Consolidated Financial Statements

# Toronto Hydro Corporation

DECEMBER 31, 2007

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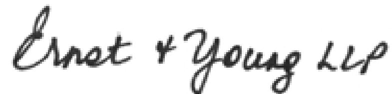
# AUDITORS' REPORT

To the Shareholder of
**Toronto Hydro Corporation**

We have audited the consolidated balance sheets of **Toronto Hydro Corporation** [the "Corporation"] as at December 31, 2007 and 2006 and the consolidated statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.




Chartered Accountants
Licensed Public Accountants

Toronto, Canada,
February 20, 2008 [except as to note 27, which is as of March 5, 2008].

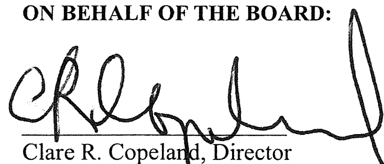
# Toronto Hydro Corporation

## CONSOLIDATED BALANCE SHEET

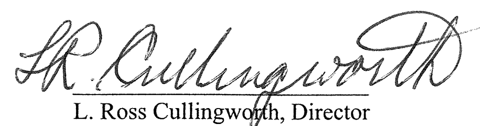
**[in thousands of dollars]**

| As at December 31 | 2007<br>$ | 2006<br>$ |
|---|---|---|
| **ASSETS** | | |
| **Current** | | |
| Cash and cash equivalents | **216,002** | 327,524 |
| Accounts receivable, net of allowance for doubtful accounts | **170,346** | 218,452 |
| Unbilled revenue | **261,816** | 216,857 |
| Inventories | **26,860** | 22,458 |
| Prepaid expenses | **1,646** | 2,277 |
| Future income tax assets *[note 17]* | **710** | 791 |
| Assets from discontinued operations *[note 24]* | **-** | 12,098 |
| **Total current assets** | **677,380** | 800,457 |
| Investments held to maturity *[note 22]* | **74,941** | - |
| Property, plant and equipment, net *[note 5]* | **1,822,822** | 1,657,346 |
| Intangible assets, net *[note 6]* | **63,313** | 48,788 |
| Regulatory assets *[note 7]* | **18,553** | 66,528 |
| Other assets *[note 8]* | **485** | 2,578 |
| Future income tax assets *[note 17]* | **15,031** | 16,009 |
| **Total assets** | **2,672,525** | 2,591,706 |
| **LIABILITIES AND SHAREHOLDER'S EQUITY** | | |
| **Current** | | |
| Accounts payable and accrued liabilities | **272,397** | 284,869 |
| Current portion of other liabilities *[note 10]* | **18,976** | 16,952 |
| Current portion of deferred revenue | **2,544** | 7,320 |
| Current portion of promissory note payable *[note 11]* | **-** | 245,058 |
| Liabilities from discontinued operations *[note 24]* | **2,874** | 906 |
| **Total current liabilities** | **296,791** | 555,105 |
| **Long-term liabilities** | | |
| Debentures *[note 11]* | **471,015** | 225,000 |
| Promissory note payable *[note 11]* | **735,173** | 735,173 |
| Post-employment benefits *[note 12]* | **144,355** | 134,682 |
| Regulatory liabilities *[note 7]* | **59,151** | 11,840 |
| Other liabilities *[note 13]* | **5,601** | 3,949 |
| Asset retirement obligations *[note 14]* | **7,523** | 7,581 |
| Customers' advance deposits | **23,867** | 25,944 |
| Future income tax liabilities *[note 17]* | **354** | 368 |
| **Total long-term liabilities** | **1,447,039** | 1,144,537 |
| **Total liabilities** | **1,743,830** | 1,699,642 |
| Commitments and contingencies *[notes 20 and 21]* | | |
| **Shareholder's equity** | | |
| Share capital *[note 18]* | **567,817** | 567,817 |
| Retained earnings | **360,878** | 324,247 |
| **Total shareholder's equity** | **928,695** | 892,064 |
| **Total liabilities and shareholder's equity** | **2,672,525** | 2,591,706 |

**ON BEHALF OF THE BOARD:**



Clare R. Copeland, Director



L. Ross Cullingworth, Director

The accompanying notes are an integral part of the consolidated financial statements.

## CONSOLIDATED STATEMENT OF INCOME

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

| Year ended December 31 | 2007 $ | 2006 $ |
|---|---|---|
| **Revenues** | **2,389,178** | 2,246,989 |
| **Costs** | | |
| Purchased power and other | **1,860,500** | 1,705,845 |
| Operating expenses | **206,260** | 194,197 |
| Depreciation and amortization | **151,635** | 137,344 |
| | **2,218,395** | 2,037,386 |
| **Income before interest, impairment, other and provision for payments in lieu of corporate taxes** | **170,783** | 209,603 |
| Interest income | **14,068** | 17,726 |
| Interest expense | | |
| Long-term debt | **(75,312)** | (75,894) |
| Other interest | **1,389** | (2,902) |
| Impairment of investments held to maturity *[note 22]* | **(13,059)** | - |
| Other | **1,739** | 89 |
| **Income before provision for payments in lieu of corporate taxes** | **99,608** | 148,622 |
| Provision for payments in lieu of corporate taxes *[note 17]* | **40,975** | 58,403 |
| **Income from continuing operations** | **58,633** | 90,219 |
| Income from discontinued operations - net of tax *[note 24]* | **24,198** | 2,178 |
| **Net income** | **82,831** | 92,397 |
| Basic and fully diluted net income per share from continuing operations *[note 23]* | **58,633** | 90,219 |
| Basic and fully diluted net income per share from discontinued operations *[note 23]* | **24,198** | 2,178 |
| **Basic and fully diluted net income per share** | **82,831** | 92,397 |

## CONSOLIDATED STATEMENT OF RETAINED EARNINGS

**[in thousands of dollars]**

| Year ended December 31 | 2007 $ | 2006 $ |
|---|---|---|
| **Retained earnings, beginning of year** | **324,247** | 278,050 |
| Net income | **82,831** | 92,397 |
| Dividends *[note 18]* | **(46,200)** | (46,200) |
| **Retained earnings, end of year** | **360,878** | 324,247 |

The accompanying notes are an integral part of the consolidated financial statements.

## CONSOLIDATED STATEMENT OF CASH FLOWS

**[in thousands of dollars]**

| **Year ended December 31** | **2007** **$** | **2006** $ |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Income from continuing operations | **58,633** | 90,219 |
| Adjustments for non-cash items | | |
| Depreciation and amortization | **151,635** | 137,344 |
| Impairment of investments held to maturity *[note 22]* | **13,059** | - |
| Net change in other assets and liabilities | **1,413** | (3,191) |
| Electricity mark-to-market assets and liabilities | **-** | 26,422 |
| Post-employment benefits | **9,673** | 9,267 |
| Future income taxes | **1,045** | (2,488) |
| Gain on disposals of property, plant and equipment | **(1,739)** | (89) |
| Changes in non-cash working capital balances | | |
| Decrease (increase) in accounts receivable | **48,106** | (44,003) |
| Decrease (increase) in unbilled revenue | **(44,959)** | 54,510 |
| Increase in inventories | **(4,402)** | (4,269) |
| Decrease (increase) in prepaid expenses | **631** | (60) |
| Decrease in accounts payable and accrued liabilities | **(12,472)** | (137,787) |
| Decrease in deferred revenue | **(4,776)** | (13,179) |
| Increase in current portion of other liabilities | **1,010** | 32 |
| **Net cash provided by operating activities** | **216,857** | 112,728 |
| **INVESTING ACTIVITIES** | | |
| Purchase of property, plant and equipment | **(276,139)** | (166,956) |
| Purchase of intangible assets | **(24,511)** | (18,351) |
| Investments held to maturity *[note 22]* | **(88,000)** | - |
| Net change in regulatory assets and liabilities | **64,081** | (4,233) |
| Proceeds on disposal of property, plant and equipment | **1,941** | 938 |
| **Net cash used in investing activities** | **(322,628)** | (188,602) |
| **FINANCING ACTIVITIES** | | |
| Decrease in promissory note payable | **(245,058)** | - |
| Dividends paid *[note 18]* | **(46,200)** | (46,200) |
| Proceeds from debentures | **250,000** | - |
| Increase in deferred debt issuance costs | **(1,621)** | - |
| Increase (decrease) in customers' advance deposits | **(802)** | 1,835 |
| Repayment of capital lease liability | **(334)** | (1,182) |
| **Net cash used in financing activities** | **(44,015)** | (45,547) |
| **Net cash used in continuing operations** | **(149,786)** | (121,421) |
| Net cash provided by discontinued operations | **38,264** | 575 |
| **Net decrease in cash and cash equivalents during the year** | **(111,522)** | (120,846) |
| Cash and cash equivalents, beginning of year | **327,524** | 448,370 |
| **Cash and cash equivalents, end of year** | **216,002** | 327,524 |
| **Supplementary cash flow information** | | |
| Total interest paid | 75,020 | 77,442 |
| Payments in lieu of corporate income taxes | 65,579 | 106,771 |

