

Consolidated Financial Statements

Toronto Hydro Corporation

JUNE 30, 2005

Consolidated Financial Statements

Toronto Hydro Corporation

JUNE 30, 2005

Contents	Page
Interim Consolidated Balance Sheet	1
Interim Consolidated Statement of Retained Earnings	2
Interim Consolidated Statement of Income	3
Interim Consolidated Statement of Cash Flows	4
Notes to Interim Consolidated Financial Statements	5

Toronto Hydro Corporation

INTERIM CONSOLIDATED BALANCE SHEET

[in thousands of dollars, unaudited]

	As at June 30, 2005 \$	As at December 31, 2004 \$
ASSETS		
Current		
Cash and cash equivalents	365,095	386,625
Accounts receivable, net of allowance for doubtful accounts [notes 3[a] and 5]	216,420	183,579
Unbilled revenue	247,178	246,122
Inventories	19,340	19,908
Prepaid expenses	3,044	2,213
Electricity mark-to-market assets [note 12]	58,307	26,799
Future income tax assets	15,263	6,698
Total current assets	924,647	871,944
Property, plant and equipment, net	1,546,201	1,547,557
Intangible assets, net	43,673	47,841
Regulatory assets [notes 3[a] and 6]	50,326	71,003
Electricity mark-to-market assets, long-term [note 12]	22,549	22,313
Future income tax assets, long-term	23,579	22,325
Other assets	5,570	5,871
Total assets	2,616,545	2,588,854
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities [note 3[a] and 5]	334,978	330,797
Deferred revenue [note 3[b]]	6,089	-
Current portion of other long-term liabilities	16,563	16,861
Current portion of promissory note payable [note 8]	330,000	330,000
Electricity mark-to-market liabilities [note 12]	37,315	14,298
Future income tax liabilities	21,060	9,680
Total current liabilities	746,005	701,636
Long-term liabilities		
Long-term debentures [note 8]	225,000	225,000
Promissory note payable [note 8]	650,231	650,231
Post-employment benefits [note 9]	121,469	118,117
Customers' advance deposits and other deposits	24,357	45,967
Asset retirement obligations [note 10]	4,202	4,274
Electricity mark-to-market liabilities, long-term [note 12]	11,179	7,118
Future income tax liabilities, long-term	8,893	8,497
Other long-term liabilities	8,197	6,592
Total long-term liabilities	1,053,528	1,065,796
Total liabilities	1,799,533	1,767,432
Commitments and contingencies [notes 10, 12, 13, 15 and 20[a]]		
Shareholder's equity		
Share capital [note 11]	567,817	567,817
Retained earnings	249,195	253,605
Total shareholder's equity	817,012	821,422
Total liabilities and shareholder's equity	2,616,545	2,588,854

Toronto Hydro Corporation

INTERIM CONSOLIDATED STATEMENT OF RETAINED EARNINGS

[in thousands of dollars, unaudited]

	Three months ended June 30,		Six months ended June 30,	
	2005 \$	2004 \$	2005 \$	2004 \$
		<i>[restated]</i>		<i>[restated]</i>
Retained earnings, beginning of period	225,441	200,527	253,605	205,458
Net income for the period	29,754	40,674	50,590	64,943
Dividends <i>[note 11 and 20[b]]</i>	(6,000)	(5,000)	(55,000)	(34,200)
Retained earnings, end of period	249,195	236,201	249,195	236,201

Toronto Hydro Corporation

INTERIM CONSOLIDATED STATEMENT OF INCOME

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2005	2004	2005	2004
	\$	\$	\$	\$
		<i>[restated]</i>		<i>[restated]</i>
Revenues <i>[note 3 [b] and 12]</i>	589,001	539,486	1,201,827	1,137,706
Costs				
Purchased power and other	447,823	375,141	925,994	838,425
Operating expenses	39,744	47,881	85,663	92,218
Depreciation and amortization	34,689	33,560	69,199	66,932
	522,256	456,582	1,080,856	997,575
Income before interest and provision for payments in lieu of corporate taxes	66,745	82,904	120,971	140,131
Interest income	3,243	2,802	6,647	5,925
Interest expense				
Long-term debt <i>[note 8]</i>	(20,101)	(20,101)	(40,202)	(40,202)
Other interest	(737)	(976)	(1,373)	(1,666)
Income before provision for payments in lieu of corporate taxes	49,150	64,629	86,043	104,188
Provision for payments in lieu of corporate taxes <i>[note 14]</i>	19,396	23,955	35,453	39,245
Net income for the period	29,754	40,674	50,590	64,943
Basic and fully diluted net income per share <i>[note 16]</i>	29,754	40,674	50,590	64,943

Toronto Hydro Corporation

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS

[in thousands of dollars, unaudited]

