

# HYDRO ONE INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### RESULTS OF OPERATIONS

As used in this section, references to increases and decreases, whether in terms of amounts or percentages, are made by comparison of the three and nine months ended September 30, 2006 to the three and nine months ended September 30, 2005.

#### Revenues

	Three months ended September 30				Nine months ended September 30			
	2006	2005	\$ Change	% Change	2006	2005	\$ Change	% Change
<i>(Canadian dollars in millions)</i>								
Transmission	331	356	(25)	(7)	945	991	(46)	(5)
Distribution	828	818	10	1	2,441	2,385	56	2
Other	6	5	1	20	17	15	2	13
	1,165	1,179	(14)	(1)	3,403	3,391	12	-
Average Ontario 60-minute peak demand (MW) <sup>1</sup>	24,358	25,297	(939)	(4)	23,112	23,312	(200)	(1)
Distribution - units distributed to customers (TWh) <sup>1</sup>	7.0	7.1	(0.1)	(1)	21.6	22.2	(0.6)	(3)

<sup>1</sup> System-related statistics are preliminary

The demand for electricity generally follows normal weather-related variations, and therefore our energy-related revenues, all other things being equal, will tend to be higher in the first and third quarters than in the second and fourth quarters.

#### Transmission

Transmission revenues predominantly consist of our transmission tariff, which is based on the monthly peak demand for electricity across our high-voltage network. The tariff is designed to recover revenues necessary to support a transmission system that has sufficient capacity to accommodate the maximum expected demand. Maximum expected demand is primarily influenced by weather, as well as economic conditions. Transmission revenues also include minor amounts of ancillary revenues, which are primarily attributable to maintenance services provided to generators and secondary use of our land rights-of-way.

Transmission revenues decreased by \$25 million, or 7%, to \$331 million in the third quarter and by \$46 million, or 5%, to \$945 million during the first nine months of 2006 compared to the same periods last year. Although a new record Ontario peak demand of 27,005 MW was set on August 1, 2006, the average demand for the quarter was lower than last year, resulting in a reduction in tariff revenues of about \$14 million. On a cumulative basis, the average peak demand for 2006 was also lower, reflecting a milder winter followed by a warmer spring. Consequently, transmission revenues were also lower by \$14 million for the first nine-months compared to same period last year.

Transmission tariff revenues for the third quarter and for the first nine months of 2006 also reflect two recent Ontario Energy Board (OEB) decisions. On February 21, 2006, the OEB applied an earnings sharing mechanism to any transmission earnings in excess of our approved rate of return of 9.88% for the period January 1, 2006 until new rates are set. Consequently, 50% of excess earnings recovered from customers are deferred as a regulatory liability. This decision had the effect of reducing transmission revenues by \$6 million in the quarter and by \$23 million year-to-date. On December 8, 2005, the OEB adjusted revenue allocation factors for all of the Province's electricity transmitters, reducing transmission revenues in the quarter by \$3 million and for the year-to-date period by \$10 million. The remaining changes in transmission revenues reflect ancillary revenues.

#### Distribution

Distribution revenues include our distribution tariff, which is based on OEB-approved rates, as well as amounts to recover the cost of purchased power used by our customers. Accordingly, distribution revenues are primarily influenced by our distribution rates, the amount of electricity we distribute, and the cost of purchased power. Distribution revenues also include a minor amount of ancillary distribution services revenues, such as fees related to the use of our poles by the telecommunications and cable television industries, and miscellaneous charges such as those for late payments.