The accompanying notes are an integral part of the consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2007

## 1. INCORPORATION

On June 23, 1999, Toronto Hydro Corporation [the "Corporation"] was incorporated under the Business Corporations Act (Ontario) [the "BCA"] along with two wholly-owned subsidiary companies, Toronto Hydro-Electric System Limited ["LDC"] and Toronto Hydro Energy Services Inc. ["TH Energy"]. The incorporation was required in accordance with the provincial government's Electricity Act, 1998.

Under the terms of By-law No. 374-1999 of the City of Toronto ["Transfer By-law"] made under section 145 of the Electricity Act, 1998 and in accordance with continuity of interest accounting, the former Toronto Hydro-Electric Commission and the City of Toronto [the "City"] transferred, at book value, their assets and liabilities [effective July 1, 1999] and employees [effective January 1, 2000] associated with:

[a] electricity distribution to LDC in consideration for the issuance of equity securities of LDC and long-term notes payable to the City; and

[b] electricity generation, co-generation and energy services to TH Energy in consideration for the issuance of equity securities of TH Energy.

The equity securities of LDC and TH Energy were subsequently transferred by the City to the Corporation in consideration for the issuance of equity securities of the Corporation to the City.

Certain surplus real property assets and cash funds were excluded from the transfer and were retained by the City. In addition, the long-term debt incurred by the City on behalf of the former Toronto Hydro-Electric Commission was excluded from the liabilities transferred and was retained by the City.

The book value of the assets transferred at July 1, 1999 was $1,548,048,000. The principal amount of the long-term notes payable to the City was $980,231,000 and the value of the common shares of the Corporation received by the City was $567,817,000.

The Corporation supervises the operations of, and provides corporate and management services and strategic direction to, its subsidiary companies [each of which is listed below, incorporated under the BCA and wholly-owned, directly or indirectly, by the Corporation]:

[a] LDC [incorporated June 23, 1999] – which distributes electricity to customers located in the City and is subjected to rate regulation. LDC is also engaged in the delivery of "Conservation and Demand Management" ["CDM"] programs.

[b] TH Energy [incorporated June 23, 1999] – which owns and operates a street lighting system located in the City and is engaged in the sale of energy efficiency products and services.

[c] Toronto Hydro Telecom Inc. ["Telecom"] [incorporated September 26, 2000] – which provides fibre optic cable capacity and manages data communications services.

[d] 1455948 Ontario Inc. [incorporated December 21, 2000] – which owns a 50% interest in EBT Express Partnership [“EBT Express”], a joint venture with a wholly-owned subsidiary of Ontario Power Generation Inc. EBT Express owns a 67% controlling interest in The SPi Group, a corporation formed to provide, among other things, centralized electronic data management and transaction services to energy industry participants.

The principal business of the Corporation is the regulated distribution of electricity by LDC.

## 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.

The Ontario Energy Board [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.

LDC is required to charge its customers for the following amounts (all of which, other than the distribution rate, represent a pass through of amounts payable to third parties):

[i] *Electricity Price and Related Rebates*. The electricity price and related rebates represent a pass through of the commodity cost of electricity.

[ii] *Distribution Rate*. The distribution rate is designed to recover the costs incurred by LDC in delivering electricity to customers and the OEB-allowed rate of return. Distribution rates are regulated by the OEB and typically comprise a fixed charge and a usage-based (consumption) charge.

The volume of electricity consumed by LDC’s customers during any period is governed by events largely outside LDC’s control (principally sustained periods of hot or cold weather which increase the consumption of electricity and sustained periods of moderate weather which decrease the consumption of electricity).

[iii] *Retail Transmission Rate*. The retail transmission rate represents a pass through of wholesale costs incurred by distributors in respect of the transmission of electricity from generating stations to local areas. Retail transmission rates are regulated by the OEB.

[iv] *Wholesale Market Service Charge*. The wholesale market service charge represents a pass through of various wholesale market support costs. Retail rates for the recovery of wholesale market service charges are regulated by the OEB.

## 3. ELECTRICITY DISTRIBUTION RATES

In connection with the restructuring of Ontario's electricity industry in 1999, the OEB had authorized electricity distributors to adjust their distribution rates to incorporate a market-based rate of return of 9.88% on the deemed debt to equity structure of LDC of 65:35. The adjustment was being phased in over three adjustment periods 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 $39,800,000.

In March 2005, LDC received approval from the OEB to increase distribution rates to recover $39,800,000, representing the third and final adjustments necessary to achieve a market-based rate of return of 9.88%. The rate increase was effective as of April 1, 2005 and subjected the LDC to a financial commitment to invest $39,800,000 in CDM activities by September 2007.

In April 2006, the OEB approved a decrease in the distribution rates of LDC for the period May 1, 2006 to April 30, 2007 representing a revenue reduction of approximately $57,956,000, including the new regulatory treatment for revenues relating to smart meters [*note 7*]. The methodology used by the OEB to establish the distribution rates was based on, among other things, a rate base of $1,861,000,000, a deemed debt to equity structure of 65:35 and an allowed return on deemed equity of 9%. The OEB also allowed for the recovery of regulatory assets related to prior years' pension costs and OEB fees and reduced the allowable interest rate recoverable on related party debt including the outstanding promissory note between LDC and the Corporation from 6.8% to 5% per annum.

In December 2006, the 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 LDC's 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 rate application was amended by LDC on December 21, 2007. The requested base distribution revenue requirements for these rate years are $490,500,000, $532,500,000 and $564,300,000, respectively. The OEB decision on LDC's application is expected in April 2008.

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 and other permitted recoveries.

# 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Corporation have been prepared in accordance with Canadian generally accepted accounting principles ["GAAP"], including accounting principles prescribed by the OEB in the handbook "Accounting Procedures Handbook for Electric Distribution Utilities" ["AP Handbook"], and reflect the significant accounting policies summarized below.

## *a) Basis of consolidation*

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

## *b) Regulation*

The following regulatory treatments have resulted in accounting treatments which differ from Canadian GAAP for enterprises operating in an unregulated environment:

***Regulatory Assets and Liabilities***

In accordance with Canadian Institute of Chartered Accountants ["CICA"] Accounting Guideline 19 "Disclosures by Entities Subject to Rate Regulation" ["AcG-19"], certain costs and variance account balances deemed to be "regulatory assets" or "regulatory liabilities" in the LDC are reflected separately on the Corporation's balance sheet until the manner and timing of disposition is determined by the OEB *[note 7]*.

***Payments in lieu of corporate taxes***

The Corporation and its subsidiaries are exempt from tax under the *Income Tax Act (Canada)* ["ITA"] and the *Corporations Tax Act (Ontario)*, if not less than 90% of the capital of the Corporation is owned by the City and not more than 10% of the income and each of its subsidiaries is derived from activities carried on outside the municipal geographical boundaries of the City.