	Three months ended June 30,		Six months ended June 30,	
	2005 \$	2004 \$	2005 \$	2004 \$
		<i>[restated]</i>		<i>[restated]</i>
OPERATING ACTIVITIES				
Net income for the period	29,754	40,674	50,590	64,943
Adjustments for non-cash items				
Depreciation and amortization	34,689	33,560	69,199	66,932
Net change in other assets and liabilities	1,138	(303)	929	(178)
Electricity mark-to-market assets and liabilities <i>[note 12]</i>	(3,378)	(33,702)	(4,666)	(34,497)
Post-employment benefits <i>[note 9]</i>	1,676	1,481	3,352	2,962
Future income taxes	1,281	9,547	1,957	9,247
Changes in non-cash working capital balances				
Decrease (increase) in accounts receivable	20,942	11,707	(32,841)	(7,934)
Decrease (increase) in unbilled revenue	(20,274)	9,579	(1,056)	27,984
Decrease in inventories	1,293	1,099	568	1,178
Decrease (increase) in prepaid expenses	(838)	450	(831)	345
Increase (decrease) in accounts payable and accrued liabilities	(21,511)	(2,919)	4,181	(58,130)
Increase in deferred revenue	6,089	-	6,089	-
Increase in current portion of other long-term liabilities	272	375	713	791
Net cash provided by operating activities	51,133	71,548	98,184	73,643
INVESTING ACTIVITIES				
Purchase of property, plant and equipment	(37,701)	(25,940)	(58,729)	(52,611)
Purchase of intangible assets	(3,414)	(3,166)	(4,031)	(3,733)
Decrease in regulatory assets <i>[note 6]</i>	20,753	4,595	20,677	6,286
Net cash used in investing activities	(20,362)	(24,511)	(42,083)	(50,058)
FINANCING ACTIVITIES				
Increase (decrease) in customers' advance deposits	4,121	2,384	(21,610)	3,315
Repayment of capital lease liability	(514)	(437)	(1,021)	(915)
Dividends paid <i>[note 11]</i>	(6,000)	(5,000)	(55,000)	(34,200)
Net cash used in financing activities	(2,393)	(3,053)	(77,631)	(31,800)
Net increase (decrease) in cash and cash equivalents during the period	28,378	43,984	(21,530)	(8,215)
Cash and cash equivalents, beginning of period	336,717	245,472	386,625	297,671
Cash and cash equivalents, end of period	365,095	289,456	365,095	289,456
Supplementary cash flow information				
Total interest paid	23,876	23,963	41,006	41,048
Payments in lieu of corporate income tax and LCT	14,528	12,787	48,319	49,711

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

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 for the year ended December 31, 2004, except as disclosed in note 3, and should be read in conjunction with those statements.

2. REGULATION

In April 1999, the government of Ontario initiated a restructuring of Ontario's electricity industry. The restructuring was intended, among other things, to facilitate competition in the generation and sale of electricity, to protect the interests of consumers with respect to prices and the reliability and quality of electricity service and to promote economic efficiency in the generation, transmission and distribution of electricity.

a) Open Access

On May 1, 2002, the Province of Ontario opened Ontario's wholesale and retail markets to competition by providing generators, retailers and consumers with open access to Ontario's transmission and distribution network ["Open Access"].

Since the commencement of Open Access, Toronto Hydro-Electric System Limited ["LDC"] and other electricity distributors have been purchasing their electricity requirements from the wholesale market administered by the Independent Electricity System Operator [the "IESO"] and recovering the cost of electricity and certain other costs at a later date in accordance with procedures mandated by the Ontario Energy Board [the "OEB"].

The OEB has regulatory oversight of electricity matters in the Province of Ontario. The *Ontario Energy Board Act, 1998* sets out the OEB's authority to issue a distribution licence which must be obtained by owners or operators of a distribution system in Ontario. The OEB prescribes licence requirements and conditions including, among other things, specified accounting records, regulatory accounting principles, separation of accounts for separate businesses and filing/process requirements for rate-setting purposes.

The OEB's authority and responsibilities include the power to approve and fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity customers and the responsibility for ensuring that electricity distribution companies fulfill obligations to connect and service customers.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

b) Price protection and rate caps

During the summer of 2002, Ontario experienced higher than expected electricity prices due to prolonged periods of unseasonably hot and humid weather and unanticipated shortages of Ontario-based generation capacity. In December 2002, the Province passed the *Electricity Pricing, Conservation and Supply Act, 2002* ["Bill 210"] which, among other things:

- [a] fixed the price of electricity payable by consumers of electricity who annually utilize less than 250,000 kWh ["Low Volume Consumers"] and consumers comprised principally of municipalities, universities, schools, hospitals, charities, health and community service organizations, consumers with a demand of 50 kW or less and multi-unit residential buildings ["Designated Consumers"] at 4.3¢ per kWh (retroactive to May 1, 2002);
- [b] capped distribution rates at current levels and deferred rate increases and certain cost recoveries by electricity distributors (including scheduled third adjustment for market-based rate of return); and
- [c] deemed certain costs and variance account balances of distributors to be "regulatory assets" which are required to be reflected in a distributor's balance sheet until the manner and timing of disposition is determined by the OEB.

