Consolidated Financial Statements

Toronto Hydro Corporation

DECEMBER 31, 2008

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Contents **Page**

Auditors' Report	**1**
Consolidated Balance Sheets	**2**
Consolidated Statements of Income	**3**
Consolidated Statements of Retained Earnings	**3**
Consolidated Statements of Cash Flows	**4**
Notes to Consolidated Financial Statements	**5**

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, 2008 and 2007 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, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Canada,
February 24, 2009 [except as to note 29 [a] and note 29 [b] which are as of March 10, 2009].

ERNST & YOUNG
A member firm of Ernst & Young Global Limited

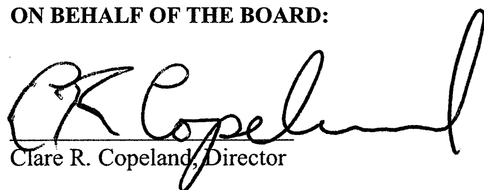
Toronto Hydro Corporation

CONSOLIDATED BALANCE SHEETS

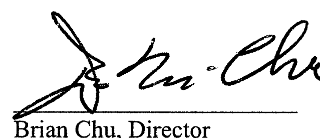
[in thousands of dollars]

As at December 31	2008 $	2007 $
ASSETS		
Current		
Cash and cash equivalents	340,492	216,002
Accounts receivable, net of allowance for doubtful accounts *[note 18[b]]*	131,582	155,413
Unbilled revenue	266,061	276,749
Payments in lieu of corporate taxes receivable	23,977	23,226
Inventories *[note 5]*	5,069	4,546
Prepaid expenses	2,503	1,646
Future income tax assets *[note 20]*	-	710
Total current assets	769,684	678,292
Property, plant and equipment, net *[note 6]*	1,853,606	1,845,136
Intangible assets, net *[note 7]*	66,701	63,313
Investments held to maturity *[notes 8 and 29[a]]*	52,908	74,941
Regulatory assets *[note 9]*	26,213	18,553
Other assets *[note 10]*	7,862	485
Future income tax assets *[note 20]*	2,809	15,031
Total assets	2,779,783	2,695,751
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities	294,810	289,621
Current portion of other liabilities *[note 12]*	17,382	18,976
Deferred revenue	3,274	8,546
Current portion of promissory note payable *[note 13]*	245,058	-
Liabilities from discontinued operations *[note 26]*	890	2,874
Total current liabilities	561,414	320,017
Long-term liabilities		
Debentures *[note 13]*	471,521	471,015
Promissory note payable *[note 13]*	490,115	735,173
Post-employment benefits *[note 14]*	152,771	144,355
Regulatory liabilities *[note 9]*	83,516	59,151
Other liabilities *[note 15]*	2,230	4,154
Asset retirement obligations *[note 16]*	6,528	7,523
Customers' advance deposits	30,283	25,314
Future income tax liabilities *[note 20]*	114	354
Total long-term liabilities	1,237,078	1,447,039
Total liabilities	1,798,492	1,767,056
Commitments and contingencies *[notes 23 and 24]*		
Shareholder's equity		
Share capital *[note 21]*	567,817	567,817
Retained earnings	413,474	360,878
Total shareholder's equity	981,291	928,695
Total liabilities and shareholder's equity	2,779,783	2,695,751

ON BEHALF OF THE BOARD:



Clare R. Copeland, Director



Brian Chu, Director

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

CONSOLIDATED STATEMENTS OF INCOME

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

Year ended December 31	2008 $	2007 $
Revenues	**2,382,542**	2,351,486
Costs		
Purchased power and other	**1,884,296**	1,853,874
Operating expenses	**205,472**	190,404
Depreciation and amortization	**156,347**	143,983
	2,246,115	2,188,261
Income before interest, impairment, other and provision for payments in lieu of corporate taxes	**136,427**	163,225
Interest income	**12,350**	13,949
Interest expense		
Long-term debt	**(71,542)**	(75,312)
Other interest	**(3,212)**	1,403
Impairment of investments held to maturity *[note 8]*	**(22,033)**	(13,059)
Other	**-**	1,674
Income before provision for payments in lieu of corporate taxes	**51,990**	91,880
Provision for payments in lieu of corporate taxes *[note 20]*	**5,697**	37,802
Income from continuing operations	**46,293**	54,078
Income from discontinued operations - net of tax *[note 26]*	**122,719**	28,753
Net income	**169,012**	82,831
Basic and fully diluted net income per share from continuing operations *[note 25]*	46,293	54,078
Basic and fully diluted net income per share from discontinued operations *[note 25]*	122,719	28,753
Basic and fully diluted net income per share	**169,012**	82,831

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

[in thousands of dollars]

Year ended December 31	2008 $	2007 $
Retained earnings, beginning of year	**360,878**	324,247
Net income	**169,012**	82,831
Dividends *[note 21]*	**(116,416)**	(46,200)
Retained earnings, end of year	**413,474**	360,878

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

Toronto Hydro Corporation

CONSOLIDATED STATEMENTS OF CASH FLOWS

[in thousands of dollars]

Year ended December 31	2008 $	2007 $
OPERATING ACTIVITIES		
Income from continuing operations	**46,293**	54,078
Adjustments for non-cash items		
Depreciation and amortization	**156,347**	143,983
Impairment of investments held to maturity *[note 8]*	**22,033**	13,059
Net change in other assets and liabilities	**(2,657)**	(17,998)
Post-employment benefits	**8,719**	9,520
Future income taxes *[note 20]*	**1,786**	(1,131)
Gain on disposals of property, plant and equipment	**-**	(1,674)
Changes in non-cash working capital balances		
Decrease in accounts receivable	**18,516**	64,342
Decrease (increase) in unbilled revenue	**10,290**	(59,605)
Decrease (increase) in inventories	**(523)**	987
Decrease (increase) in prepaid expenses	**(1,069)**	711
Increase in accounts payable and accrued liabilities	**8,161**	10,044
Decrease in deferred revenue	**(1,435)**	(2,662)
Increase in current portion of other liabilities	**171**	500
Net cash provided by operating activities	**266,632**	214,154
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	**(188,809)**	(265,430)
Purchase of intangible assets	**(26,098)**	(24,072)
Investments held to maturity *[note 8]*	**-**	(88,000)
Net change in regulatory assets and liabilities	**16,705**	64,081
Proceeds on disposal of property, plant and equipment	**599**	1,845
Net cash used in investing activities	**(197,603)**	(311,576)
FINANCING ACTIVITIES		
Decrease in promissory note payable	**-**	(245,058)
Dividends paid *[note 21]*	**(116,416)**	(46,200)
Proceeds from debentures	**-**	250,000
Increase in deferred debt issuance costs	**-**	(1,621)
Increase (decrease) in customers' advance deposits	**3,694**	(433)
Repayment of capital lease liability	**(200)**	(334)
Net cash used in financing activities	**(112,922)**	(43,646)
Net cash used in continuing operations	**(43,893)**	(141,068)
Net cash provided by discontinued operations	**168,383**	29,546
Net increase (decrease) in cash and cash equivalents during the year	**124,490**	(111,522)
Cash and cash equivalents, beginning of year	**216,002**	327,524
Cash and cash equivalents, end of year	**340,492**	216,002
Supplementary cash flow information		
Total interest paid	**72,606**	75,020
Payments in lieu of corporate income taxes	**33,751**	65,579

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, 2008

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"] activities.