The Corporation and each of its subsidiaries is a Municipal Electricity Utility ["MEU"] for purposes of the Payments In Lieu of Corporate Taxes ["PILs"] regime contained in the Electricity Act, 1998. The Electricity Act, 1998 provides that a MEU that is exempt from tax under the ITA and the *Corporations Tax Act (Ontario)* is required to make, for each taxation year, a PILs, to the Ontario Electricity Financial Corporation in an amount equal to the tax that it would be liable to pay under the ITA and the *Corporations Tax Act (Ontario)* if it were not exempt from tax.

The PILs regime came into effect on October 1, 2001, at which time the Corporation and each of its subsidiaries were deemed to have commenced a new taxation year for purposes of determining the respective liabilities for PILs. Accordingly, the Corporation and its subsidiaries were deemed to have disposed of their assets at their then fair market value and to have re-acquired such assets at the same amount. The differences between the financial statement carrying value and tax basis of assets and liabilities were accounted for by the Corporation as follows:

[a] in the case of the Corporation's unregulated businesses, the liability method of accounting was applied in accordance with recommendations of the CICA; and

[b] in the case of the Corporation's regulated electricity distribution business, the taxes payable method of accounting was applied in accordance with recommendations of the CICA and the OEB.

Under the liability method, current income taxes payable are recorded based on taxable income. Future income taxes arise from temporary differences in the accounting and tax basis of assets and liabilities. Future tax assets and liabilities are provided based on substantively enacted tax rates that will be in effect when the differences are expected to reverse.

Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of the regulated business at that time.

The OEB's Electricity Distribution Rate Handbooks, issued in March 2000 and May 2005, provide for the recovery of PILs by LDC through annual distribution rate adjustments as permitted by the OEB. The OEB-approved distribution rate for PILs recoveries is based on estimated consumption volumes. The difference between actual billings that relate to the recovery of PILs and the OEB-approved PILs amount up to April 30, 2006, is tracked by LDC as a variance amount in accordance with OEB guidelines for regulatory assets and with criteria set out in the AP Handbook. Commencing May 1, 2006, any differences that result from a legislative or regulatory change to the tax rates or rules assumed in the 2006 electricity distribution rate application is tracked by LDC as a variance amount.

***Contributions in aid of construction***

Capital contributions received from outside sources are used to finance additions to property, plant and equipment of LDC. According to the AP Handbook, capital contributions received are treated as a "credit" to property, plant and equipment. The amount is subsequently amortized by a charge to accumulated amortization and a credit to amortization expense at an equivalent rate to that used for the depreciation of the related property, plant and equipment.

***Allowance for funds used during construction***

Commencing January 1, 2007, LDC prospectively adopted Article 410 of the 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 December 31, 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-process for financial reporting purposes, charged to operations through depreciation over the service life of the related assets and recovered through future revenue.

***Spare transformers***

Spare transformers are items that are expected to substitute for original distribution plant transformers when these original plant assets are being repaired and are held and dedicated for the specific purpose of backing up plant in service as opposed to assets available for other uses. According to the criteria set out in the AP Handbook, spare transformers are treated as capital assets *[note 5]*, which would be recorded as inventory under Canadian GAAP for unregulated businesses.

## *c) Cash and cash equivalents*

Cash and cash equivalents include cash in bank accounts and short-term investments with terms to maturity of 90 days or less from their date of acquisition.

## *d) Inventories*

Inventories consist primarily of maintenance and construction materials and are stated at the lower of cost and replacement cost, with cost determined on an average cost basis net of the provision for obsolescence.

## *e) Investments held to maturity*

Investments held to maturity include third party Asset-Backed Commercial Paper [“ABCP”] notes impacted by the liquidity issues that arose in August 2007. These investments are classified as long-term investments on the balance sheet. Investments held to maturity are recorded at fair value. Under this classification, the Corporation recognizes impairments to net income as they arise. The impairment is the difference between the estimated fair value and the carrying amount of the investment.

## *f) Property, plant and equipment and depreciation*

Property, plant and equipment are stated at cost and are removed from the accounts at the end of their estimated average service lives, except in those instances where specific identification allows their removal at retirement or disposition. Gains or losses at retirement or disposition of such assets are credited or charged to “other” in the consolidated statement of income.

In the event that facts and circumstances indicate that property, plant and equipment may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the asset are compared to the carrying amount of the asset to determine if a write-down is required. The impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value.

Depreciation is provided on a straight-line basis over the estimated service lives at the following annual rates:

| | |
|---|---|
| Buildings | 1.7% to 10.0% |
| Stations | 2.9% to 5.0% |
| Distribution lines | 2.5% to 25.0% |
| Transformers | 3.3% to 4.0% |
| Meters | 2.9% to 4.0% |
| Other capital assets | 6.7% to 12.5% |
| Communications | 5.0% to 20.0% |
| Computer hardware | 20.0% to 25.0% |
| Rolling stock | 12.5% to 33.3% |
| Equipment and tools | 10.0% |

Construction in progress includes assets not currently in use which are not depreciated.

### *g) Intangible assets*

Intangible assets, which lack physical substance, are stated at cost. Amortization is provided on a straight-line basis over their estimated useful service lives at the following annual rates:

| | |
|---|---|
| Land rights | 2.0% |
| Computer software | 14.0% to 33.0% |
| Capital contributions | 4.0% |

Software in development includes assets not currently in use which are not amortized.

### *h) Deferred debt issue costs*

In 2003 and 2007, the Corporation incurred debt issue costs arising from the Corporation's debenture offerings. Effective January 1, 2007, in accordance with the adoption of CICA Handbook Section 3855 - "Financial Instruments - Recognition and Measurement", the Corporation transferred the deferred debt issue costs, net of accumulated amortization, previously included in "Other Assets" on the Corporation's balance sheet to the principal amount of the "Debentures". The debentures are accreted back to their face value using the effective interest rate method over the remaining period to maturity. The transfer was done prospectively as of January 1, 2007.

### *i) Workplace Safety and Insurance Act*

The Corporation is a Schedule 1 employer for workers' compensation under the Workplace Safety and Insurance Act ["WSIA"]. As a Schedule 1 employer, the Corporation is required to pay annual premiums into an insurance fund established under the WSIA and recognizes expenses based on funding requirements.

## *j) 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.

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 was subject to a financial commitment by LDC to spend $39,800,000 in CDM activities by September 2007. The revenue of $39,800,000 was billed to customers over a period of 11-months 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”.

In May 2007, LDC entered into CDM agreements with the Ontario Power Authority [“OPA”] for the period from 2007 to 2010. The revenues and costs associated with these programs are accounted for using the net basis of accounting, while any performance fees are recognized as the related CDM programs are delivered.

Revenues from Lost Revenue Adjustment Mechanism [“LRAM”] and Shared Savings Mechanism [“SSM”] are recognized as related CDM programs are delivered.

Other income, which includes revenues from electricity distribution related services, is recognized as the services are rendered.

***TH Energy***

Energy efficiency products and services revenue is accounted for under the percentage of completion method, with revenue recognized proportionately with the degree of completion of the services under contract. Losses on contracts are fully recognized when they become evident.

TH Energy provides certain services to the City at commercial rates, including street lighting services and consolidated billing services. These services are recognized when services are rendered.

Water heater revenue is accounted for when the service is rendered. TH energy sold its water heater business on February 8, 2007.

Prior to the expiration of all contracts on December 31, 2006, TH Energy accounted for notional block contracts and non-designated purchase contracts using the mark-to-market method of accounting. Under the mark-to-market method of accounting, TH Energy recorded the fair value of the contracts, less related reserves, as mark-to-market assets or liabilities at the time of contract execution. All transactions were recognized on a net basis as mark-to-market revenue. Mark-to-market revenue included gains or losses on new transactions at origination, unrealized gains and losses from changes in the fair value of contracts, net gains or losses from realized transactions and changes in reserves.

***Telecom***

Fibre leasing and data communications services revenues are recognized as services are rendered.