In November 2003, the Province:

- [a] announced its intention to increase (effective April 1, 2004) the price of electricity payable by Low Volume Consumers and Designated Consumers from 4.3¢ to 4.7¢ per kWh on the first 750 kWh consumed during a month and 5.5¢ per kWh thereafter;
- [b] directed the OEB to develop new pricing mechanisms (to take effect no later than May 1, 2005) for setting the price of electricity payable by Low Volume Consumers and Designated Consumers; and
- [c] announced initiatives with respect to the recovery of regulatory assets and the third distribution rate adjustment to achieve a market-based rate of return.

In March 2005, the OEB announced a Regulated Price Plan ["RPP"] for Low Volume Consumers and Designated Consumers under which the price of electricity commencing April 1, 2005 until October 31, 2005 is 5.0¢ per kWh on the first 750 kWh [the "threshold amount"] consumed during a month and 5.8¢ per kWh thereafter. After October 31, 2005, the threshold amount will vary seasonally for residential customers [1,000 kWh per month during November through April and 600 kWh per month during May through October]. Commencing April 1, 2006, for consumers with smart meters, prices will vary depending on the time of usage [2.9¢ per kWh during off-peak periods, 6.4¢ per kWh during mid-peak periods and 9.3¢ per kWh during on-peak periods].

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

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

- [a] in the case of electricity distributors, for amounts by which the purchase price of the electricity purchased by them in the IESO-administered wholesale market on behalf of Low Volume Consumers and Designated Consumers is greater than the fixed price per kWh charged to customers; and
- [b] in the case of electricity retailers, for amounts by which the retail contract price agreed to between retailers and Low Volume Consumers and Designated Consumers is greater than the fixed price per kWh charged to customers.

c) Market-based rate of return

Before the introduction of rate caps in December 2002, the OEB had authorized electricity distributors to adjust their distribution rates to incorporate a market-based rate of return. The adjustment was being phased in over three adjustment periods (2001, 2002 and 2003) to lessen the rate impact on customers. Effective on each of December 1, 2000 and March 1, 2002, the OEB authorized LDC to increase its distribution rates to allow for the recovery of additional annual revenue of \$39.8 million.

In March 2005, LDC received approval from the OEB to increase distribution rates to recover \$39.8 million, representing the third adjustment necessary to achieve a market-based rate of return. The rate increase was effective as of April 1, 2005 and is subject to a financial commitment by LDC to invest \$39.8 million in Conservation and Demand Management ["CDM"] activities over the next three years.

d) Regulatory assets

Under Bill 210, electricity distributors are required to reflect certain prescribed costs on their balance sheets until the manner and timing of disposition is determined by the OEB. These costs are:

- [a] transition costs resulting from the ramp-up to Open Access;
- [b] variances between the cost of electricity purchased by LDC from Ontario Power Generation Inc. ["OPG"] and the revenue that LDC was permitted to receive for electricity supplied by it to customers during the period January 1, 2001 to April 30, 2002; and
- [c] variances between amounts charged by LDC to customers (based on regulated rates) and the corresponding cost of non-competitive electricity service incurred by it in the wholesale market administered by the IESO.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

In November 2003, the OEB announced its intention to permit LDC and other electricity distributors to make rate applications to the OEB for the recovery of regulatory asset balances as at December 31, 2003. The recovery of these balances is being phased in over a four-year period commencing in March 2004 [note 20 [c]].

Regulatory asset recovery account:

As at March 31, 2005, the OEB ordered that the approved regulatory asset balances be aggregated into a single regulatory account. The approved transition costs, pre-market opening energy electricity variance and settlement variances balances were transferred to the “regulatory asset recovery account” [“RARA”]. Commencing April 1, 2005, the RARA is credited with recovery amounts and is debited by the OEB prescribed carrying charges.

Post December 31, 2003, unapproved settlement variances continue to be calculated and attract carrying charges as prescribed by the OEB.

e) Electricity sector reorganization

In December 2004, the Province initiated a further restructuring of Ontario’s electricity industry with the passage of the *Electricity Restructuring Act, 2004* [“Bill 100”]. The restructuring was intended, among other things, to ensure efficient and effective management of electricity, promote the expansion of new electricity supply and capacity, encourage electricity conservation and renewable energy and regulate prices in parts of the electricity sector.

Bill 100:

- [a] established the Ontario Power Authority [the “OPA”], an independent, non-profit, self-financed corporation, with a broad mandate to ensure adequate long-term electricity supply in the Province;
- [b] reorganized the Independent Electricity Market Operator as the IESO, a non-share corporation, which will continue to operate the wholesale market and be responsible for the operation and reliability of the integrated power system; and
- [c] established a Conservation Bureau within the OPA responsible for assuming a leadership role in planning and coordinating electricity conservation measures and load management in the Province.