[b] TH Energy [incorporated June 23, 1999] – which owns and operates street lighting and expressway lighting assets located in the City and is engaged in the sale of energy efficiency products and services to commercial and industrial customers.

[c] 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] *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).

[ii] *Electricity Price and Related Rebates*. The electricity price and related rebates represent a pass through of the commodity cost 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 adjustment necessary to achieve a market-based rate of return of 9.88%. The rate increase was effective as of April 1, 2005 and subjected 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 9]*. 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 market-based rate of return 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. Pursuant to that adjustment, 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 May 15, 2008, the OEB issued its decision regarding LDC's electricity distribution rates application for 2008, 2009 and 2010. In its decision, the OEB provided final approval for 2008 base distribution revenue requirement and rate base of $473,000,000 and $1,968,900,000, respectively. The allowable market-based rate of return percentage for LDC was set at 8.57% by the OEB for 2008. The OEB's decision also provides for an option for a mechanistic adjustment based on the then-prevailing incentive regulation mechanism, for 2010. It should be noted that the deemed debt to equity structure of LDC was modified to 62.5% debt and 37.5% equity for 2008 and to 60% debt and 40% equity for 2009 thereafter.

In its decision on LDC's rate application for 2008, 2009 and 2010, the OEB found that 100% of the net after-tax gains on the sale of certain LDC properties should be deducted from the revenue requirement recovered through distribution rates. The OEB deemed this amount to be $10,300,000 [the "deemed amount"]. On June 16, 2008, LDC filed an appeal with the Divisional Court of Ontario [the "Divisional Court"] seeking to overturn the gain on sale aspects of the OEB decision and also sought and obtained a stay order with respect to the deduction of the deemed amount from the revenue requirement recovered through rates. LDC expects that the appeal will be heard by the Divisional Court in 2009.

On December 15, 2008, LDC applied to the OEB to recover Lost Revenue Adjustment Mechanism [“LRAM”] and Shared Savings Mechanism [“SSM”] amounts related to CDM programs undertaken in 2007. The total of the recovery sought is $3,700,000.

On December 15, 2008, LDC applied to the OEB to refund to customers amounts related to the unanticipated extension for three months of rate riders that were to have expired April 30, 2008. The rate riders were extended by the OEB at LDC’s request to avoid rate instability prior to the implementation of 2008 rates as of August 1, 2008. In total, the extension produced excess collection of $7,700,000, which together with interest is proposed to be refunded to customers commencing May 1, 2009.

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 in the future.

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 LDC are reflected separately on the Corporation’s consolidated balance sheet until the manner and timing of disposition is determined by the OEB *[note 9]*.

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. 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.

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, was 4.72%, from July 1, 2007 to June 30, 2008, was 5.18%, and from July 1, 2008 to December 31, 2008, was 5.43%, and is applied to the balance of the construction-in-progress assets on a simple interest basis. Prospectively, AFUDC is included in property, plant and equipment and construction-in-progress for financial reporting purposes, charged to operations through depreciation over the service life of the related assets and recovered through future revenue.

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

Effective January 1, 2008, the Corporation adopted CICA Handbook Section 3031 – "Inventories" which is based on the International Accounting Standards Board's International Accounting Standard 2 and replaced existing CICA Handbook Section 3030. Under this new standard, inventories are required to be measured at the lower of cost and net realizable value and any items considered to be major future components of property, plant and equipment are to be transferred to property, plant and equipment. The new standard also provides updated guidance on the appropriate methods of determining cost and the impact of any write-downs to net realizable value. The implementation of this standard did not have any impact on the Corporation's results of operations.

Inventories consist primarily of maintenance and construction materials. The Corporation has retrospectively reclassified all major future components of its electricity distribution system infrastructure from inventory to property, plant and equipment. Once capitalized, these items are not amortized until they are put into service. Inventories are carried at the lower of cost and net realizable value, with cost determined on an average cost basis net of a provision for obsolescence.

e) Investments held to maturity

Investments held to maturity include third-party non-bank sponsored 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 consolidated balance sheet. Investments held to maturity are recorded at amortized cost, which, upon initial recognition, is considered equivalent to fair value. Under this classification, the Corporation recognizes impairments to net income when there is objective evidence that it is impaired and there is a decline in the fair value below amortized cost that is other than temporary. The impairment is the difference between the estimated fair value and the carrying amount of the investment *[note 8]*.

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 6.7%
Other capital assets	5.0% to 12.5%
Communications	10.0% 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.

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

Revenues from the sale of electricity are recorded on a basis of cyclical billings and also include unbilled revenues accrued in respect of electricity delivered but not yet billed.

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 LRAM and SSM are recognized as related programs are delivered and measurable.

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

TH Energy

Revenues from the delivery of street lighting and expressway lighting services are recorded as services are rendered.

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

k) Financial instruments

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. The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm’s length transaction between willing parties.

The Corporation classifies its financial instruments as follows and uses the following methods and assumptions to estimate the fair value of each class of financial instruments for which carrying amounts are included in the consolidated balance sheet:

- Cash is classified as “Assets Held-for-Trading” and is measured at fair value. The carrying amount approximates fair value because of the short maturity.
- 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. The carrying amounts approximate fair value because of the short maturity of these instruments.
- 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. The carrying amounts approximate fair value because of the short maturity of these instruments.
- 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. The carrying amount is reduced to its estimated fair value when there is objective evidence of impairment and there is a decline in fair value below amortized cost that is other than temporary. Estimated fair value has been determined using valuation techniques that incorporate discounted future cash flows reflecting market conditions and other factors that a market participant would consider *[note 8]*.
- Accounts payable and accrued liabilities 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. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Series 1 and Series 2 debentures and the City Note are classified as “Other Financial Liabilities” and are initially measured at their fair value. The carrying amounts of the Series 1 and Series 2 debentures and the City Note are carried at amortized cost, based on an initial fair value as determined at the time using quoted market price for similar debt instruments. The fair value of the Series 1 and Series 2 debentures and the City Note is calculated by discounting the related cash flows at the estimated yield to maturity of similar debt instruments *[note 18]*. 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 in the consolidated financial statements.