## *k) Financial instruments*

Effective January 1, 2007, the Corporation adopted the 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 consolidated financial statements have not been restated. These new Handbook Sections have lead to changes in the accounting for financial instruments and hedging transactions. All relevant changes are outlined below.

***Financial Instruments – Recognition and Measurement - Section 3855***

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

- Cash is classified as "Assets Held-for-Trading" and is measured at fair value.
- Cash equivalents, comprising short-term investments, are classified as "Held-to-Maturity Investments" and are measured at amortized cost, which, upon initial recognition, is considered equivalent to fair value.
- Accounts receivable are classified as "Loans and Receivables" and are measured at amortized cost, which, upon initial recognition, is considered equivalent to fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method.
- Investments held to maturity, comprised of third party ABCP notes, are classified as "Held-to-Maturity Investments" and are measured at amortized cost, which, upon initial recognition, is considered equivalent to fair value.
- 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 year-ended December 31, 2007, the adoption of this standard does not have an impact on the December 31, 2007 consolidated financial statements.

***Hedges – Section 3865***

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

## *l) Employee future benefits*

***Pension plan***

The Corporation provides a pension plan for its full-time employees through Ontario Municipal Employees Retirement System [“OMERS”]. OMERS is a multi-employer, contributory, defined benefit pension plan established in 1962 by the Province for employees of municipalities, local boards and school boards in Ontario. Both participating employers and employees are required to make plan contributions based on participating employees’ contributory earnings. The Corporation recognizes the expense related to this plan as contributions are made.

***Employee future benefits other than pension***

Employee future benefits other than pension provided by the Corporation include medical and life insurance benefits, accumulated sick leave credits and voluntary exit incentive program liability. These plans provide benefits to employees when they are no longer providing active service. Employee future benefit expense is recognized in the period in which the employees render services on an accrual basis.

The accrued benefit obligations and current service cost are calculated using the projected benefit method prorated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. The excess of the net actuarial gains (losses) over 10% of the accrued benefit obligation is amortized into expense on a straight-line basis over the average remaining service period of active employees to full eligibility. The effects of a curtailment gain or loss are recognized in income in the year of the event giving rise to the curtailment. The effects of a settlement gain or loss are recognized in the period in which a settlement occurs.

## *m) Customers' advance deposits*

Customers' advance deposits are cash collections from customers to guarantee the payment of energy bills. The customers’ advance deposits liability includes interest credited to the customers’ deposit accounts, with the debit charged to interest expense. Deposits expected to be refunded to customers within the next fiscal year are classified as a current liability.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2007

### *n) Asset retirement obligations*

The Corporation recognizes a liability for the future environmental remediation of certain properties and for future removal and handling costs for contamination in distribution equipment and in storage. Initially, the liability is measured at present value and the amount of the liability is added to the carrying amount of the related asset. In subsequent periods, the asset is depreciated and the liability is adjusted quarterly for the discount applied upon initial recognition of the liability [“accretion expense”] and for changes in the underlying assumptions. The liability is recognized when the asset retirement obligation [“ARO”] is incurred and when the fair value is determined.

### *o) Use of estimates*

The preparation of the Corporation’s consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that 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 year. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Minister of Energy or the Minister of Finance.

## 5. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consist of the following:

| | 2007 | | | 2006 | | |
|---|---|---|---|---|---|---|
| | Cost<br>$ | Accumulated depreciation<br>$ | Net book value<br>$ | Cost<br>$ | Accumulated depreciation<br>$ | Net book value<br>$ |
| Land | **4,078** | **—** | **4,078** | 4,088 | — | 4,088 |
| Buildings | **148,178** | **47,244** | **100,934** | 145,281 | 44,016 | 101,265 |
| Stations | **202,394** | **106,143** | **96,251** | 191,833 | 99,988 | 91,845 |
| Distribution lines | **2,180,917** | **1,109,103** | **1,071,814** | 2,069,674 | 1,024,020 | 1,045,654 |
| Transformers | **514,921** | **282,415** | **232,506** | 493,878 | 264,308 | 229,570 |
| Meters | **196,175** | **88,485** | **107,690** | 131,886 | 80,032 | 51,854 |
| Other capital assets | **67,214** | **33,423** | **33,791** | 44,770 | 30,342 | 14,428 |
| Communications | **87,672** | **53,717** | **33,955** | 73,041 | 45,629 | 27,412 |
| Computer hardware | **42,902** | **37,484** | **5,418** | 39,511 | 35,237 | 4,274 |
| Rolling stock | **56,234** | **42,209** | **14,025** | 57,237 | 44,243 | 12,994 |
| Equipment and tools | **34,548** | **25,026** | **9,522** | 33,168 | 23,488 | 9,680 |
| Construction in progress | **112,838** | **—** | **112,838** | 64,282 | — | 64,282 |
| | **3,648,071** | **1,825,249** | **1,822,822** | 3,348,649 | 1,691,303 | 1,657,346 |

At December 31, 2007, spare transformers with carrying amounts of $6,758,000 [2006 - $5,486,000], are included in “Property, plant and equipment, net” *[note 4[b] “Spare transformers”].* In the absence of rate regulation, inventory would have been $6,758,000 higher [2006 - $5,486,000].

For the year ended December 31, 2007, AFUDC in the amount of $3,444,000 [2006 - $nil] was capitalized to property, plant and equipment and credited to interest expense. In the absence of rate regulation, property, plant and

equipment would have been $3,444,000 lower [2006 - $nil] and interest expense would have been $3,444,000 higher [2006 - $nil].

At December 31, 2007, net book value of stranded meters related to the deployment of smart meters amounting to $28,034,000 [2006 - $12,185,000] is included in "property, plant and equipment, net". In the absence of rate regulation, property, plant and equipment would have been $28,034,000 lower [2006 - $12,185,000] and loss on disposal of property, plant and equipment would have been $15,849,000 higher [2006 - $12,185,000].

## 6. INTANGIBLE ASSETS, NET

Intangible assets consist of the following:

| | 2007 | | | 2006 | | |
|---|---|---|---|---|---|---|
| | Cost $ | Accumulated amortization $ | Net book value $ | Cost $ | Accumulated amortization $ | Net book value $ |
| Land rights | **10,350** | **2,227** | **8,123** | 10,229 | 2,022 | 8,207 |
| Computer software | **132,297** | **97,644** | **34,653** | 118,861 | 86,070 | 32,791 |
| Capital contributions | **2,043** | **279** | **1,764** | 2,043 | 197 | 1,846 |
| Software in development | **18,773** | **—** | **18,773** | 5,944 | — | 5,944 |
| | **163,463** | **100,150** | **63,313** | 137,077 | 88,289 | 48,788 |

## 7. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

| | 2007 $ | 2006 $ |
|---|---|---|
| Regulatory assets recovery account | **9,660** | 37,510 |
| Smart meters | **2,357** | 29,018 |
| Lost revenue adjustment mechanism and shared savings mechanism | **6,536** | — |
| | **18,553** | 66,528 |

Regulatory liabilities consist of the following:

| | 2007 $ | 2006 $ |
|---|---|---|
| Pre-market opening line loss variance | **3,965** | 2,880 |
| Settlement variances | **48,121** | 7,990 |
| Other | **7,065** | 970 |
| | **59,151** | 11,840 |

For the year ended December 31, 2007, LDC recovered approved regulatory assets amounts of $28,368,000 through permitted distribution rate adjustments [2006 – $26,877,000]. These recovery amounts are for the recovery of approved regulatory assets recorded in reporting periods prior to January 1, 2005.

For the years ended December 31, 2007 and December 31, 2006, recovery amounts were credited directly to reduce the regulatory assets recovery account. The regulatory assets and liabilities balances of the Corporation are defined as follows:

**[a] Regulatory assets recovery account**

On March 31, 2005, the OEB ordered that the approved regulatory asset balances be aggregated into a single regulatory account. Approved regulatory assets of $71,465,000 consisted of transition costs of $37,868,000, pre-market opening energy electricity variance of $26,129,000 and settlement variances of $31,852,000, less recoveries of $24,384,000, which were transferred to the "regulatory asset recovery account" ["RARA"]. This approved balance will be recovered over a period ending March 31, 2008. The RARA is credited with recovery amounts and is debited by OEB-prescribed carrying charges. In the absence of rate regulation, interest income in 2007 would have been $291,000 lower [2006 - $1,685,000].

