEB approved the disposition of the balance relating to 2006 in the smart meter deferral account and the addition of the 2006 smart meter assets to the rate base. This resulted in decreased Regulatory Assets of \$23,000,000, increased Property, Plant and Equipment of \$23,900,000, increased Revenue of \$5,200,000, increased Depreciation and Amortization of \$1,900,000 and decreased Interest Income of \$1,800,000. The revenue requirement related to the 2006 smart meters will be recovered through a rate rider for the period November 1, 2007 to April 30, 2008. The financial impact of this decision is included in the 2007 third quarter financial statements.

Lost Revenue Adjustment Mechanism and Shared Savings Mechanism

On March 23, 2007, LDC submitted an application to the OEB for recovery of costs and benefits associated with LDC's Conservation and Demand Management ["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.

On September 11, 2007, LDC received approval from the OEB to recover \$2,900,000 for Lost Revenue Adjustment Mechanism ["LRAM"] which represents the lost revenue from CDM programs and \$4,300,000 for Shared Savings Mechanism ["SSM"] which represents its share of provincial savings related to these programs. In approving the SSM recovery balance, the OEB rejected LDC's claim for recovery of related payments in lieu of corporate taxes ["PILs"] for \$3,000,000. LDC expects to recover the approved amounts over a 6-month period commencing on November 1, 2007. The impact of this decision resulted in an increase in revenue amounting to \$7,200,000 and an increase in regulatory assets of \$7,200,000 in the 2007 third quarter unaudited consolidated financial statements.

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 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 led to changes in the accounting for financial instruments and hedging transactions. All relevant changes are outlined below.

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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 and nine month period ended September 30, 2007, the adoption of this standard does not have an impact on the September 30, 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 September 30, 2007, the adoption of this standard does not have an impact on the September 30, 2007 unaudited interim consolidated financial statements.

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b) Deferred debt issue costs – Section 3855

In 2003, the Corporation incurred debt issue costs arising from the Corporation's debenture offering. Deferred debt issue costs are included in "Other assets" and represent the unamortized amount of debt costs arising from the issuance of debt, and other related costs. Effective January 1, 2007, in accordance with the adoption of CICA Handbook Section 3855 - "Financial Instruments - Recognition and Measurement", the Corporation was required to change its method of amortizing deferred debt issue costs. Beginning in 2007, the Corporation no longer records amortization on a straight line basis over the remaining period to maturity of the debt, amortization is now recorded using the effective interest rate method. As provided under CICA Handbook Section 3855, the comparative interim financial statements have not been restated.

c) 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 June 30, 2007, is 4.72%, and from July 1, 2007 to September 30, 2007, is 5.18%, 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 nine months ended September 30, 2007, \$1,717,000 was capitalized within property, plant and equipment and was credited to interest expense.

As the AFUDC includes a non-cash component, the property, plant and equipment assets would have been lower by \$1,717,000 and the interest expense account balances would have been higher by \$1,717,000 in the absence of rate regulation.

d) 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.

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4. REGULATORY ASSETS AND LIABILITIES

For the three months and nine months ended September 30, 2007, LDC recovered approved regulatory asset amounts of \$7,321,000 and \$21,455,000 through permitted distribution rate adjustments [three months and nine months ended September 30, 2006 - \$7,730,000 and \$20,114,000]. These recovery amounts are for the recovery of approved regulatory assets recorded in reporting periods prior to January 1, 2005.

Smart Meters

Effective May 1, 2006, the OEB allowed LDC to defer capital expenditures, operating and depreciation expenses and revenues relating to smart meters. Accordingly, LDC deferred these items in accordance with the criteria set out in the AP Handbook.

On August 8, 2007, the OEB approved the disposition of deferred amounts associated with 2006 smart metering activities, incurred by LDC for minimum smart meter infrastructure functionality.

At September 30, 2007, the deferral of smart meter capital expenditures, net of accumulated depreciation, not yet approved for recovery by the OEB, totalled \$31,828,000 [December 31, 2006 - \$30,347,000]. 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 \$31,828,000 higher at September 30, 2007 [December 31, 2006 - \$30,347,000].

The manner and timing of disposition of the remaining smart meter deferral accounts have not been determined by the OEB at this time.

5. CREDIT FACILITIES

At September 30, 2007, \$45,083,000 [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, Toronto Hydro Energy Services Inc. ["TH Energy"], and Toronto Hydro Telecom Inc. ["Telecom"]. At September 30, 2007, no amount had been drawn for working capital purposes [December 31, 2006 - \$nil].

At September 30, 2007, no amount had been drawn on the bilateral demand line of credit [December 31, 2006 - \$nil].