Effective January 1, 2008, the Corporation adopted CICA Handbook Sections 3862 – “Financial Instruments – Disclosures” and 3863 – “Financial Instruments – Presentation”, which establish the requirement of disclosure of risks associated with both recognized and unrecognized financial instruments and the management of those risks. The adoption of these standards did not have any impact on the Corporation’s results of operations or financial position *[note 18]*.

l) Capital disclosures

Effective January 1, 2008, the Corporation adopted CICA Handbook Section 1535 – “Capital Disclosures” which requires disclosure of the Corporation’s objectives, policies and processes for managing capital as well as its compliance with any external capital requirements. The implementation of this standard did not have any impact on the Corporation’s results of operations or financial position. The resulting disclosures from implementation are presented below *[note 17]*.

m) Employee future benefits

Pension plan

The Corporation provides a pension plan for its full-time employees through the 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, and accumulated sick leave credits. 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 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.

n) 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.

o) 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 in service 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.

p) 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.

q) Future Accounting Pronouncements

Rate Regulated Entities

During 2007, the Accounting Standards Board ["AcSB"] issued an exposure draft proposing to remove all specific references to rate regulated accounting from the CICA Handbook. In August 2007, the AcSB decided to remove a temporary exemption in CICA Handbook Section 1100 "Generally Accepted Accounting Principles", retain existing references to rate regulated accounting in the CICA Handbook, amend CICA Handbook Section 3465 "Income Taxes" to require the recognition of future income tax liabilities and assets as well as a corresponding regulatory asset or liability, and retain existing requirements to disclose the effects of rate regulation per AcG-19. The new rules will apply prospectively to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2009.

Currently, LDC uses the taxes payable method of accounting for income taxes. The estimated effect on the Corporation's consolidated financial statements, if it had adopted amended CICA Handbook Section 3465 as at December 31, 2008, would have been an increase in future income tax assets of $298,514,000, including an amount associated with income taxes that will become payable on future revenues as they are collected from customers when the tax timing differences reverse. There would also be a corresponding increase in regulatory liabilities of $298,514,000. There is no impact to opening retained earnings expected upon adoption of these amendments on January 1, 2009. The Corporation is continuing to assess and monitor any additional implications on its consolidated financial statements.

Goodwill and Intangible Assets and Other Standards

In January 2008, the CICA issued Handbook Section 3064, "Goodwill and Intangible Assets", and amended Handbook Section 1000, "Financial Statement Concepts", and Accounting Guideline 11 "Enterprises in the Development Stage" and withdrew Handbook Section 3450, "Research and Development Costs". Handbook Section 3064 clarifies that costs may only be deferred when they relate to an item that meets the definition of an asset. The concept of matching revenues and expenses remains appropriate for allocating the cost of an asset that is consumed in general revenue over multiple reporting periods. Handbook Section 3064 replaces Handbook Section 3062 and provides extensive guidance on when expenditures qualify for recognition as intangible assets. These changes are effective for fiscal years beginning on or after October 1, 2008. The Corporation is currently in the process of evaluating the potential impact of these standards on its consolidated financial statements.

International Financial Reporting Standards ["IFRS"]

On February 13, 2008, the AcSB confirmed that publicly accountable enterprises will be required to adopt IFRS in place of Canadian GAAP for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. A limited number of converged or IFRS-based standards will be incorporated into Canadian GAAP prior to 2011, with the remaining standards to be adopted at the change over date. The Corporation has an internal initiative to govern the conversion process and is currently in the process of evaluating the potential impact of the conversion to IFRS on its consolidated financial statements. At this time, the impact on the Corporation's future financial position and results of operations is not reasonably determinable or estimable.

5. INVENTORIES

Inventories consist of the following:

	2008 $	2007 $
Consumables, tools and other maintenance items	**1,478**	1,167
Fuses	**1,014**	1,105
Vehicle parts and supplies	**436**	463
Other	**2,235**	2,239
Less: Allowance for provisions	**(94)**	(428)
	5,069	4,546

As a result of the adoption of CICA Handbook Section 3031 – "Inventories", $17,683,000 was reclassified out of inventories and into property, plant and equipment as at December 31, 2008 [December 31, 2007 - $22,314,000]. For the year ended December 31, 2008, the Corporation recognized operating expenses of $5,822,000, related to inventory used in the servicing of electrical distribution assets [2007 - $5,728,000].

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

6. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consist of the following:

	2008			2007		
	Cost $	Accumulated depreciation $	Net book value $	Cost $	Accumulated depreciation $	Net book value $
Land	**4,073**	**—**	**4,073**	4,078	—	4,078
Buildings	**151,029**	**50,717**	**100,312**	148,178	47,244	100,934
Stations	**242,557**	**113,315**	**129,242**	202,394	106,143	96,251
Distribution lines	**2,324,813**	**1,197,962**	**1,126,851**	2,175,733	1,109,103	1,066,630
Transformers	**542,176**	**301,446**	**240,730**	514,921	282,415	232,506
Meters	**199,127**	**97,145**	**101,982**	196,175	88,485	107,690
Other capital assets	**65,612**	**38,413**	**27,199**	67,214	33,423	33,791
Communications	**29,351**	**23,381**	**5,970**	87,672	53,717	33,955
Computer hardware	**49,299**	**40,055**	**9,244**	42,902	37,484	5,418
Rolling stock	**59,209**	**41,749**	**17,460**	56,234	42,209	14,025
Equipment and tools	**35,827**	**26,579**	**9,248**	34,548	25,026	9,522
Construction in progress	**81,295**	**—**	**81,295**	140,336	—	140,336
	3,784,368	**1,930,762**	**1,853,606**	3,670,385	1,825,249	1,845,136

For the year ended December 31, 2008, AFUDC in the amount of $2,016,000 [2007 - $3,444,000] was capitalized to property, plant and equipment and credited to interest expense.

At December 31, 2008, net book value of stranded meters related to the deployment of smart meters amounting to $25,866,000 [December 31, 2007 - $19,890,000] is included in property, plant and equipment. In the absence of rate regulation, property, plant and equipment would have been $25,866,000 lower at December 31, 2008 [December 31, 2007 - $19,890,000].

7. INTANGIBLE ASSETS, NET

Intangible assets consist of the following:

	2008			2007		
	Cost $	**Accumulated amortization $**	**Net book value $**	**Cost $**	**Accumulated amortization $**	**Net book value $**
Land rights	**1,720**	**242**	**1,478**	10,350	2,227	8,123
Computer software	**151,804**	**111,895**	**39,909**	132,297	97,644	34,653
Capital contributions	**2,043**	**361**	**1,682**	2,043	279	1,764
Software in development	**23,632**	**—**	**23,632**	18,773	—	18,773
	179,199	**112,498**	**66,701**	163,463	100,150	63,313

8. INVESTMENTS HELD TO MATURITY

At December 31, 2008, 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 liquidity issues in the Canadian ABCP market. The Corporation’s ABCP notes last traded in an active market on or about August 13, 2007 and there are currently no market quotations available. 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.