The transition costs and pre-market opening energy electricity variance are defined as follows:

[i] Transition costs

The OEB allowed LDC to defer the costs incurred to align systems and practices with the requirements of the competitive electricity market in Ontario in accordance with the *Ontario Energy Board Act, 1998*. Accordingly, the Corporation has deferred these expenditures in accordance with the criteria set out in the OEB's Electricity Distribution Rate Handbook and the AP Handbook.

Under such regulation, expenditures were allowed to be deferred during the period January 1, 2000 to December 31, 2002, which would be capitalized or expensed under Canadian GAAP for unregulated businesses. For the period January 1, 2003 to March 31, 2005, transition costs were increased for carrying charges in accordance with the OEB's direction.

[ii] Pre-market opening energy electricity variance

The OEB has allowed LDC to recognize the pre-market opening energy electricity variance for the period January 1, 2001 to April 30, 2002, the date of market opening. The pre-market opening energy variance represented the difference between LDC's cost of power purchased based upon time-of-use ["TOU"] rates and the amounts billed for the cost of power to non-TOU customers at an average rate for the same period. Accordingly, the Corporation has deferred these expenditures in accordance with the criteria set out in the AP Handbook.

Under such regulation, the deferred expenditures would have been expensed under Canadian GAAP for unregulated businesses. For the period January 1, 2001 to March 31, 2005, the pre-market opening energy electricity variance was increased for carrying charges in accordance with the OEB's direction.

**[b] Smart Meters**

In support of the Province of Ontario'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 has installed approximately 416,000 meters as at December 31, 2007.

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

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.

Following this decision, the Corporation ceased to defer capital expenditures, operating and depreciation expenses and revenue related to the deployment of 2006 and 2007 smart meters, resulting in a decrease in regulatory assets of $58,573,000, an increase in property, plant and equipment of $61,948,000, an increase in revenue of $10,806,000, an increase in operating expenses of $2,427,000, an increase in depreciation and amortization of $3,238,000 and a decrease in interest income of $1,766,000.

**[c] Lost Revenue Adjustment Mechanism and Shared Savings Mechanism.**

On September 11, 2007, LDC received approval from the OEB to recover $2,900,000 for LRAM which represents the lost revenue from CDM programs and $4,300,000 for SSM which represents its share of provincial savings related to these programs delivered in 2005 and 2006. Following this decision, the Corporation also recognized the LRAM and SSM balances relating to CDM programs delivered in 2007, which amounted to $1,300,000 and $200,000 respectively. The impact of this decision resulted in an increase in revenue amounting to $8,700,000 and an increase in regulatory assets amounting to $8,700,000 for 2007.

**[d] Pre-market opening line loss variance**

The OEB has allowed LDC to defer the pre-market opening line loss variance for the period June 1, 2001 to April 30, 2002. This balance represents the variance between amounts charged by LDC to customers for the OEB-approved loss adjustment factor and LDC actual loss adjustment factor. Accordingly, the Corporation has deferred this variance in accordance with the OEB's direction. Under such direction, the deferred variance would be recorded as revenue under Canadian GAAP for unregulated businesses. In the absence of rate regulation, there would have been no impact on the Consolidated Statement of Income for 2007 and 2006.

In 2007, the Corporation recorded carrying charges of $1,085,000 [2006 - $nil] on the deferred variance retroactively for the period May 1, 2002 to December 31, 2007, to coincide with the proposed disposition of the variance in the August 2, 2007 rate application. In the absence of rate regulation, interest income in 2007 would have been $1,085,000 higher [2006 - $nil]. The manner and timing of disposition of the variance have not been determined by the OEB.

**[e] Settlement variances**

The OEB has allowed LDC to defer settlement variances from May 1, 2002 to December 31, 2007. This balance represents the variances between amounts charged by LDC to customers (based on regulated rates) and the corresponding cost of non-competitive electricity service incurred by LDC after May 1, 2002. The settlement variances relate primarily to service charges, non-competitive electricity charges, imported power charges and the global adjustment. Accordingly, LDC has deferred these recoveries in accordance with the criteria set out in the AP Handbook.

Settlement variances of $27,980,000 relating to the period from May 1, 2002 to December 31, 2004, were approved for recovery by the OEB and are included in the RARA balance. The remaining balance, representing settlement variances arising after January 1, 2005, is deferred in a regulatory liability account.

The deferred balance for unapproved settlement variances continues to be calculated and attract carrying charges in accordance with the OEB's direction. The manner and timing of disposition of the variance have not been determined by the OEB. In the absence of rate regulation, interest income in 2007 would have been $1,150,000 higher [2006 - $49,000 lower].

**[f] Other**

As at December 31, 2007, LDC has accumulated a PILs variance amount representing differences that have resulted from a legislative or regulatory change to the tax rates or rules assumed in the rate adjustment model totalling an over-recovery of $7,065,000 [2006 - $1,702,000].

## 8. OTHER ASSETS

Other assets consist of the following:

| | **2007**<br>**$** | **2006**<br>**$** |
|---|---|---|
| Deferred debt issue costs, net of accumulated amortization of $nil [2006 - $1,412,000] | — | 2,457 |
| Other | **485** | 121 |
| | **485** | 2,578 |

In accordance with the adoption of CICA Handbook Section 3855 - "Financial Instruments - Recognition and Measurement", the Corporation transferred from other assets the deferred debt issue costs, net of accumulated amortization, totalling $3,985,000, on the Corporation's balance sheet to a reduction of the principal amount of the "Debentures" [*note 11*].

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
[all tabular amounts in thousands of dollars]

December 31, 2007

## 9. BANK INDEBTEDNESS, BANKERS' ACCEPTANCES AND LETTERS OF CREDIT

On December 17, 2007, the Corporation amended and extended its revolving credit facility with a syndicate of Canadian banks [the “Revolving Credit Facility”] for a two-year period to May 3, 2010. 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 and LDC capital expenditure 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 TH Energy and general credit requirements of the Corporation and its subsidiaries.

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

At December 31, 2007, $45,083,000 [December 31, 2006 - $81,620,000] had been utilized under the revolving credit facility in the form of letters of credit to support the prudential requirements of LDC. At December 31, 2007, no amounts had been drawn for working capital purposes [December 31, 2006 - $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. At December 31, 2007, no amounts had been drawn on the line of credit [December 31, 2006 - $nil].

## 10. CURRENT PORTION OF OTHER LONG-TERM LIABILITIES

Current portion of other long-term liabilities consist of the following:

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| Current portion of obligations under capital leases *[note 20]* | **190** | 733 |
| Customers' advance deposits | **17,677** | 15,904 |
| Other | **1,109** | 315 |
| | **18,976** | 16,952 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
[all tabular amounts in thousands of dollars]

December 31, 2007

## 11. LONG-TERM DEBT

Long-term debt consists of the following:

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| Senior unsecured debentures | | |
| Series 1 - 6.11% due May 7 2013 | **222,620** | 225,000 |
| Series 2 - 5.15% due November 14, 2017 | **248,395** | — |
| Promissory note payable to the City | **735,173** | 980,231 |
| | **1,206,188** | 1,205,231 |
| Less: Current portion of promissory note payable to the City | **—** | 245,058 |
| Long-term debt | **1,206,188** | 960,173 |
| **Comprising:** | | |
| Debentures | **471,015** | 225,000 |
| Promissory note payable to the City | **735,173** | 735,173 |

All long-term debt of the Corporation ranks equally.

### *a) Senior unsecured debentures*

On May 7, 2003, the Corporation issued $225,000,000 10-year senior unsecured debentures [“Series 1”]. The Series 1 debentures 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 Series 1 debentures mature on May 7, 2013.