**HYDRO ONE INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Distribution revenue increased by \$10 million, or 1%, to \$828 million in the third quarter and by \$56 million, or 2%, to \$2,441 million during the first nine months of 2006 compared to the same periods last year, primarily due to OEB-approved distribution tariff rate increases that were effective May 1, 2006 and April 1, 2005. During April 2006, after reviewing evidence submitted, the OEB approved increases in distribution tariff rates for our Hydro One Networks Inc. and Hydro One Brampton Networks Inc. subsidiaries. These new rates were effective on May 1, 2006. We also received OEB approval for low-voltage rates for services provided to local distribution companies embedded within our service territory. The April 1, 2005 increase was originally scheduled to be effective March 1, 2003, and was subsequently suspended for all local distribution companies by the *Electricity Pricing, Conservation and Supply Act, 2002*. These increases support the maintenance and investment requirements of the distribution system to enable the safe and reliable delivery of electricity to customers throughout Ontario. These OEB-approved rate changes increased distribution revenue by approximately \$31 million in the quarter and by \$71 million for the first nine months compared to last year. The increased distribution tariff revenues were partially mitigated by lower recoveries of purchased power costs of \$17 million in the quarter and \$16 million in the year-to-date period, as described below under "Purchased Power." The remaining changes in distribution revenues primarily reflect a lower volume of electricity in the quarter and ancillary revenues.

**Purchased Power**

Purchased power costs incurred by our distribution business represent the cost of electricity delivered to customers within our distribution service territory and consist of the wholesale commodity cost of energy, the Independent Electricity System Operator's (IESO's) wholesale market service charges, and transmission charges levied by the IESO. From April 1, 2004 to March 31, 2005, for certain low-volume and designated customers, the commodity price of electricity was based on an interim two-tiered pricing structure. This structure was subsequently replaced by the OEB's Regulated Price Plan (RPP), which consists of a two-tiered pricing structure with threshold amounts adjusted twice annually. Customers who are not eligible for the RPP continue to pay the market price for electricity, adjusted for the difference between market prices and the prices paid to generators under the *Electricity Restructuring Act, 2004*. A summary of the interim pricing plan and RPP is provided below.

**Summary of Interim Pricing Plan & RPP**

Price Plan	Effective Date	Tier Threshold (kWh)		Tier Rates (cents/kWh)	
		Residential	Non-Residential	First Tier	Second Tier
Interim	April 1, 2004	750	750	4.7	5.5
RPP	April 1, 2005	750	750	5.0	5.8
RPP	November 1, 2005	1,000	750	5.0	5.8
RPP	May 1, 2006	600	750	5.8	6.7

Purchased power costs decreased by \$17 million to \$564 million in the third quarter and by \$16 million to \$1,667 million on a year-to-date basis compared to last year. These reductions reflect lower wholesale commodity prices of \$64 million in the quarter and \$99 million in the first nine months for customers who are not eligible for the RPP and lower wholesale market service charges levied by the IESO of \$28 million in the quarter and \$42 million for the year-to-date period. Purchased power costs also decreased due to lower year-over-year demand for electricity of \$9 million in the quarter and \$42 million in the first nine months. The impact of these various decreases in costs was partially offset by increased purchased power costs associated with the OEB's RPP for residential and other eligible customers. This year-over-year increase amounted to \$84 million for the third quarter and \$167 million for the year-to-date.

**Operation, Maintenance and Administration**

Our operation, maintenance and administration costs are comprised primarily of labour, material, equipment and purchased services in support of the operation and maintenance of the transmission and distribution systems. These costs also include property taxes and payments in lieu thereof on our transmission and distribution lines, stations and buildings.

**HYDRO ONE INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Operation, maintenance and administration costs for each of our three business segments were as follows:

<i>(Canadian dollars in millions)</i>	<b>Three months ended September 30</b>				<b>Nine months ended September 30</b>			
	<b>2006</b>	<b>2005</b>	<b>\$ Change</b>	<b>% Change</b>	<b>2006</b>	<b>2005</b>	<b>\$ Change</b>	<b>% Change</b>
Transmission	105	91	14	15	307	261	46	18
Distribution	122	100	22	22	328	288	40	14
Other	6	6	-	-	17	18	(1)	(6)
	233	197	36	18	652	567	85	15