On March 17, 2008, a court order was obtained through which the restructuring of the ABCP notes was placed under the protection of the Companies’ Creditors Arrangement Act [“CCAA”]. On April 25, 2008, the restructuring proposal put forward by the Montreal Committee was approved by the required majority of the ABCP holders. The plan was sanctioned by the Ontario Superior Court on June 5, 2008.

On June 18, 2008, proceedings were taken by a number of corporate ABCP noteholders in the Ontario Court of Appeal seeking to challenge the Ontario Superior Court of Justice decision that sanctioned the restructuring plan. In a unanimous decision issued on August 18, 2008, the Ontario Court of Appeal dismissed the appeal. On September 2, 2008, a number of the unsuccessful appellants sought leave to appeal the Ontario Court of Appeal decision to the Supreme Court of Canada. On September 19, 2008, the Supreme Court of Canada announced that it would not grant leave to hear the appeal.

On December 24, 2008, the Montreal Committee announced that a final restructuring agreement had been reached on an enhanced and amended plan. The announcement stated that, pursuant to the agreement, the governments of Canada, Quebec, Ontario and Alberta, together with certain participants in the restructuring, agreed to provide, in aggregate, $4,450,000,000 of additional margin facilities, which will rank senior to all other margin funding facilities. The final restructuring plan also calls for an 18-month moratorium on margin calls.

Based on the latest information available at December 31, 2008, it is estimated that of the $88,000,000 of ABCP in which the Corporation has invested, $80,300,000 is represented by a combination of leveraged collateralized debt, synthetic assets and traditional securitized assets which will be replaced by senior Class A-1 and Class A-2 and subordinated Class B and Class C long-term FRNs. Upon completion of the restructuring, the Corporation expects to receive replacement notes with par values of $37,000,000 for Class A-1; $34,600,000 for Class A-2; $6,300,000 for Class B and $2,400,000 for Class C.

In addition to the above notes, the Corporation also expects to receive $7,700,000 in notes that are represented by assets that have an exposure to U.S. mortgages and sub-prime mortgages, which will be classified as Ineligible Tracking notes.

The valuation technique used by the Corporation to estimate the fair value of its investments in ABCP notes as at December 31, 2008, incorporates a discounted cash flow model 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. The assumptions used to determine the estimated fair value reflect information contained in documents released by the Montreal Committee to all affected noteholders.

A weighted average interest rate of 1.58% was used to determine interest income on the restructured notes, except for the Ineligible Tracking notes, for which a weighted average interest rate of 2.38% was used. These rates were based on a forecast of 90-day Bankers' Acceptance ["BA"] rates less 50 basis points from 2009 through 2016. To derive a net present value of the principal and future cash flows, each note class was discounted using an interest rate spread over forecast BA rates ranging from 500 basis points to 1,800 basis points over a period ranging from 4 years to 7 years. On a weighted average basis, the discount rates used for each note class were as follows:

Long-Term FRNs	Discount Rates
Class A-1	7.08% (ranging from 5.65% to 8.50%)
Class A-2	7.08% (ranging from 5.65% to 8.50%)
Class B	7.33% (ranging from 5.90% to 8.75%)
Class C	7.33% (ranging from 5.90% to 8.75%)
Ineligible Tracking notes	20.08% (ranging from 18.65% to 21.50%)

As noted above, discount rates vary by each of the different replacement long-term FRNs to be issued as each is expected to have a different risk profile. The discount rates used to value the notes include a risk premium factor that incorporates current indicative credit default swap spreads, an estimated liquidity premium, and a premium for credit losses.

Based on the assumptions described above, the discounted cash flows resulted in an estimated fair value of the Corporation's investment in ABCP notes of $52,908,000 as at December 31, 2008 [December 31, 2007 - $74,941,000]. The decrease in value of $22,033,000 from December 31, 2007 was primarily due to the deterioration of the global credit markets which impacted the recovery assumptions and lead to a change in the methodology for discounting the various classes of notes by using different risk-adjusted discount rates for each note class. The impairment in the fair value of $35,092,000 compared to the maturity value of the ABCP notes was recorded as a reduction of income in the consolidated financial statements.

A sensitivity analysis was also conducted to examine the impact of an increase or a decrease in the overall weighted average discount rate. Based on the Corporation's mark-to-model valuation, a variation of 1% (100 basis points) would reduce or increase the estimated fair value of the ABCP notes by $3,000,000.

The estimation by the Corporation of the fair value of its ABCP notes, as at December 31, 2008, is subject to significant risks and uncertainties, including the timing and amount of future cash flows, 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 liquidity crisis in the third-party ABCP market has no significant impact on the Corporation's operations. 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

[see note 29 - Subsequent Events a) Investments held to maturity].

9. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

	2008 $	2007 $
Regulatory assets recovery account	—	9,660
Smart meters	**25,830**	2,357
Lost revenue adjustment mechanism and shared savings mechanism	—	6,536
Other	**383**	—
	26,213	18,553

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

December 31, 2008

Regulatory liabilities consist of the following:

	2008 $	2007 $
Regulatory assets recovery account	**13,832**	—
Pre-market opening line loss variance	**—**	3,965
Settlement variances	**57,516**	48,121
Other	**12,168**	7,065
	83,516	59,151

For the year ended December 31, 2008, LDC recovered approved regulatory assets amounts of $15,381,000 through permitted distribution rate adjustments [2007 – $28,368,000]. These recovery amounts are for the recovery of approved regulatory assets recorded in reporting periods prior to January 1, 2005. For the year ended December 31, 2008, LDC disposed of approved regulatory liability amounts of $9,671,000 through permitted distribution rate adjustments [2007 – $nil].

The regulatory assets and liabilities balances of the Corporation are defined as follows:

[a] Regulatory assets recovery account [“RARA”]

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 RARA. This approved balance was recovered over a period ended July 31, 2008. The RARA is credited with recovery amounts and is debited or credited by OEB-prescribed carrying charges. In the absence of rate regulation, interest expense in 2008 would have been $564,000 lower [interest income for 2007 - $291,000 lower].

In its decision regarding the electricity distribution rates of LDC issued on May 15, 2008, the OEB approved the disposition of regulatory liabilities of $18,622,000, consisting of settlement variances of $14,590,000 and pre-market opening line loss variance of $4,032,000, which were transferred to the 2008 RARA in June 2008. The 2008 RARA is debited with disposition amounts and is credited by OEB-prescribed carrying charges.

[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 587,000 meters as at December 31, 2008.

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.

The OEB's decision issued on May 15, 2008 regarding the electricity distribution rates application of LDC provided directions regarding the accounting treatment of smart meter expenditures incurred in 2007 and 2008. In its decision, the OEB directed LDC to record to property, plant and equipment all capital expenditures incurred prior to December 31, 2007 and to record to a deferral account all expenditures incurred after January 1, 2008. The recovery of expenditures incurred after January 1, 2008 will be subjected to a prudence review by the OEB in the near future. The decision rendered by the OEB also allowed LDC to keep the net book value of the stranded meters related to the deployment of smart meters in its rate base.