On November 14, 2007, the Corporation issued $250,000,000 10-year senior unsecured debentures [“Series 2”]. The Series 2 debentures bear interest at the rate of 5.15% per annum, 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.

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.

In accordance with the adoption of CICA Handbook Section 3855 - "Financial Instruments - Recognition and Measurement", the Corporation recorded the deferred debt issue costs, net of accumulated amortization, totalling $3,985,000, on the Corporation’s balance sheet in reduction of the principal amount of the debentures.

### *b) Promissory note payable to the City of Toronto*

LDC issued a promissory note to the City on July 1, 1999 ["Initial Note"] in the principal amount of $947,000,000 in partial consideration for the assets in respect of the electricity distribution system transferred by the Toronto Hydro-Electric Commission and the City to LDC effective July 1, 1999. The Initial Note was non-interest bearing until December 31, 1999 and interest bearing thereafter at the rate of 6% per annum. Pursuant to the Transfer By-law, the principal amount of the Initial Note was adjusted effective January 1, 2000 to $980,231,000 to reflect the deemed debt to equity structure of LDC [65:35] permitted by the OEB. At the same time, the Initial Note was replaced by a promissory note ["Replacement Note"] issued by LDC, which was interest bearing at the rate of 6.8% per annum. At December 31, 2002, the Replacement Note was payable on the earlier of demand and December 31, 2003.

Concurrent with the closing of the debenture offering on May 7, 2003, the City transferred the Replacement Note to the Corporation in consideration for the issue by the Corporation to the City of a new promissory note in the principal amount of $980,231,000 [the "City Note"].

On September 5, 2006, the Corporation announced that it and the City had amended and restated the City Note effective May 1, 2006 by fixing the interest rate at 6.11% and establishing an agreed repayment schedule. The Corporation is required to pay the principal amount of the note as follows: $245,058,000 on the last business day before each of December 31, 2007, December 31, 2009, December 31, 2011 and on May 6, 2013. Interest is calculated and payable quarterly in arrears on the last business day of March, June, September and December of each year.

On December 31, 2007, the Corporation made the first scheduled payment of $245,058,000 to the City in accordance with the terms of the City Note. Accordingly, the remainder of the principal amount outstanding under the City Note is classified as a long-term liability.

## 12. EMPLOYEE FUTURE BENEFITS

### *Pension*

For the year ended December 31, 2007, the Corporation's OMERS current service pension costs were $11,055,000 [2006 - $10,343,000].

### *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. The Corporation pays certain medical and life insurance benefits under unfunded defined benefit plans on behalf of its retired employees. The Corporation pays accumulated sick leave credits, up to certain established limits based on service, in the event of retirement, termination or death of certain employees.

The Corporation measures its accrued benefits obligation for accounting purposes as at December 31 of each year. The latest actuarial valuation was performed as at January 1, 2007.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2007

**[a] Accrued benefit obligation**

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| Balance at beginning of year | **167,461** | 167,013 |
| Experience gain at beginning of year | **(2,344)** | — |
| Current service cost | **3,715** | 3,907 |
| Interest cost | **8,740** | 8,412 |
| Benefits paid | **(4,711)** | (5,372) |
| Actuarial gains | **(7,200)** | (6,499) |
| **Balance at end of year** | **165,661** | 167,461 |

**[b] Reconciliation of the accrued benefit obligation to the balance sheet accrued benefits liability**

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| Accrued benefit obligation | **165,661** | 167,461 |
| Unamortized net actuarial loss | **(16,223)** | (26,593) |
| Unamortized past service costs | **(5,083)** | (6,186) |
| **Post-employment benefits liability** | **144,355** | 134,682 |

**[c] Components for net periodic defined benefit costs**

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| Current service cost | **3,715** | 3,907 |
| Interest cost | **8,740** | 8,412 |
| Actuarial gains | **(9,544)** | (6,499) |
| Cost incurred in the year | **2,911** | 5,820 |
| **Differences between costs incurred and costs recognized in the year in respect of:** | | |
| Actuarial loss | **10,137** | 7,789 |
| Past service costs | **965** | 985 |
| | **11,102** | 8,774 |
| **Defined benefit costs recognized** | **14,013** | 14,594 |
| Capitalized as part of property, plant and equipment | **5,610** | 6,385 |
| **Charged to operations** | **8,403** | 8,209 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2007

**[d] Significant assumptions**

| | 2007<br>% | 2006<br>% |
|---|---|---|
| **Accrued benefit obligation as of December 31:** | | |
| Discount rate | **5.5** | 5.3 |
| Rate of compensation increase | **4.0** | 4.0 |
| **Benefit costs for years ended December 31:** | | |
| Discount rate | **5.3** | 5.0 |
| Rate of compensation increase | **4.0** | 4.0 |
| **Assumed health care cost trend rates at December 31:** | | |
| Rate of increase in dental costs | **4.0** | 4.5 |

For December 31, 2007, medical costs are assumed to increase at 9.0% [2006 - 10.5%] graded down by 0.5% [2006 - 1.0%] annual decrements to 5.0% [2006 - 4.5%] in 2016 and thereafter.

**[e] Sensitivity analysis**

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage-point change in assumed health care cost trend rates have the following effects for 2007:

| | Increase<br>$ | Decrease<br>$ |
|---|---|---|
| Net periodic benefit cost (at 5.3%) | **2,367** | (1,766) |
| Accrued benefit obligation at December 31, 2007 (at 5.5%) | **27,768** | (21,093) |

## 13. OTHER LONG-TERM LIABILITIES

Other long-term liabilities consist of the following:

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| Obligations under capital leases *[note 20]* | **474** | 1,033 |
| Security deposits | **1,447** | 1,575 |
| Other | **3,680** | 1,341 |
| | **5,601** | 3,949 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
[all tabular amounts in thousands of dollars]

December 31, 2007

During 2007, the Corporation acquired "Property, plant and equipment" through capital lease transactions totaling $295,000 [2006 - $556,000]. These non-cash transactions have been excluded from the Consolidated Statement of Cash Flows.

## 14. ASSET RETIREMENT OBLIGATIONS

A reconciliation between the opening and closing ARO liability balances is as follows:

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| Balance, beginning of year | **7,581** | 5,691 |
| ARO liabilities incurred in the year | **(369)** | 2,039 |
| ARO liabilities settled in the year | **(85)** | (509) |
| Accretion expense | **396** | 360 |
| **Balance, end of year** | **7,523** | 7,581 |

At December 31, 2007, the Corporation estimates the undiscounted amount of cash flows required over the next ten years to settle the ARO is $10,822,000 [2006 - $11,372,000]. Discount rates ranging from 4.3% to 6.0% were used to calculate the carrying value of the ARO liabilities. No assets have been legally restricted for settlement of the liability.

## 15. FINANCIAL INSTRUMENTS

### *a) Credit risk*

Financial instruments result in exposure to credit risk stemming from the risk of the counter-party defaulting on its obligations. The Corporation monitors and limits its exposure to counter-parties with lower credit ratings and evaluates its counter-party credit exposure on a continuous basis. The Corporation provides reserves for credit risks based on the financial condition and short and long-term exposures to counter-parties.

The Corporation provides for an allowance for doubtful accounts to absorb credit losses. At December 31, 2007, there were no significant concentrations of credit risk with respect to any class of financial assets.

### *b) 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 9]*, the Corporation may obtain 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 90 days, exposing the Corporation to fluctuations in short-term interest rates. These fluctuations could impact the level of interest income earned by the Corporation.

### *c) Fair value of financial instruments*

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 December 31, 2007, the fair values of the City Note [$735,173,000] and the senior unsecured debentures [$475,000,000] are $766,445,000 and $491,243,000 [2006 - $1,034,640,000 and $247,515,000]. 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 11]*.

## 16. FINANCIAL GUARANTEES

Participants in the electricity market 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.