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6. LONG-TERM DEBT

Long-term debt consists of the following:

	September 30 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 of the Corporation and LDC to create security interests, incur additional indebtedness or dispose of all or substantially all of their assets.

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 agreeing to a 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

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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.

c) Fair market value of long-term debt

At September 30, 2007, the fair values of the City Note [\$980,231,000] and the senior unsecured debentures [\$225,000,000] were \$1,009,724,000 and \$239,945,000 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.

7. EMPLOYEE FUTURE BENEFITS

a) Pension

For the three months and the nine months ended September 30, 2007, the Corporation's current service pension costs payable to Ontario Municipal Employees Retirement System were \$2,473,000 and \$8,192,000 [three months and nine months ended September 30, 2006 - \$2,321,000 and \$7,611,000].

b) Employee future benefits other than pension

For the three months and the nine months ended September 30, 2007, the Corporation recognized periodic benefit costs of \$3,621,000 and \$10,862,000 [three months and nine months ended September 30, 2006 - \$3,656,000 and \$10,970,000] of which \$1,512,000 and \$4,312,000 [three months and nine months ended September 30, 2006 - \$1,759,000 and \$5,346,000] were capitalized as part of property, plant and equipment, resulting in \$2,109,000 and \$6,550,000 [three months and nine months ended September 30, 2006 - \$1,897,000 and \$5,624,000] charged to operations.

8. SHARE CAPITAL

At September 30, 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.

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 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 \$6,000,000 in respect of the second quarter of 2007, which was paid on June 29, 2007.

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On August 23, 2007, the board of directors of the Corporation declared a dividend in the amount of \$6,000,000 in respect of the third quarter of 2007, which was paid on September 28, 2007.

9. FINANCIAL INSTRUMENTS

a) Risk Management Policies

The Corporation's risk management process is intended to assist with management's decision-making processes to minimize potential losses and improve the mitigation of existing risks. The process provides the Corporation with a method of identifying, ranking, and then mitigating 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

LDC, TH Energy and Telecom provide for an allowance for doubtful accounts to absorb credit losses. At September 30, 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 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 ninety 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

In recognition that the last of TH Energy's retail electricity contracts expired on December 31, 2006, the board of directors of the Corporation determined on August 23, 2007 to rescind a prior approval authorizing the Corporation to issue parental guarantees [not to exceed \$386,000,000] on behalf of TH Energy which had been used to enable TH Energy to meet its collateral credit requirements relating to its retailing activities.

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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 and nine months ended September 30, 2007, LDC provided electricity and other services related to the distribution of electricity to the City in the amount of \$26,456,000 and \$80,395,000 [three months and nine months ended September 30, 2006 - \$28,184,000 and \$85,125,000]. At September 30, 2007, included in "Accounts receivable, net of allowance for doubtful accounts" is \$17,272,000 [December 31, 2006 - \$22,064,000] receivable from the City related to these services. At September 30, 2007, included in unbilled receivable is a balance amounting to \$7,626,000 relating to these services.

For the three months and nine months ended September 30, 2007, TH Energy provided energy efficiency products and services, street and expressway lighting services and consolidated billing services to the City amounting to \$4,775,000 and \$12,622,000 [three months and nine months ended September 30, 2006 - \$3,904,000 and \$11,005,000]. At September 30, 2007, included in "Accounts receivable, net of allowance for doubtful accounts" is \$13,125,000 [December 31, 2006 - \$5,905,000] receivable from the City related to these services.

For the three months and nine months ended September 30, 2007, LDC incurred contractor costs of \$1,500 and \$3,517,000 owing to the City related to road repair services [three months and nine months ended September 30, 2006 - \$1,317,000 and \$2,583,000]. At September 30, 2007, included in "Accounts payable" is \$3,849,000 [December 31, 2006 - \$679,000] payable to the City related to services received from the City.

For the three months and nine months ended September 30, 2007, LDC paid property tax expenses to the City of \$929,000 and \$4,062,000 [three months and nine months ended September 30, 2006 - \$1,665,000 and \$5,212,000]. At September 30, 2007, included in "Accounts payable" is \$4,957,000 [December 31, 2006 - \$4,899,000] payable to the City relating to property taxes.

For the three months and nine months ended September 30, 2007, Telecom incurred municipal access fees to the City totalling \$235,000 and \$704,000 [three months and nine months ended September 30, 2006 - \$273,000 and \$761,000].

At September 30, 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 and nine months ended September 30, 2007, interest of \$14,973,000 and \$44,919,000 [for the three months and nine months ended September 30, 2006 - \$14,973,000 and \$47,174,000], on the promissory note was paid to the City [*note 6*].

Toronto Hydro Corporation

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12. CONTINGENCIES

a) 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 on 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.

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' 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.

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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.