In connection with its smart meter initiatives, the Corporation has incurred costs amounting to $34,125,000 for the year ended December 31, 2008. At December 31, 2008, smart meter capital expenditures, net of accumulated depreciation, totalling $27,559,000 have been recorded to regulatory assets [December 31, 2007 - $nil]. These expenditures would otherwise have been recorded as property, plant and equipment under Canadian GAAP for unregulated businesses. In the absence of rate regulation, property, plant and equipment would have been $27,559,000 higher at December 31, 2008 [December 31, 2007 - $nil].

For the year ended December 31, 2008, smart meter operating expenses of $863,000 were deferred which would be expensed under Canadian GAAP for unregulated businesses [2007 - $nil], and smart meter depreciation expense of $1,128,000 was deferred which otherwise would have been charged to depreciation expense under Canadian GAAP for unregulated businesses [2007 - $nil]. In the absence of rate regulation, for the year ended December 31, 2008, operating expenses would have been $863,000 higher [2007 - $nil], and depreciation expense would have been $1,128,000 higher [2007 - $nil].

For the year ended December 31, 2008, smart meter customer revenues of $3,796,000 were deferred [2007 - $nil]. In the absence of rate regulation, revenue for the year ended December 31, 2008 would have been $3,796,000 higher [2007 - $nil].

[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. LDC recovered the approved amounts over the period commencing on November 1, 2007 and ending July 31, 2008.

Following this decision, the Corporation recognized in 2008 the LRAM and SSM balances relating to CDM programs delivered in 2007 and 2008, in the amounts of $1,104,000 and $386,000 [2007 - $1,300,000 and $200,000].

[d] Settlement variances

The OEB has allowed LDC to defer settlement variances from May 1, 2002 to December 31, 2008. 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 for settlement variances 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. In the absence of rate regulation, interest expense for the year ended December 31, 2008 would have been $2,254,000 lower [interest income for 2007 - $1,150,000 higher]. The manner and timing of disposition of the variance have not been determined by the OEB.

[e] Other

As at December 31, 2008, 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 $11,712,000 [December 31, 2007 - $7,065,000].

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

10. OTHER ASSETS

Other assets consist of the following:

	2008 $	2007 $
Prepaid leases	**7,544**	—
Other	**318**	485
	7,862	485

11. 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, 2008, $45,078,000 [December 31, 2007 - $45,083,000] had been utilized under the revolving credit facility in the form of letters of credit to primarily support the prudential requirements of LDC. At December 31, 2008, no amounts had been drawn for working capital purposes [December 31, 2007 - $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, 2008, no amounts had been drawn on the line of credit [December 31, 2007 - $nil].

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

12. CURRENT PORTION OF OTHER LIABILITIES

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

	2008 $	2007 $
Current portion of obligations under capital leases *[note 23]*	**199**	190
Customers' advance deposits	**16,402**	17,677
Other	**781**	1,109
	17,382	18,976

13. LONG-TERM DEBT

Long-term debt consists of the following:

	2008 $	2007 $
Senior unsecured debentures		
Series 1 - 6.11% due May 7, 2013	**223,001**	222,620
Series 2 - 5.15% due November 14, 2017	**248,520**	248,395
Promissory note payable to the City	**735,173**	735,173
	1,206,694	1,206,188
Less: Current portion of promissory note payable to the City	**245,058**	—
Long-term debt	**961,636**	1,206,188
Comprising:		
Debentures	**471,521**	471,015
Promissory note payable to the City	**490,115**	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 the 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.

b) Promissory note payable to the City

On July 1, 1999, LDC issued a promissory note to the City [“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 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. 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. As a result of the next scheduled payment for December 31, 2009, $245,058,000 of the principal amount outstanding under the City Note is classified as a short-term liability, with the remainder being classified as a long-term liability. Interest is calculated and payable quarterly in arrears on the last business day of March, June, September and December of each year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

14. EMPLOYEE FUTURE BENEFITS

Pension

For the year ended December 31, 2008, the Corporation's OMERS current service pension costs were $11,116,000 [2007 - $10,486,000].

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.

[a] Accrued benefit obligation

	2008 $	2007 $
Balance, beginning of year	**165,661**	167,461
Experience gain at beginning of year	**—**	(2,370)
Sale of Telecom	**(294)**	—
Current service cost	**3,613**	3,642
Interest cost	**9,155**	8,724
Benefits paid	**(5,055)**	(4,711)
Actuarial gains	**(44,276)**	(7,176)
Adjustment for restatement of income related to discontinued operations	**—**	91
Balance, end of year	**128,804**	165,661

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

	2008 $	2007 $
Accrued benefit obligation	**128,804**	165,661
Unamortized net actuarial gain (loss)	**28,073**	(16,245)
Unamortized past service costs	**(4,106)**	(5,070)
Adjustment for restatement of income related to discontinued operations	**—**	9
Post-employment benefits liability	**152,771**	144,355

[c] Components for net periodic defined benefit costs

	2008 $	2007 $
Current service cost	**3,613**	3,642
Interest cost	**9,155**	8,724
Actuarial gains	**(44,276)**	(9,547)
Cost incurred in the year	**(31,508)**	2,819
Differences between costs incurred and costs recognized in the year in respect of:		
Actuarial gains	**44,318**	10,139
Past service costs	**964**	965
	45,282	11,104
Defined benefit costs recognized	**13,774**	13,923
Capitalized as part of property, plant and equipment	**6,093**	5,610
Charged to operations	**7,681**	8,313

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

December 31, 2008

[d] Significant assumptions

	2008 %	2007 %
Accrued benefit obligation as of December 31:		
Discount rate	**7.5**	5.5
Rate of compensation increase	**4.0**	4.0
Benefit costs for years ended December 31:		
Discount rate	**5.5**	5.3
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**	4.0

For December 31, 2008, medical costs are assumed to increase at 8.5% [2007 - 9.0%] graded down by 0.5% [2007 - 0.5%] annual decrements to 5.0% [2007 - 5.0%] 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 2008:

	Increase $	Decrease $
Total of current service and interest cost (at 5.5 %)	**2,406**	**(1,803)**
Accrued benefit obligation at December 31, 2008 (at 7.5 %)	**18,289**	**(14,292)**

15. OTHER LIABILITIES

Other long-term liabilities consist of the following:

	2008 $	2007 $
Obligations under capital leases *[note 23]*	**397**	474
Other	**1,833**	3,680
	2,230	4,154

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

16. ASSET RETIREMENT OBLIGATIONS

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

	2008 $	2007 $
Balance, beginning of year	**7,523**	7,581
ARO liabilities incurred in the year	**(10)**	(369)
ARO liabilities settled in the year	**(463)**	(85)
Accretion expense	**405**	396
Revision in estimated cash flows	**(927)**	—
Balance, end of year	**6,528**	7,523

At December 31, 2008, the Corporation estimates the undiscounted amount of cash flows required over the next ten years to settle the ARO is $9,244,000 [December 31, 2007 - $10,822,000]. Discount rates ranging from 4.3% to 6.6% were used to calculate the carrying value of the ARO liabilities. No assets have been legally restricted for settlement of the liability.