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. At December 31, 2007, the Corporation's board of directors had approved $nil in parental guarantees on behalf of TH Energy [2006 - $386,000,000], of which $nil has been issued to unrelated parties [2006 - $56,500,000].

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2007

## 17. 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:

***Consolidated Statement of income***

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| **Rate reconciliation** | | |
| Income before PILs | **99,608** | 148,622 |
| Consolidated Statutory Canadian federal and provincial income tax rate | **36.12%** | 36.12% |
| Expected provision for PILs | **35,978** | 53,682 |
| Temporary differences not benefited | **1,017** | 3,482 |
| Valuation allowance | **(5,347)** | 1,150 |
| Decrease in federal future tax rates | **1,578** | 2,215 |
| Permanent difference on sale of discontinued operations | **5,046** | — |
| Other | **2,703** | (2,126) |
| **Provision for PILs** | **40,975** | 58,403 |
| **Effective tax rate** | **41.14%** | 39.30% |
| **Components of provision for PILs** | | |
| Current tax provision | **39,930** | 60,891 |
| Future income tax provision (recovery) related to the origination and reversal of temporary differences | **1,045** | (2,488) |
| **Provision for PILs** | **40,975** | 58,403 |

***Consolidated Balance sheet***

Significant components of the Corporation's future income tax assets and liabilities are as follows:

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| Non-capital loss carryforwards | **595** | 576 |
| Property, plant and equipment and intangible assets | **19,647** | 27,968 |
| Other taxable temporary differences | **6,552** | 4,735 |
| Valuation allowance | **(11,407)** | (16,847) |
| | **15,387** | 16,432 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

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***Presented on the consolidated balance sheet as follows:***

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| Future income tax assets, current | **710** | 791 |
| Future income tax assets, long-term | **15,031** | 16,009 |
| Future income tax liabilities, long-term | **(354)** | (368) |
| | **15,387** | 16,432 |

Under the taxes payable method applicable to LDC, no adjustments are made for differences between the financial statement carrying values and the tax basis of assets and liabilities. As at December 31, 2007, future income tax assets of $186,779,000 [2006 - $234,217,000], based on substantively enacted income tax rates, have not been recorded. In the absence of rate regulated accounting, the Corporation's provision for PILs would have been recognized using the liability method rather than the taxes payable method. As a result, the provision for PILs in 2007 would have been $1,017,000 lower [2006 – $3,482,000][*note 4 [b]*].

As at December 31, 2007, the Corporation has accumulated tax losses for PILs purposes of approximately $2,053,000 [2006 - $1,744,000], which are available to reduce future years' taxable income. These loss carry forwards begin to expire in 2008.

## 18. SHARE CAPITAL

Share capital consists of the following:

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| **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 |

### *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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
[all tabular amounts in thousands of dollars]

December 31, 2007

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. The dividends are not cumulative and 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 fiscal 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.

During 2007, the board of directors of the Corporation declared and paid dividends totaling $46,200,000 to the City [2006 - $46,200,000].

## 19. 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 year ended December 31, 2007, LDC provided electricity to the City in the amount of $96,205,000 [2006 - $102,771,000] at prevailing market prices and normal trade terms. At December 31, 2007, included in "unbilled revenue" is a balance amounting to $8,283,000 [December 31, 2006 - $8,753,000] receivable from the City related to the provision of electricity for the month of December.

For the year ended December 31, 2007, LDC provided services related to the distribution of electricity to the City in the amount of $10,838,000 [2006 - $9,281,000]. At December 31, 2007, included in "Accounts receivable, net of allowance for doubtful accounts" is $2,617,000 [December 31, 2006 - $2,320,000] receivable from the City related to these services.

For the year ended December 31, 2007, TH Energy provided energy efficiency products and services, street lighting services and consolidated billing services to the City amounting to $19,540,000 [2006 - $17,297,000]. At December 31, 2007, included in "Accounts receivable, net of allowance for doubtful accounts" is $6,001,000 [December 31, 2006 - $5,905,000] receivable from the City related to these services.

For the year ended December 31, 2007, LDC purchased services of $6,916,000 [2006 - $4,874,000] from the City. At December 31, 2007, included in "Accounts payable and Accrued liabilities" is $3,353,000 [December 31, 2006 - $538,000] payable to the City related to services received from the City.

For the year ended December 31, 2007, LDC and TH Energy paid property tax expenses to the City of $6,365,000 [2006 - $7,306,000].

For the year ended December 31, 2007, Telecom incurred municipal access fees to the City totalling $913,000 [2006 $172,000]. At December 31, 2007, included in "Accounts payable and Accrued liabilities" is $75,000 [December 31, 2006 - $5,031,000] payable to the City related to these fees.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]



At December 31, 2007, a promissory note in the amount of $735,173,000 [December 31, 2006 - $980,231,000] was payable to the City. On December 31, 2007, the Corporation made the first scheduled payment of $245,058,000 to the City in accordance with the terms of the City note. For the year ended December 31, 2007, interest of $59,892,000 [2006 - $62,147,000], on the promissory note was paid to the City [*note 11*].

## 20. LEASE COMMITMENTS

### *Operating lease obligations*

As at December 31, 2007, the future minimum annual lease payments under property and computer hardware operating leases with remaining lease terms from one to five years are as follows:

| | $ |
|---|---|
| 2008 | **5,823** |
| 2009 | **5,578** |
| 2010 | **5,429** |
| 2011 | **5,122** |
| 2012 | **1,580** |
| Thereafter | **1,538** |
| **Total minimum lease payments** | **25,070** |

### *Capital lease obligations*

As at December 31, 2007, the future minimum annual lease payments under capital leases with remaining lease terms from one to five years are as follows:

| | $ |
|---|---|
| 2008 | **229** |
| 2009 | **215** |
| 2010 | **181** |
| 2011 | **124** |
| 2012 | **8** |
| Total amount of future minimum lease payments | **757** |
| Less interest | **93** |
| | **664** |
| Current portion *[note 10]* | **190** |
| Long-term portion *[note 13]* | **474** |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2007

## 21. 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 consolidated 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 the Corporation's reported tax obligations upon reassessment. As the audit has not yet been completed, management is not able to determine the impact, if any, of the audit on the consolidated financial statements or the Corporation's tax reserves. The Corporation adjusts its tax reserves when there is sufficient information available, or when an event occurs requiring a change to the reserves.

### *b) Legal Proceeding*

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

On February 4, 2008, the OEB, in response to an application filed by Enbridge, ruled that all of Enbridge's costs related to settlements of the class action lawsuits, including legal costs, settlement costs and interest, are recoverable from ratepayers.

LDC is not a party to the Enbridge 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 Enbridge 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 Enbridge 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 Enbridge class action.

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

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. Also, decisions of the OEB are fact specific in each circumstance and the decisions of the OEB in respect of Enbridge's application for recovery of costs related to the settlement is not necessarily determinative of the outcome of any similar application which LDC may make to the OEB in the future. 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.

## 22. INVESTMENTS HELD TO MATURITY

At December 31, 2007, the Corporation held third party ABCP notes issued by a number of trusts with an aggregate principal amount of $88,000,000. On the dates the Corporation purchased these notes, they were rated R1(High), by DBRS Limited ["DBRS"], the highest credit rating issued for commercial paper. These notes matured during the third quarter of 2007 but were not repaid at that time, due to the liquidity issues in the ABCP market. The Corporation's ABCP notes last traded in the active market on or about August 13, 2007 and there are currently no market quotations available. As a result, the Corporation has classified its ABCP notes as Investments Held to Maturity, and presented them as long-term assets, after initially classifying them as Cash and cash equivalents.

On August 16, 2007, a group representing banks, asset providers and major investors [the "Montreal Committee"] agreed in principle to a long-term proposal and interim arrangements regarding the restructuring of the affected ABCP notes [the "Montreal Proposal"] into long-term Floating Rate Notes ["FRNs"] maturing no earlier than the scheduled maturity of the underlying assets. The restructuring proposal is expected to be completed by the end of March 2008. During the restructuring period, 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 developing implications".