13. INVESTMENTS HELD TO MATURITY

At September 30, 2007, the Corporation held \$88,000,000 in non-bank sponsored Asset-Backed Commercial Paper notes ["ABCP"] which matured in August 2007 and remain unpaid. All the ABCP notes held by the Corporation were rated R1 High by Dominion Bond Rating Services Limited ["DBRS"] at the time of purchase. This rating is the highest quality rating for commercial paper. These notes are directly impacted by the current liquidity issues affecting the non-bank sponsored ABCP notes.

On August 16, 2007, a group representing banks, asset providers and major investors agreed in principle to a long-term proposal and interim arrangements regarding the restructuring of the affected ABCP notes [the "Montreal Proposal"]. Under this proposal, the affected ABCP notes would be converted into floating rate notes ["FRN"] maturing no earlier than the maturing dates of the underlying assets. During the restructuring period, currently scheduled to end on December 14, 2007, no payments of principal or accrued interest are being made on the ABCP notes. Following the announcement of the Montreal Proposal, DBRS maintained its R1 High rating on the Corporation's ABCP notes but qualified its rating by adding "under review with development implications".

The Corporation's ABCP notes are financial instruments and have been classified as Investments Held to Maturity. These investments are classified as long term investments on the balance sheet. Under this classification, the Corporation should recognize any impairment loss to net income. The impairment loss is the difference between the estimated fair value and the carrying amount of the investments. The Corporation's ABCP notes have not traded in the market since August 2007 and there is currently no market quote available. The Corporation's estimate of the fair value of its investments in ABCP notes was based on valuation techniques which incorporate a probability-weighted approach for recovery applied to the cash flows considering the best available data for such investments and a mark-to-model valuation of the notes.

During the third quarter of 2007, the Corporation recognized an impairment loss amounting to \$13,059,000, representing the difference between the original purchase of \$88,000,000 and the estimated fair value of \$74,941,000. The impact of the loss was recorded in other interest in the statement of income.

Toronto Hydro Corporation

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The estimation by the Corporation at September 30, 2007 of the fair value of its ABCP notes is subject to significant risks and uncertainties, including with respect to the timing and amount of future cash flows, the outcome of the Montreal Proposal and any other restructuring process, market liquidity and the quality of the underlying assets and financial instruments. Accordingly, there can be no assurance that the Corporation's assessment of the estimated fair value of its ABCP notes will not change materially in subsequent periods.

The Corporation has sufficient cash to fund all of its ongoing liquidity and capital expenditure requirements and is in compliance with the financial covenants under the terms of its outstanding indebtedness.

14. 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:

	September 30	December 31
	2007	2006
	\$	\$
Current assets from discontinued operations		
Property, plant and equipment	—	12,098
Current liabilities from discontinued operations		
Accounts payable and accrued liabilities	413	103
Payments in lieu of corporate taxes payable	2,995	803
	3,408	906

For the three and nine month periods ended September 30, 2007 and September 30, 2006, the following revenues and expenses of the water heater business have been reclassified from continuing operations to discontinued operations:

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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September 30, 2007

	Three months ended September 30 2007 \$	Three months ended September 30 2006 \$	Nine months ended September 30 2007 \$	Nine months ended September 30 2006 \$
Revenues	—	1,968	1,781	6,074
Expenses				
Purchased power and other	—	459	506	1,347
Operating expenses (recovery)	(111)	190	581	706
Depreciation and amortization	—	365	—	2,037
Provision for (recovery of) payments in lieu of corporate taxes	(111)	1,014	1,087	4,090
	(50)	257	121	535
Gain on sale of water heater business prior to purchase price adjustment – net of tax	—	—	24,202	—
Purchase Price Adjustment	250	—	250	—
Net gain (loss) on sale of water heater business – net of tax	(250)	—	23,952	—
Income (loss) from discontinued operations	(89)	697	24,525	1,449

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.

During the period ended September 30, 2007, TH Energy incurred a \$250,000 purchase price adjustment as the number of active water heater customers fell below the amount specified in the sale agreement. The adjustment has been accounted for in the current period as a charge to income from discontinued operations.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

September 30, 2007

15. 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 consists 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 and up until February 8, 2007, the management of a waterheater rental business. The non-regulated business of Telecom consists primarily 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:

Assets		
	September 30 2007 \$	December 31 2006 \$
Electricity Distribution	2,360,090	2,280,811
Non-Regulated	1,443,344	1,505,987
Intersegment Eliminations	(1,187,370)	(1,207,190)
Discontinued Operations	—	12,098
Total	2,616,064	2,591,706

Toronto Hydro Corporation

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[all tabular amounts in thousands of dollars, unaudited]