17. CAPITAL DISCLOSURES

The Corporation's main objectives when managing capital are to:

- ensure ongoing access to funding to maintain and improve the electricity distribution system of LDC, and to meet any capital needs of its other subsidiary companies should such needs arise;
- ensure compliance with covenants related to its credit facilities, senior unsecured debentures and the City Note;
- maintain an A- credit rating as required under its shareholder direction; and
- align its capital structure for regulated activities of LDC with the debt to equity structure deemed by the OEB.

As at December 31, 2008, the Corporation's definition of capital includes shareholder's equity and long-term debt which includes the current portion of the promissory note payable to the City. As at December 31, 2008, shareholder's equity amounts to $981,291,000 [December 31, 2007 – $928,695,000] and long-term debt, including the current portion of the promissory note payable to the City, amounts to $1,206,694,000 [December 31, 2007 – $1,206,188,000]. The Corporation's capital structure as at December 31, 2008 is 55% debt and 45% equity [December 31, 2007 - 57% debt and 43% equity]. There have been no changes in the Corporation's approach to capital management during the year.

As at December 31, 2008, the Corporation is subject to debt agreements that contain various covenants. The Corporation's unsecured debentures and the City Note limit consolidated funded indebtedness to a maximum of 75% of total consolidated capitalization. As at December 31, 2008, consolidated funded indebtedness to consolidated capitalization was 56% [December 31, 2007 – 61%].

The Corporation's revolving credit facility limits the debt to capitalization ratio to a maximum of 75%. As at December 31, 2008, the debt to capitalization ratio was 56% [December 31, 2007 – 57%].

The Corporation's long-term debt agreements also include negative covenants such as limitations on funded indebtedness, limitations on designated subsidiary indebtedness, restrictions on mergers and dispositions of designated subsidiaries, and amendments to the City Note. As at December 31, 2008, and as at December 31, 2007, the Corporation was in compliance with all covenants included in its long-term debt agreements, City Note and short-term revolving credit facility.

18. FINANCIAL INSTRUMENTS

a) Recognition and measurement

The Corporation's carrying value and fair value of financial instruments consist of the following:

	2008 $		2007 $	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Cash and cash equivalents	**340,492**	**340,492**	216,002	216,002
Accounts receivable, net of allowance for doubtful accounts	**131,582**	**131,582**	155,413	155,413
Investments held to maturity	**52,908**	**52,908**	74,941	74,941
Accounts payable and accrued liabilities	**294,810**	**294,810**	289,621	289,621
Senior unsecured debentures				
Series 1 – 6.11% due May 7, 2013	**223,001**	**242,522**	222,620	239,045
Series 2 – 5.15% due November 14, 2017	**248,520**	**247,872**	248,395	252,198
Promissory note payable	**735,173**	**770,224**	735,173	766,445

b) Risk Factors

The following is a discussion of risks and related mitigation strategies that have been identified by the Corporation for financial instruments. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks listed. Risks related to the Corporation's investment in ABCP notes are discussed in more detail in Investments held to maturity *[note 8]*.

The Corporation's activities provide for a variety of financial risks, particularly credit risk, interest rate risk and liquidity risk.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

Credit risk

Financial instruments are exposed to credit risk as a result of the risk of the counter-party defaulting on its obligations. The Corporation monitors and limits its exposure to credit risk 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's credit risk associated with accounts receivable is primarily related to payments from LDC customers. LDC has approximately 684,000 customers, the majority of which are residential. LDC collects security deposits from customers in accordance with directions provided by the OEB. As at December 31, 2008, LDC held security deposits in the amount of $46,685,000 [December 31, 2007 - $42,991,000].

The carrying amount of accounts receivable is reduced through the use of an allowance for doubtful accounts and the amount of the related impairment loss is recognized in the income statement. Subsequent recoveries of receivables previously provisioned are credited to the income statement.

Credit risk associated with accounts receivable is as follows:

	2008 **$**	**2007** **$**
Total accounts receivable	**141,692**	167,142
Less: Allowance for doubtful accounts	**(10,110)**	(11,729)
Total accounts receivable, net	**131,582**	155,413
Of which:		
Outstanding for not more than 30 days	**104,869**	129,792
Outstanding for more than 30 days but not more than 120 days	**21,668**	22,129
Outstanding for more than 120 days	**15,155**	15,221
Less: Allowance for doubtful accounts	**(10,110)**	(11,729)
Total accounts receivable, net	**131,582**	155,413

At December 31, 2008, there were no significant concentrations of credit risk with respect to any class of financial assets or counterparties with the exception of Investments held to maturity *[note 8]*. The Corporation's maximum exposure to credit risk is equal to the carrying value of its financial assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

Interest rate risk

The Corporation is exposed to interest rate risk in holding certain financial instruments. The Corporation's objective is to minimize net interest expense. The Corporation attempts to minimize interest rate risk by issuing long-term fixed rate debt, and by extending or shortening the term of its short-term money market investments by assessing the monetary policy stance of the Bank of Canada, while ensuring that all payment obligations are met on an on-going basis.

Under the Corporation's Revolving Credit Facility *[note 11]*, the Corporation may obtain short-term borrowings for working capital purposes. These borrowings 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 that are 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.

Liquidity risk

The Corporation monitors and manages its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements. The Corporation's objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing interest expense. The Corporation has access to credit facilities and monitors cash balances daily to ensure that sufficient levels of liquidity are on hand to meet financial commitments as they come due. Liquidity risks associated with financial commitments are as follows:

December 31, 2008			
	Due within 1 year **$**	**Due between 1 year and 5 years** **$**	**Due after 5 years** **$**
Financial liabilities			
Accounts payable and accrued liabilities	**294,810**	**—**	**—**
Promissory note payable to the City	**245,058**	**490,115**	**—**
Senior unsecured debentures			
Series 1 – 6.11% due May 7, 2013	**—**	**223,001**	**—**
Series 2 – 5.15% due November 14, 2017	**—**	**—**	**248,520**
	539,868	**713,116**	**248,520**

Hedging and Derivatives risk

As at December 31, 2008, and as at December 31, 2007, the Corporation has not entered into hedging and derivative financial instruments.

Foreign exchange risk

As at December 31, 2008, the Corporation has limited exposure to the changing values of foreign currencies. While the Corporation purchases goods and services which are payable in U.S. dollars, and purchases U.S. currency to meet the related payables commitments when required, the impact of these transactions is not material to the consolidated financial statements.