On December 23, 2007, the Montreal Committee released certain details about the proposed restructuring. It is expected that under the Montreal Proposal, the ABCP notes will be grouped into three large asset pools that reflect the credit quality and similarities of the underlying assets. Upon completion of the restructuring, separate FRNs will be issued from each of the generic asset pools. Based on this and other public information, it is estimated that of the Corporation's $88,000,000 of ABCP notes:

- $81,300,000 will be represented by a combination of leveraged collateralized debt, synthetic assets and traditional securitized assets which, upon completion of the restructuring, will be replaced by senior and subordinated long-term FRNs. Current indications are that the senior notes will receive a AAA rating from two rating agencies, while the subordinated notes are likely to be unrated. The senior notes will pay quarterly interest in cash, reflecting money market rates, and the subordinated notes will begin paying principal and interest upon maturity of the senior notes; and

- $6,700,000 will be represented by assets that have exposures to U.S. sub-prime or home equity loans and mortgages. Separate "tracking notes" will be issued for these assets based on maturities of the underlying assets. These notes are expected to amortize and be repaid in part from time-to-time as the underlying assets mature or as value can be realized via asset sales.

The valuation technique used by the Corporation to estimate the fair value of its investments in ABCP notes incorporates probability-weighted discounted cash flows considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments and a mark-to-model valuation of the notes, as at December 31, 2007. The assumptions used in determining the estimated fair value reflect the public statements made by the Montreal Committee that it expects the ABCP notes will be converted into various long-term FRNs, as discussed above, with maturities reflecting the maturities of the underlying assets and bearing market interest rates commensurate with the nature of the underlying assets and their associated cash flows and the credit rating and risk associated with the long-term FRNs. The interest rates and maturities of the various long-term FRNs, discount rates and credit losses modelled are:

| | |
|---|---|
| Weighted average interest rate | 4.5 per cent |
| Weighted average long-term discount rate | 5.6 per cent |
| Maturity of long-term floating rate notes | 7 years |
| Credit losses | 2 to 40 per cent on a going concern basis |
| | 30 per cent on a liquidation basis |

Interest rates and credit losses vary by each of the different replacement long-term FRNs to be issued as each is expected to have different credit ratings and risk. Interest rates and credit losses also vary by the different probable cash flow scenarios that have been modelled.

Discount rates vary depending upon the credit rating of the replacement long-term FRNs. Maturities vary by different replacement long-term floating rate notes as a result of the expected maturity of the underlying assets. In addition, assumptions have also been made as to the amount of the restructuring costs that the Corporation will incur.

Based on the assumptions described above, the probability weighted cash flows resulted in an estimated fair value of the Corporation's investment in ABCP of $74,941,000 at December 31, 2007. This was unchanged from the estimated fair value at September 30, 2007. The reduction in the fair value of $13,059,000 compared to the maturity value of the ABCP notes was recorded as a charge to income in the Consolidated Financial Statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2007

The estimation by the Corporation of the fair value of its ABCP notes, as at December 31, 2007, is subject to significant risks and uncertainties, including 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.

## 23. NET INCOME PER SHARE

The weighted daily average numbers of shares outstanding were 1,000 as at December 31, 2007 and 2006, for purposes of determining basic and fully diluted net income per share for continuing and discontinued operations. Basic and fully diluted net income per share for continuing and discontinued operations were determined by dividing the net income for the year by the weighted daily average number of shares outstanding.

## 24. 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. The net assets from discontinued operations are as follows:

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| **Current assets from discontinued operations** | | |
| Property, plant and equipment | — | 12,098 |
| **Current liabilities from discontinued operations** | | |
| Accounts payable and accrued liabilities | **82** | 103 |
| Payments in lieu of corporate taxes payable | **2,792** | 803 |
| | **2,874** | 906 |

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

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| **Revenues** | **1,779** | 8,085 |
| **Expenses** | | |
| Purchased power and other | **506** | 1,820 |
| Operating expenses | **1,087** | 879 |
| Depreciation and amortization | **—** | 2,405 |
| | **1,593** | 5,104 |
| Provision for payments in lieu of corporate taxes | **111** | 803 |
| Gain on sale of water heater business – net of tax | **24,123** | — |
| **Income from discontinued operations** | **24,198** | 2,178 |

The water heater sale agreement included a six-month purchase price adjustment period commencing April 2, 2007. In connection with the provision of the purchase agreement, TH Energy incurred $271,000 in purchase price adjustments 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 year as a charge to income from discontinued operations.

## 25. 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 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 water heater 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
[all tabular amounts in thousands of dollars]

December 31, 2007

Segment information is as follows:

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| **Electricity distribution** | | |
| Revenues | **2,321,169** | 2,264,469 |
| Purchased power and other | **1,841,121** | 1,784,144 |
| Operating expenses | **172,722** | 169,064 |
| Depreciation and amortization | **137,020** | 124,560 |
| Income before interest, other and provision for payments in lieu of corporate taxes | **170,306** | 186,701 |
| Interest income | **8,141** | 11,225 |
| Interest expense | **72,129** | 76,537 |
| Other | **1,698** | 598 |
| Provision for payments in lieu of corporate taxes | **42,395** | 46,001 |
| Income from continuing operations | **65,621** | 75,986 |
| **Non-regulated** | | |
| Revenues | **70,880** | 75,511 |
| Purchased power and other | **22,143** | 14,654 |
| Operating expenses | **33,645** | 25,171 |
| Depreciation and amortization | **14,615** | 12,784 |
| Income before interest, impairment, other and provision for (recovery of) payments in lieu of corporate taxes | **477** | 22,902 |
| Interest income | **79,052** | 84,520 |
| Interest expense | **74,919** | 80,278 |
| Impairment of investments held to maturity | **13,059** | — |
| Other | **41** | (509) |
| Provision for (recovery of) payments in lieu of corporate taxes | **(1,420)** | 12,402 |
| Income (loss) from continuing operations | **(6,988)** | 14,233 |
| **Intersegment eliminations** | | |
| Revenues | **(2,871)** | (92,991) |
| Purchased power and other | **(2,764)** | (92,953) |
| Operating expenses | **(107)** | (38) |
| Interest income | **(73,125)** | (78,019) |
| Interest expense | **(73,125)** | (78,019) |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2007

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| **Total** | | |
| Revenues | **2,389,178** | 2,246,989 |
| Purchased power and other | **1,860,500** | 1,705,845 |
| Operating expenses | **206,260** | 194,197 |
| Depreciation and amortization | **151,635** | 137,344 |
| Income before interest, impairment, other and provision for payments in lieu of corporate taxes | **170,783** | 209,603 |
| Interest income | **14,068** | 17,726 |
| Interest expense | **73,923** | 78,796 |
| Impairment of investments held to maturity | **13,059** | — |
| Other | **1,739** | 89 |
| Provision for payments in lieu of corporate taxes | **40,975** | 58,403 |
| Income from continuing operations | **58,633** | 90,219 |

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| **Expenditures on property, plant and equipment and intangible assets** | | |
| Electricity distribution | **275,586** | 167,685 |
| Non-regulated | **25,265** | 22,934 |
| Intersegment eliminations | **(201)** | (5,312) |
| **Total** | **300,650** | 185,307 |

| | 2007<br>$ | 2006<br>$ |
|---|---|---|
| **Assets** | | |
| Electricity distribution | **2,402,649** | 2,280,811 |
| Non-regulated | **1,450,973** | 1,505,987 |
| Intersegment eliminations | **(1,181,097)** | (1,207,190) |
| Discontinued operations | — | 12,098 |
| **Total** | **2,672,525** | 2,591,706 |

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

## 26. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

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

## 27. SUBSEQUENT EVENTS

### *Dividends*

On March 5, 2008, the board of directors of the Corporation declared dividends in the amount of $22,416,000. The dividends are comprised of a $16,416,000 payment for 2007 net income, payable to the City on March 14, 2008 and a $6,000,000 payment in connection with the first quarter of 2008, payable to the City on March 31, 2008.