Under Bill 100, the commodity cost of electricity for certain customer classes will be determined by the OEB on an annual basis based on a combination of regulated (i.e., electricity generated by existing generation assets principally owned by OPG), contract (i.e., new capacity under contract between generators and the OPA) and competitive market (i.e., spot market) prices for electricity. Customers that do not wish to or are not eligible to participate in the regulated plan may purchase electricity in the competitive market or through licenced retailers.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

The continuing restructuring of Ontario's electricity industry and other regulatory developments, including current and possible future consultations between the OEB and interested stakeholders, may affect the distribution rates, including payments in lieu of corporate taxes ["PILs"] recoveries, that LDC may charge and the costs that LDC may recover, including the balance of its regulatory assets.

f) 2006 Rate Application

On May 11, 2005, the OEB issued the 2006 Electricity Distribution Rate Handbook which directs electricity distributors to file rate applications by August 2, 2005 for rates to be effective on May 1, 2006. LDC filed the required documentation within the timeline prescribed by the OEB.

3. ACCOUNTING POLICIES

a) Regulation

Regulatory Assets

Under Bill 210, certain costs and variance account balances are deemed to be "regulatory assets" and are reflected in LDC's balance sheet until the manner and timing of disposition is determined by the OEB. The principal regulatory assets of the Corporation are comprised of transition costs, a pre-market opening energy electricity variance, settlement variances and other regulatory assets.

Deferral Account for Cash Pension Contributions:

The OEB has allowed the LDC to apply for the recovery of incremental Ontario Municipal Employees Retirement System ["OMERS"] pension expenditures for the fiscal years starting after January 1, 2005. Accordingly, the Corporation has recorded these expenditures in accordance with the directions set out in the Accounting Procedures Handbook for Electric Distribution Utilities ["AP Handbook"].

Under such directions, expenditures that would be expensed under Canadian GAAP for unregulated businesses are being deferred. The ultimate disposition of the deferred balances and their eligibility for recovery will be the subject of a future proceeding before the OEB.

LDC continually assesses the likelihood of full recovery of regulatory assets. If full recovery through future rates was no longer considered probable, the amounts would be charged to the results of operations in the period that the assessment was made. For any future recovery decisions made by the OEB or the Minister of Energy to allow recovery of the regulatory assets, the recovery is accounted for based upon the nature of the regulatory assets and the accounting treatment applied initially to recognize such regulatory assets.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

Global Adjustment

Effective January 1, 2005, the IESO implemented, pursuant to the *Electricity Restructuring Act, 2004*, a new price adjustment applicable to customers not subject to price protection and rate caps. This new price adjustment, referred to as Global Adjustment, is a variable rate calculated by the IESO based on the difference between electricity market prices and the mix of regulated and contract prices paid to electricity generators. This calculation will result in positive or negative bill adjustments depending on prevailing electricity market conditions. LDC expects that the variable Global Adjustment rate will take effect later this year.

In the interim, LDC has been directed by the IESO to credit eligible customers using fixed interim adjustment rates. Concurrently, LDC is paid or receives from the IESO fixed interim adjustment rates in respect of the electricity consumed by these customers. The difference between the amount credited to customers and the amount received from the IESO by LDC is being tracked in a variance account and reflected as a regulatory asset pending the OEB's direction with respect to recovery [note 6].

Business Protection Plan ["BPP"]

Consumers other than designated consumers who annually utilize more than 250,000 kWh are eligible to receive BPP rebates from IESO to the extent that electricity prices exceed certain prescribed thresholds.

LDC and other electricity distributors are required to pass these rebates through to eligible consumers and other market participants (including retailers). LDC includes amounts due from IESO in accounts receivable and includes amounts due to eligible consumers and market participants in accounts payable and accrued liabilities.

Depending on the terms of its retail contracts with eligible consumers and other market participants, Toronto Hydro Energy Services Inc. ["Energy Services"] either passes the rebates received from IESO through LDC and other electricity distributors to its eligible consumers and other market participants or retains the rebates to reduce the cost of purchased power.

With the enactment of Bill 100, the BPP rebates plan has been eliminated effective March 31, 2005.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

b) Revenue recognition

LDC

Revenue from the sale of electricity is recorded on a basis of cyclical billings and also includes unbilled revenue accrued in respect of electricity delivered but not yet billed. However, in March 2005, LDC received approval from the OEB to increase distribution rates to recover \$39,800,000. The rate increase was effective as of April 1, 2005 and is subject to a financial commitment by LDC to invest \$39,800,000 in CDM activities over the next three years [*note 2c*]. The revenue of \$39,800,000 is being billed to customers over an approximate 11-month period commencing April 1, 2005. At each reporting date, on a life-to-date basis, to the extent the earned customer revenue exceeds the CDM activity spending, the difference is recorded in the balance sheet as “Deferred revenue”.

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. AMENDED AND RESTATED RESULTS FOR JUNE 30, 2004 AND MARCH 31, 2004

In May 2004, the IESO informed LDC of a variance in consumption data recorded at the Ellesmere wholesale metering sub-station. In August 2004, LDC received its monthly wholesale power invoice from the IESO which included a credit in connection with the variance in consumption data for the period of May 1, 2002 to January 31, 2004. Following notification by the IESO of the metering variance, LDC commenced an in-depth review of its revenue, cost of power and regulatory assets calculation model and related market assumptions.