19. FINANCIAL GUARANTEES

The City has authorized the Corporation to provide financial assistance to its subsidiaries, and LDC to provide financial assistance to other subsidiaries of the Corporation, in the form of letters of credit and guarantees, for the purpose of enabling them to carry on their businesses up to an aggregate amount of $500,000,000.

In recognition that the last of TH Energy's retail electricity contracts expired in December 2006, the board of directors of the Corporation determined in August 2007 to rescind a prior approval authorizing the Corporation to issue parental guarantees on behalf of TH Energy which had been used to enable TH Energy to meet its collateral credit requirements relating to its retailing activities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

20. 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

	2008 $	2007 $
Rate reconciliation		
Income before PILs	**51,990**	91,880
Consolidated Statutory Canadian federal and provincial income tax rate	**33.50%**	36.12%
Expected provision for PILs	**17,417**	33,187
Temporary differences not benefited	**3,658**	1,017
Valuation allowance	**5,333**	(5,347)
Decrease in federal future tax rates	**—**	302
Permanent difference on sale of discontinued operations	**—**	6,221
Change in income tax positions *[note 24[a]]*	**(28,503)**	(4,198)
Other	**7,792**	6,620
Provision for PILs	**5,697**	37,802
Effective tax rate	**10.96%**	41.14%
Components of provision for PILs		
Current tax provision	**3,911**	38,933
Future income tax provision (recovery) related to the origination and reversal of temporary differences	**1,786**	(1,131)
Provision for PILs	**5,697**	37,802

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

Consolidated Balance sheet

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

	2008 $	2007 $
Non-capital loss carryforwards	**643**	595
Property, plant and equipment and intangible assets	**9,910**	19,647
Other taxable temporary differences	**8,807**	6,552
Valuation allowance	**(16,665)**	(11,407)
	2,695	15,387

Presented on the consolidated balance sheet as follows:

	2008 $	2007 $
Future income tax assets, current	**—**	710
Future income tax assets, long-term	**2,809**	15,031
Future income tax liabilities, long-term	**(114)**	(354)
	2,695	15,387

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, 2008, future income tax assets of $298,514,000 [December 31, 2007 - $186,779,000], 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 2008 would have been $3,658,000 lower [2007 – $1,017,000][*note 4[b]*].

As at December 31, 2008, the Corporation has accumulated tax losses for PILs purposes of approximately $2,218,000 [December 31, 2007 - $2,032,000], which are available to reduce future years' taxable income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

21. SHARE CAPITAL

Share capital consists of the following:

	2008 $	2007 $
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 provides that the Corporation will pay dividends to the City each year amounting to the greater of $25,000,000 or 50% of the Corporation's 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 2008, the board of directors of the Corporation declared and paid dividends totalling $116,416,000 [2007 – $46,200,000] to the City, including a $75,000,000 special dividend payment in relation to the sale of the shares of Telecom.

22. 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, 2008, LDC provided electricity to the City in the amount of $97,632,000 [2007 - $96,205,000]. At December 31, 2008, included in "unbilled revenue" is a balance amounting to $9,090,000 [December 31, 2007 - $8,283,000] receivable from the City related to the provision of electricity for the previous months.

For the year ended December 31, 2008, LDC provided relocation services related to the City in the amount of $991,000 [2007 - $1,261,000]. At December 31, 2008, included in "Accounts receivable, net of allowance for doubtful accounts" is $4,098,000 [December 31, 2007 - $2,617,000] receivable from the City related to these services and other construction activities.

For the year ended December 31, 2008, TH Energy provided energy efficiency products and services, street lighting services and consolidated billing services to the City amounting to $19,853,000 [2007 - $19,540,000]. At December 31, 2008, included in "Accounts receivable, net of allowance for doubtful accounts" is $4,884,000 [December 31, 2007 - $6,734,000] receivable from the City related to these services.

For the year ended December 31, 2008, LDC purchased road cut and other services of $4,877,000 [2007 - $6,916,000] from the City. At December 31, 2008, included in "Accounts payable and Accrued liabilities" is $4,514,000 [December 31, 2007 - $3,353,000] payable to the City related to services received from the City.

For the year ended December 31, 2008, LDC and TH Energy paid property tax to the City of $6,533,000 [2007 - $6,365,000].

At December 31, 2008, a promissory note in the amount of $735,173,000 [December 31, 2007 - $735,173,000] was payable to the City. As a result of the next scheduled payment for December 31, 2009, $245,058,000 of the principal amount outstanding under the promissory note is classified as a short-term liability, with the remainder being classified as a long-term liability. For the year ended December 31, 2008, interest of $44,919,000 [2007 - $59,892,000], on the promissory note was paid to the City *[note 13]*.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

23. LEASE COMMITMENTS

Operating lease obligations

As at December 31, 2008, 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:

	$
2009	**5,249**
2010	**5,092**
2011	**4,524**
2012	**1,178**
2013 and thereafter	**—**
Total minimum lease payments	**16,043**

Capital lease obligations

As at December 31, 2008, the future minimum annual lease payments under capital leases with remaining lease terms from one to five years are as follows:

	$
2009	**223**
2010	**215**
2011	**163**
2012	**46**
2013 and thereafter	**—**
Total amount of future minimum lease payments	**647**
Less interest	**51**
	596
Current portion *[note 12]*	**199**
Long-term portion *[note 15]*	**397**

24. CONTINGENCIES

a) Ministry of Finance Tax Audit

The Ministry of Finance completed its income tax audits of LDC for the years 2001, 2002, 2003, and 2004. The impact of the completed audits was recorded in the consolidated financial statements in 2008.

b) Legal Proceedings

Late Payment Charges Class Action

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 that portion of certain late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the Criminal Code. Although the claim related to charges collected by 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.

On February 4, 2008, the OEB, in response to an application filed by Enbridge, ruled that all of Enbridge's costs related to settlement of the class action lawsuit, including legal costs, settlement costs and interest, are recoverable from ratepayers. The representative plaintiff in the class action lawsuit has made a petition to the Lieutenant Governor in Council ["Cabinet"] under subsection 34(1) of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Schedule B. for an order that the matter be submitted back to the OEB for reconsideration. A decision by Cabinet on the petition is pending.

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 a preliminary stage. Pleadings have closed and examinations for discovery have been conducted but, as in the first action, the classes have not been certified as the parties were awaiting the outcome of the 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 decision 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 reasonably quantify the effect, if any, of the Enbridge decision on these actions or of these actions on the financial performance of the Corporation.

2 Secord Avenue

An action was commenced against LDC in October, 2008 under the *Class Proceedings Act, 1992* seeking damages in the amount of $30,000,000 as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, but a statement of defence has not been filed. Accordingly, given the preliminary status of this action, it is not possible at this time to reasonably quantify the effect, if any, of this class action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover damages which may become payable by LDC in connection with the action.