September 30, 2007

Three months ended September 30, 2007				
	Electricity Distribution	Non- Regulated	Intersegment Eliminations	Total
	\$	\$	\$	\$
Revenues	611,372	18,316	(598)	629,090
Purchased power and other	481,299	6,082	(591)	486,790
Operating expenses	40,692	8,222	(7)	48,907
Depreciation and amortization	35,036	3,719	—	38,755
Income before interest and provision for (recovery of) payments in lieu of corporate taxes	54,345	293	—	54,638
Interest income	(206)	19,484	(17,891)	1,387
Interest expense	17,661	31,519	(17,891)	31,289
Provision for (recovery of) payments in lieu of corporate taxes	16,045	(2,443)	—	13,602
Income (loss) from continuing operations	20,433	(9,299)	—	11,134
Expenditures on property, plant and equipment and intangible assets	55,594	8,113	—	63,707

Three months ended September 30, 2006				
	Electricity Distribution	Non- Regulated	Intersegment Eliminations	Total
	\$	\$	\$	\$
Revenues	608,047	17,276	(25,676)	599,647
Purchased power and other	480,540	3,549	(25,676)	458,413
Operating expenses	45,467	4,326	—	49,793
Depreciation and amortization	30,917	3,203	—	34,120
Income before interest and provision for payments in lieu of corporate taxes	51,123	6,198	—	57,321
Interest income	2,615	19,715	(17,890)	4,440
Interest expense	18,520	18,425	(17,890)	19,055
Provision for payments in lieu of corporate taxes	12,684	1,825	—	14,509
Income from continuing operations	22,534	5,663	—	28,197
Expenditures on property, plant and equipment and intangible assets	38,015	4,271	—	42,286

Toronto Hydro Corporation

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[all tabular amounts in thousands of dollars, unaudited]

September 30, 2007

Nine months ended September 30, 2007				
	Electricity Distribution	Non- Regulated	Intersegment Eliminations	Total
	\$	\$	\$	\$
Revenues	1,748,888	50,211	(1,828)	1,797,271
Purchased power and other	1,391,844	14,318	(1,793)	1,404,369
Operating expenses	131,947	25,042	(35)	156,954
Depreciation and amortization	100,430	10,802	—	111,232
Income before interest and provision for (recovery of) payments in lieu of corporate taxes	124,667	49	—	124,716
Interest income	4,953	58,919	(53,580)	10,292
Interest expense	53,548	67,906	(53,580)	67,874
Provision for (recovery of) payments in lieu of corporate taxes	31,797	(3,746)	—	28,051
Income (loss) from continuing operations	44,275	(5,192)	—	39,083
Expenditures on property, plant and equipment and intangible assets	165,239	17,040	—	182,279

Nine months ended September 30, 2006				
	Electricity Distribution	Non- Regulated	Intersegment Eliminations	Total
	\$	\$	\$	\$
Revenues	1,718,799	52,627	(72,349)	1,699,077
Purchased power and other	1,355,720	9,738	(72,349)	1,293,109
Operating expenses	129,025	14,685	—	143,710
Depreciation and amortization	92,789	9,376	—	102,165
Income before interest and provision for payments in lieu of corporate taxes	141,265	18,828	—	160,093
Interest income	8,620	60,518	(55,834)	13,304
Interest expense	57,969	57,591	(55,834)	59,726
Provision for payments in lieu of corporate taxes	35,897	9,609	—	45,506
Income from continuing operations	56,019	12,146	—	68,165
Expenditures on property, plant and equipment and intangible assets	118,073	9,070	—	127,143

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

Toronto Hydro Corporation

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16. 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.

17. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the September 30, 2007 consolidated financial statements.

18. SUBSEQUENT EVENTS

a) Dividends

On November 28, 2007, the board of directors of the Corporation declared a dividend in the amount of \$7,000,000 in respect of the fourth quarter of 2007. The dividend is payable on December 31, 2007.

b) Medium-Term Note Program

On October 19, 2007, the Corporation filed an amendment to the short form shelf prospectus dated January 13, 2006 relating to the issuance in an aggregate principal amount of up to \$1,000,000,000 of debentures of the Corporation.

On November 14, 2007, the Corporation issued \$250,000,000 10-year senior unsecured debentures Series 2 which bear interest at the rate of 5.15% per annum and are payable semi-annually in arrears in equal instalments on May 14 and November 14 of each year. The Series 2 debentures mature on November 14, 2017 and contain covenants which, subject to certain exceptions, restrict the ability of the Corporation and LDC to create security interests, incur additional indebtedness or dispose of all or substantially all of their assets. The net proceeds of the offering will be used principally to repay \$245,058,000 of indebtedness outstanding to the City of Toronto under the terms of the City promissory note.