As a result of the findings from this review and the adjustment received from the IESO, the Corporation restated its consolidated financial statements in the fourth quarter of 2004 as at and for the years ended December 31, 2003 and 2002 and its unaudited interim consolidated financial statements as at and for the quarters ended March 31, June 30 and September 30, 2004.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

The effects of the resulting adjustments – increase or (decrease) - to the originally issued unaudited interim consolidated financial statements as at and for the six-months ended June 30, 2004 and for the three-months ended June 30, 2004 were as follows:

	June 30 2004 \$
Interim consolidated balance sheet:	
Assets	
Unbilled revenue	12,552
Regulatory assets	(5,681)
Liabilities	
Accounts payable and accrued liabilities	2,090
Shareholder's equity	
Retained earnings	4,781

	Three months ended June 30 2004 \$	Six months ended June 30 2004 \$
Interim consolidated statement of income:		
Revenues	5,068	4,792
Costs - purchased power	—	(1,721)
Interest income	147	358
Provision for PILs	1,045	2,090
Net income for the period	4,170	4,781

Interim consolidated statement of cash flows:		
Operating activities:		
Net income for the period	4,170	4,781
Changes in non-cash working capital balances		
Increase in unbilled revenue	(9,422)	(12,552)
Increase in accounts payable and accrued liabilities	1,045	2,090
Net cash used by operating activities	(4,207)	(5,681)
Investing activities:		
Decrease in regulatory assets	4,207	5,681

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

5. BUSINESS PROTECTION PLAN REBATES

At June 30, 2005, “Accounts receivable, net of allowance for doubtful accounts” include \$25,275,000 [December 31, 2004 - \$44,647,000] receivable from IESO and other electricity distributors and “Accounts payable and accrued liabilities” include \$28,340,000 [December 31, 2004 - \$51,373,000] payable to customers and electricity retailers in connection with BPP rebates. For the six months ended June 30, 2005, Energy Services recognized \$2,467,000 as a reduction of the cost of purchased power in connection with BPP rebates [six months ended June 30, 2004 - \$8,241,000]. With the elimination of the BPP rebates plan [note 3[a]], no BBP-related balance sheet amounts are expected to exist at the end 2005.

6. REGULATORY ASSETS

For the six months ended June 30, 2005, LDC recovered regulatory asset amounts of \$11,847,000 through permitted distribution rate adjustments [six months ended June 30, 2004 - \$5,775,000] [notes 2 and 3[a]].

7. BANK INDEBTEDNESS AND BANKERS' ACCEPTANCES

On May 5, 2005, the Corporation extended its revolving credit facility for a three-year period to May 2008. Under the terms of the revolving credit facility, the Corporation may borrow up to \$500,000,000, of which:

- [a] \$500,000,000 less the amount utilized under [b] is available for working capital purposes in the form of prime rate loans in Canadian dollars and bankers' acceptances; and
- [b] up to \$175,000,000 is available in the form of letters of credit to support the prudential requirements of LDC and Energy Services and general credit requirements of the Corporation and its subsidiaries.

The facility contains a negative pledge, customary covenants and events of default.

At June 30, 2005, \$98,014,000 [December 31, 2004 - \$105,421,000] had been issued by way of letters of credit to support the prudential requirements of LDC [\$80,000,000] [December 31, 2004 - \$80,000,000] and Energy Services [\$17,034,000] [December 31, 2004 - \$24,301,000] and to support general credit requirements of Telecom [\$980,000] [December 31, 2004 - \$1,120,000]. At June 30, 2005, no amounts had been drawn for working capital purposes [December 31, 2004 - \$nil].

The Corporation also has a bilateral demand line of credit for \$20,000,000 with a Canadian chartered bank. The line of credit bears interest at the bank's prime rate [June 30, 2005 – 4.25%]. At June 30, 2005, no amounts had been drawn on the line of credit [December 31, 2004 - \$nil].

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

8. LONG-TERM DEBT

	June 30 2005 \$	December 31 2004 \$
Long-term debt:		
6.11% senior unsecured debentures due 2013	225,000	225,000
6.80% promissory note payable to the City of Toronto [the "City"]	980,231	980,231
	1,205,231	1,205,231
Less: Current portion of promissory note payable to the City	330,000	330,000
Long-term debt	875,231	875,231
Comprising:		
Long-term debentures	225,000	225,000
Promissory note payable to the City	650,231	650,231

All debt of the Corporation is ranked equal in preference and priority.

a) Senior unsecured debentures

The Corporation's 10-year senior unsecured debentures in the amount of \$225,000,000 [December 31, 2004 - \$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 amount of \$980,231,000 [December 31, 2004 - \$980,231,000] is payable to the City [the "City Note"]. The principal amount of the City Note, together with accrued interest thereon, is payable:

[a] on demand on not less than 90 days written notice until May 7, 2006; and

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

[b] in accordance with a payment schedule to be delivered by the City at least 90 days before May 7, 2006;

provided that the Corporation will not be required to pay more than \$330,000,000 of the principal amount of the City Note during any twelve-month period. Accordingly, \$330,000,000 of the principal amount outstanding under the City Note is classified as a current liability. The maximum term of the City Note is ten years.