An action was commenced against LDC in February, 2009 seeking damages in the amount of $20,000,000 as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, but a statement of defence has not been filed. Accordingly, given the preliminary status of this action, it is not possible at this time to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

25. NET INCOME PER SHARE

The weighted daily average numbers of shares outstanding were 1,000 as at December 31, 2008 and 2007, 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.

26. DISCONTINUED OPERATIONS

Sale of water heater business

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.

Sale of Toronto Hydro Telecom Inc ["Telecom "]

On July 31, 2008, the Corporation sold the shares of Telecom to Cogeco Cable Canada Inc. ["Cogeco"] for cash consideration of $200,000,000, subject to post closing adjustments and transaction costs. Accordingly, the results of operations and financial position of Telecom have been segregated and presented as discontinued operations.

Current liabilities from discontinued operations for Telecom are $890,000 as at December 31, 2008 [December 31, 2007 - $nil] and the current liabilities from discontinued operations regarding the water heater business are $nil as at December 31, 2008 [December 31, 2007 - $2,874,000].

For the years ended December 31, 2008 and December 31, 2007, the following revenues and expenses of Telecom and the water heater business have been reclassified from continuing operations to discontinued operations:

	2008 $	2007 $
Revenues	**26,090**	37,377
Expenses		
Purchased power and other	**10,897**	6,626
Operating expenses	**10,638**	15,541
Depreciation and amortization	**5,306**	7,652
Net interest (income) and other	**(189)**	(170)
	26,652	29,649
Provision for (recovery of) PILs	**(4,608)**	3,173
Income from discontinued operations - Telecom	**4,046**	4,555
Income from discontinued operations - Water Heater	**—**	24,198
Gain on sale of Telecom – net of tax	**118,673**	—
Income from discontinued operations - net of tax	**122,719**	28,753

27. 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:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

[a] Electricity Distribution
The regulated business which consists of the electricity distribution business and conservation activities including OPA contracts of LDC; and

[b] Non-regulated
The non-regulated business of TH Energy consists primarily of the delivery of street lighting and expressway lighting services and energy efficiency products and services.

Segment information is as follows:

	2008 $	2007 $
Electricity distribution		
Revenues	**2,349,547**	2,320,854
Purchased power and other	**1,869,557**	1,841,121
Operating expenses	**182,363**	172,407
Depreciation and amortization	**149,019**	137,020
Income before interest, other and provision for PILs	**148,608**	170,306
Interest income	**8,897**	8,141
Interest expense	**72,402**	72,129
Other	**—**	1,698
Provision for PILs	**8,969**	42,395
Income from continuing operations	**76,134**	65,621
Non-regulated		
Revenues	**34,593**	33,461
Purchased power and other	**14,761**	13,118
Operating expenses	**23,197**	18,104
Depreciation and amortization	**7,328**	6,963
Loss before interest, impairment, other and recovery of PILs	**(10,693)**	(4,724)
Interest income	**3,453**	5,808
Interest expense	**2,352**	1,780
Impairment of investments held to maturity	**22,033**	13,059
Other	**—**	(24)
Recovery of PILs	**(3,272)**	(4,593)
Loss from continuing operations	**(28,353)**	(9,186)
Intersegment eliminations		
Revenues	**(1,598)**	(2,829)
Purchased power and other	**(22)**	(365)
Operating expenses	**(88)**	(107)

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

December 31, 2008

	2008 $	2007 $
Total		
Revenues	**2,382,542**	2,351,486
Purchased power and other	**1,884,296**	1,853,874
Operating expenses	**205,472**	190,404
Depreciation and amortization	**156,347**	143,983
Income before interest, impairment, other and provision for PILs	**136,427**	163,225
Interest income	**12,350**	13,949
Interest expense	**74,754**	73,909
Impairment of investments held to maturity	**22,033**	13,059
Other	**—**	1,674
Provision for PILs	**5,697**	37,802
Income from continuing operations	**46,293**	54,078

	2008 $	2007 $
Expenditures on property, plant and equipment and intangible assets		
Electricity distribution	**205,712**	280,975
Non-regulated	**9,195**	8,527
Total	**214,907**	289,502

	2008 $	2007 $
Assets		
Electricity distribution	**2,506,141**	2,412,300
Non-regulated	**300,042**	307,499
Intersegment eliminations	**(26,400)**	(24,048)
Total	**2,779,783**	2,695,751

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

28. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2008 consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2008

29. SUBSEQUENT EVENTS

a) Investments held to maturity

On January 12, 2009, the Ontario Superior Court approved the restructuring plan subject to the modification announced on December 24, 2008. On January 21, 2009, the amended restructuring plan was completed and the Corporation received its replacement notes. The replacement notes received have a face value of $87,700,000, and DBRS has assigned an “A” credit rating to the Class A-1 and A-2 notes; the Class B, C and Ineligible Tracking notes are unrated. According to the Eighteenth and Nineteenth Reports of the Monitor, released on January 2, 2009 and January 8, 2009, respectively, the “legal final maturity” of the restructured notes is July 15, 2056. However, the expected repayment date for the restructured Class A-1 and Class A-2 notes is January 22, 2017. It should be noted that based on the information contained in the above-mentioned reports, there is no obligation to pay interest on the notes before 2019 and no legal requirement to pay principal until 2056. The distribution by class is listed below:

Master Asset Vehicle II	Amount Received	Percent of Total
Class A-1	36,900,000	42.1%
Class A-2	34,500,000	39.3%
Class B	6,300,000	7.2%
Class C	2,400,000	2.7%
Ineligible Tracking notes	7,600,000	8.7%

The replacement notes will be measured at fair value on initial recognition and are expected to be classified as “Held-for-Trading” under the Corporation’s financial instrument policy which would require them to be fair valued at each period end with changes in fair value included in the income statement in the period in which they arise. Until an active market develops for the replacement notes, the fair value will be determined using a discounted cash flow approach based on the maximum use of inputs observed from market conditions on subsequent reporting dates.

As part of the note exchange, the Corporation received a payment of $2,700,000 representing the first installment of its share of the accumulated cash up to August 31, 2008 in the conduit trusts. This amount will be included in the determination of the fair value of the replacement notes as at March 31, 2009.

As there has been no active market for the new notes since closing on January 21, 2009, the Corporation has determined that as at March 10, 2009, there is no material change to the market conditions reported as at December 31, 2008.

b) Dividends

On March 10, 2009, the board of directors of the Corporation declared dividends in the amount of $6,169,500. The dividends are comprised of a $169,500 payment with respect to net income for the year ended December 31, 2008, payable to the City on March 19, 2009 and a $6,000,000 payment in connection with the first quarter of 2009, payable to the City on March 31, 2009.

c) Distribution rates for LDC

On February 24, 2009, the OEB issued the allowed return on equity for LDC. The 2009 percentage was set at 8.01%. Using approved 2009 distribution expenses and capital expenditures, LDC has estimated the 2009 base distribution revenue requirement and rate base at $483,816,000 and $2,034,970,000, respectively.