The rate of interest payable on the City Note is the Debt Cost Rate ["DCR"], which is currently 6.8% per annum. The DCR is a rate of interest per annum that at all times is equal to the debt cost rate prescribed from time to time by the OEB in the OEB Electricity Distribution Rate Handbook for utilities in the same rate class as LDC. Interest is calculated and payable quarterly in arrears on the last day of March, June, September and December of each year.

9. EMPLOYEE FUTURE BENEFITS

a) Pension

For the three months and the six months ended June 30, 2005, the Corporation's current service pension costs were \$2,338,000 and \$4,601,000, respectively [June 30, 2004 - \$2,269,000 and \$4,006,000].

b) Employee future benefits other than pension

The Corporation has a number of unfunded benefit plans providing retirement and post-employment benefits [excluding pension] to most of its employees. These plans provide medical and life insurance benefits, pay for accumulated sick leave credits and provide a retirement supplement for eligible employees. Components for net periodic defined benefit costs are as follows:

	Three months ended June 30		Six months ended June 30	
	2005 \$	2004 \$	2005 \$	2004 \$
Defined benefit costs recognized	2,966	2,681	5,827	5,538
Capitalized as part of property, plant and equipment	918	763	1,690	1,473
Charged to operations	2,048	1,918	4,137	4,065

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

10. ASSET RETIREMENT OBLIGATIONS

A reconciliation between the opening and closing ARO liability balances is provided below:

	2005	2004
	\$	\$
Balance January 1	4,274	4,040
ARO liabilities incurred in the period	(3)	2
ARO liabilities settled in the period	(53)	—
Accretion expense	61	58
Balance March 31	4,279	4,100
ARO liabilities incurred in the period	3	26
ARO liabilities settled in the period	(141)	(34)
Accretion expense	61	58
Balance June 30	4,202	4,150
ARO liabilities incurred in the period		111
ARO liabilities settled in the period		(106)
Accretion expense		119
Balance December 31		4,274

At June 30, 2005, the Corporation estimates the undiscounted amount of cash flows required over the next ten years to settle the ARO is \$5,084,000 [December 31, 2004 - \$5,278,000]. Discount rates ranging from 4.35% to 5.93% were used to calculate the carrying value of the ARO liabilities. No assets have been legally restricted for settlement of the liability.

11. SHARE CAPITAL

Share capital consists of the following:

	June 30	December 31
	2005	2004
	\$	\$
Authorized		
The authorized share capital of the Corporation consists of an unlimited number of common shares		
Issued and outstanding		
1,000 common shares	567,817	567,817

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

Dividends

The shareholder direction adopted by the City with respect to the Corporation provided that the Corporation's board of directors would use its best efforts to ensure that the Corporation met certain financial performance standards, including those relating to credit rating and dividends. Subject to applicable law, the shareholder direction provided that the Corporation would pay dividends to the City each year.

In October 2004, the shareholder direction adopted by the City with respect to the Corporation was amended to revise the dividend policy. Under the amended dividend policy, subject to applicable law and the shareholder direction, the amount of the annual dividends payable by the Corporation to the City is to be the greater of \$25,000,000 or 50% of the Corporation's annual consolidated net income for the year commencing with the fiscal year ended December 31, 2004.

Commencing in fiscal 2005, the dividends are payable as follows:

- [a] \$6,000,000 on the last day of each of the first three fiscal quarters in each year;
- [b] \$7,000,000 on the last day of the fourth fiscal quarter in each year; and
- [c] the amount, if any, by which 50% of the Corporation's annual consolidated net income for the year exceeds \$25,000,000 within ten days after the board of directors of the Corporation approves the Corporation's audited consolidated financial statements for the year.

On March 31, 2005, the board of directors of the Corporation declared dividends payable to the City of Toronto in the amount of \$49,000,000. The dividends were comprised of \$23,700,000 as payment in respect of 2004 net income, a \$6,000,000 payment in respect of the first quarter of 2005 and a \$19,300,000 one-time extraordinary dividend payment. These dividends were paid on March 31, 2005.

On May 27, 2005, the board of directors of the Corporation declared a dividend in the amount of \$6,000,000 in respect of the second quarter of 2005. The dividend was paid on June 30, 2005.

12. RETAIL COMMITMENTS AND FINANCIAL INSTRUMENTS

a) Electricity retailing

Energy Services manages a portfolio of electricity contracts comprised of retail full requirement and fixed notional volume contracts, wholesale financial fixed notional volume fixed-for-floating and floating-for-fixed swaps and fixed notional volume physical bilateral contracts. The contracts are derivative contracts for accounting purposes except for the retail full requirement contracts, which have variable volumes and do not have contractual minimum notional amounts.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

The electricity contracts have varying maturity dates throughout the period ending December 31, 2006. In December 2002, Energy Services ceased new electricity retailing activities in respect of new customers.

At June 30, 2005, Energy Services has floating-for-fixed electricity contracts that have an aggregate expected contract volume of 4,901,000 MWh [December 31, 2004 – 6,753,000 MWh], including contracts whereby Energy Services provides a fixed notional volume at a fixed price. The aggregate notional volume and value of these contracts are 4,882,000 MWh and \$268,369,000 [December 31, 2004 – 6,064,000 MWh and \$326,296,000].

To hedge the volume and price risk inherent in retailing electricity, Energy Services has entered into financial fixed notional volume fixed-for-floating swaps and fixed notional physical bilateral contracts with generators and marketers. At June 30, 2005, the aggregate notional volume and value of these contracts are 5,556,000 MWh and \$235,709,000 [December 31, 2004 – 7,985,000 MWh and \$344,048,000].

On April 30, 2004, Energy Services extended an existing retail electricity contract with the City from May 1, 2005 to December 31, 2006. Under the existing agreement and the extension, Energy Services will sell a fixed notional volume of electricity of 2,900,000 MWh for a total expected settlement of \$153,436,000 to the City from July 1, 2005 to December 31, 2006.

For the six months ended June 30, 2005, “Revenues” include \$19,695,000 of Energy Services electricity mark-to-market revenues [six months ended June 30, 2004 - \$42,196,000].

b) Credit risk

Financial instruments result in exposure to credit risk, since there is a risk of counter-party default. Energy Services monitors and limits its exposure to counter-parties with lower credit ratings and evaluates its counter-party credit exposure on a continuous basis. Energy Services obtains collateral from counter-parties and seeks to deal only with counter-parties with investment grade credit ratings. Energy Services had four wholesale counter-parties as at June 30, 2005 for its electricity supply portfolio. In addition, Energy Services provides reserves for credit risks based on the financial condition and short and long-term exposures to counter-parties. The largest single credit exposure at June 30, 2005 is estimated at \$114,048,000, which is the estimated replacement cost of wholesale purchase contracts with one counter-party.

For retail customers, credit losses are generally low across the sector. LDC and Energy Services provide for an allowance for doubtful accounts to absorb credit losses.

At June 30, 2005, there were no significant concentrations of credit risk with respect to any class of financial assets other than the wholesale risk mentioned above.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

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 7], the Corporation may have short-term borrowings for working capital purposes. These borrowings would 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 of the Corporation is invested in Canadian money market instruments, with terms of one day to two months, exposing the Corporation to fluctuations in short-term interest rates. These fluctuations impact the level of interest income earned by the Corporation.

d) Fair value of financial instruments

The fair value of hedging derivative financial instruments is the estimated amount the Corporation would receive (pay) to terminate the contracts. The value is based on market prices or management's best estimates if there is no organized market and/or if the market is illiquid.

Mark-to-market energy assets and liabilities

Effective January 1, 2004, Energy Services changed its accounting policy regarding hedging relationships to comply with CICA Accounting Guideline 13 "Hedging Relationships" ["AcG-13"] and CICA Emerging Issues Committee Abstract 128 "Accounting for Trading, Speculative or Non-Hedging Derivative Financial Instruments" ["EIC-128"]. Accordingly, all retail fixed notional volume fixed price contracts and all undesignated wholesale fixed notional volume fixed-for-floating swaps and fixed notional volume physical bilateral contracts are accounted for using the mark-to-market method of accounting. The following are the primary sources of the change in the net mark-to-market assets:

	2005	2004
	\$	\$
Net mark-to-market assets		
Fair value January 1	27,696	5,542
Unrealized change in fair value during the period	8,363	35,572
Realization of contracts for the period	(3,697)	(1,075)
Fair value of net mark-to-market assets at June 30	32,362	40,039
Unrealized change in fair value during the period		(7,976)
Realization of contracts for the period		(4,367)
Fair value of net mark-to-market assets at December 31		27,696

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

Other assets and liabilities

The carrying value of cash and cash equivalents, accounts receivable, unbilled revenue, and accounts payable and accrued liabilities approximates their fair value due to the immediate or short-term maturity of these financial instruments.

At June 30, 2005, the fair values of the City Note [\$980,231,000] and the senior unsecured debentures [\$225,000,000] are \$1,091,800,000 and \$253,911,000, respectively [December 31, 2004 - \$1,067,782,000 and \$247,080,000, 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 [note 8].

13. FINANCIAL GUARANTEES

Participants [including LDC and Energy Services] in the wholesale market for electricity that is administered by the IESO are required to satisfy prescribed prudential requirements. In addition, counter-parties under contracts for the purchase and sale of electricity and customers under purchase contracts may require parental financial guarantees or other forms of credit support.

The City has authorized the Corporation to provide up to \$500,000,000 in financial support [including guarantees] with respect to prudential requirements and as security for obligations under third party contracts.

At June 30, 2005, the Corporation's board of directors had approved \$386,000,000 in parental guarantees on behalf of Energy Services, of which \$166,500,000 has been issued [December 31, 2004 - \$174,500,000] [see note 20 a)].

The Corporation has issued a parental guarantee to the City as part of an agreement to purchase electricity at a fixed price from Energy Services. The fair value of the parental guarantee was \$32,516,000 at June 30, 2005 [December 31, 2004 - \$11,426,000].

At June 30, 2005, \$98,014,000 [December 31, 2004 - \$105,421,000] was utilized under the Corporation's revolving credit facility in the form of letters of credit to support the prudential requirements of LDC, Energy Services and Telecom [note 7].

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

14. PAYMENTS IN LIEU OF CORPORATE TAXES

The provision for PILs differs from the amount that would have been recorded using the combined

Canadian federal and Ontario statutory income tax rate. Reconciliation between the statutory and effective tax rates is set out below:

Statement of income

	Three months ended June 30		Six months ended June 30	
	2005 \$	2004 \$	2005 \$	2004 \$
		<i>[restated]</i>		<i>[restated]</i>
Rate reconciliation				
Income before PILs	49,150	64,629	86,043	104,188
Statutory Canadian federal and provincial income tax rate	36.12%	36.12%	36.12%	36.12%
Expected provision for PILs	17,753	23,344	31,079	37,633
Increase (decrease) in income taxes resulting from				
Large corporations tax net of surtax	438	793	933	1,443
Utilization of temporary differences previously not benefited	553	(24)	3,907	1,422
Other	652	(158)	(466)	(1,253)
Provision for PILs	19,396	23,955	35,453	39,245
Effective tax rate	39.46%	37.07%	41.20%	37.67%
Components of provision for PILs				
Current tax provision	18,110	14,093	33,491	29,999
Future income tax provision related to the origination and reversal of temporary differences	1,286	9,862	1,962	9,246
Provision for PILs	19,396	23,955	35,453	39,245

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

15. CONTINGENCIES

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

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 as the parties were awaiting the outcome of the Consumers' Gas class action.

The second is an action commenced against a predecessor of LDC under the Class Proceedings Act, 1992 seeking \$64,000,000 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.

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

16. NET INCOME PER SHARE

The weighted daily average numbers of shares outstanding were 1,000 as at June 30, 2005 and June 30, 2004, for purposes of determining basic and fully diluted net income per share. Basic and fully diluted net income per share was determined by dividing the net income for the period by the weighted daily average number of shares outstanding.

17. SEGMENT REPORTING

The Corporation has two reportable segments:

- [a] Electricity Distribution:
the regulated business which consists principally of the electricity distribution business; and
- [b] Non-regulated:
the non-regulated businesses which consist primarily of the management of an existing portfolio of electricity contracts, the sale of energy management services and the provision of “dark” fibre optic capacity and “lit” data communications services to telecommunications carriers, business customers and large institutions.

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

Segment information on the above basis is as follows:

	Three months ended June 30		Six months ended June 30	
	2005	2004	2005	2004
	\$	\$	\$	\$
		<i>[restated]</i>		<i>[restated]</i>
Electricity Distribution				
Revenues	607,885	518,515	1,243,464	1,154,050
Purchased power and other	485,419	406,939	1,004,809	923,514
Depreciation and amortization	32,225	30,664	63,702	61,236
Interest expense	20,780	21,009	41,506	41,764
Segment profit before interest, other items and provision for payments in lieu of corporate taxes	56,203	39,009	99,723	89,460

Toronto Hydro Corporation

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars, unaudited]

June 30, 2005

	June 30	December 31
	2005	2004
	\$	\$
Assets		
Electricity Distribution	2,398,031	2,389,177
Non-regulated	271,029	253,637
Intersegment eliminations	(52,515)	(53,960)
Total	2,616,545	2,588,854

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

18. SEASONAL OPERATIONS

The Corporation's quarterly results are impacted by changes in revenues resulting from variations in seasonal weather conditions. Historically, the Corporation's revenues are 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.

19. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the June 30, 2005 unaudited interim consolidated financial statements.

20. SUBSEQUENT EVENTS

a) Financial guarantees

Effective July 1, 2005, the Corporation reduced the amount of parental guarantees issued on Energy Services' behalf to LDC by \$36,500,000. The reduction reflected the lower risk exposure of Energy Services to LDC commensurate with the expiry of over 58,000 Energy Services electricity contracts between April 30 and June 30, 2005.

b) Dividends

On August 25, 2005, the board of directors of the Corporation declared a dividend in the amount of \$6,000,000 in respect of the third quarter of 2005 payable on September 30, 2005.

c) Regulatory assets

In July 2005, the OEB issued final approval for LDC's recovery of the regulatory asset balances as at December 31, 2003.