***Transmission***

Operation, maintenance and administration expenditures incurred to sustain our high-voltage transmission stations, lines and rights-of-way increased by \$14 million in the third quarter and by \$46 million on a year-to-date basis compared to the same periods last year. Within our work programs, we continued to make the investments necessary to ensure the safe and reliable operation of our installed transmission system, with particular focus on the assets that are critical to generation and to the unrestricted supply of electricity to our customers. We experienced increased work program requirements of \$14 million and \$25 million in the quarter and year-to-date periods respectively, primarily related to station corrective and preventive maintenance, the impact of the 2005 labour disruption, higher employee benefit costs attributable to a lower discount rate and general economic increases in materials and fuel costs. In addition, higher information technology requirements were offset in the quarter by the impact of reassignment of resources to support our larger transmission capital program, resulting in other expenditures to support the transmission programs being unchanged. Other costs increased by \$21 million year-to-date, reflecting higher information technology costs as well as last year's recoveries associated with insurance settlements and bad debts recoveries.

***Distribution***

Operation, maintenance and administration expenditures necessary to maintain our low-voltage distribution system increased by \$22 million in the quarter and by \$40 million in the first nine months of the year. We experienced increased work program requirements of \$20 million and \$39 million in the quarter and year-to-date periods respectively, primarily due to our lines and forestry programs, reflecting system recovery efforts following a series of destructive storms experienced this year, particularly in the third quarter. Specifically, these expenditures increased by \$13 million to \$15 million in the quarter and by \$15 million to \$18 million on a year-to-date basis. The impact of last year's labour disruption and the same economic increases that affected our transmission business also impacted our work program results compared to last year. Other costs incurred to support our distribution work programs increased marginally by \$2 million in the quarter and by \$1 million in the first nine months, primarily as a result of higher information technology requirements and fuel costs, partially offset by the reassignment of resources to support our larger capital program this year.

**Depreciation and Amortization**

Depreciation and amortization expense increased by \$12 million, or 10%, to \$132 million in the third quarter, and by \$16 million, or 4%, to \$377 million on a year-to-date basis compared to the same periods last year. These increases primarily reflect increased regulatory asset amortization expense consistent with the OEB's April 2006 distribution rate decision. In addition, higher depreciation expense resulted from increases in our fixed assets in service, consistent with recent investments made to improve the reliability of our electricity delivery network.

**Financing Charges**

Financing charges decreased by \$10 million, or 12%, to \$74 million in the quarter, and by \$27 million, or 11%, to \$220 million on a year-to-date basis compared to the respective 2005 periods. These reductions reflect the impact of lower effective interest rates. Increased capitalization of financing charges associated with the higher levels of capital construction this year also resulted in a reduction in net financing charges. For the nine-month period, interest on a refund of prior years' payments in lieu of corporate income taxes further contributed to the lowering of our financing charges.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

**Provision for Payments in Lieu of Corporate Income Taxes**

The provision for payments in lieu of corporate income taxes declined by \$5 million, or 8%, to \$59 million in the quarter and by \$21 million, or 14%, to \$133 million on a year-to-date basis relative to the prior year. The third quarter decrease was primarily due to the reduction in our income before provision for payments in lieu of corporate income taxes compared to the corresponding period in 2005, partially offset by a higher effective tax rate associated with timing differences. For the year-to-date period, lower income before provision for payments in lieu of corporate income taxes resulted in decreased taxes of approximately \$17 million. The tax benefit recognized in the first quarter of this year, following the recovery of approximately \$30 million in prior years' payments in lieu of corporate income taxes, was partially offset by the impact of last year's second quarter tax recovery in the amount of \$21 million. Payments in lieu of corporate income taxes were also positively affected by tax changes enacted in the second quarter relating to the elimination of the federal large corporations tax and higher capital cost allowance rates. These impacts were partially offset by taxes payable on transmission amounts received but not recognized for accounting purposes, primarily due to the OEB's earnings sharing mechanism.

**Net Income**

Net income was lower by \$30 million, or 23%, in the third quarter, and by \$25 million, or 7%, on a year-to-date basis compared to 2005 results. Net income levels in the quarter and year-to-date periods reflect the impacts of higher expenditures required to operate and maintain our transmission and distribution systems, particularly as a result of the damaging storms experienced over the summer months, and lower transmission tariff revenues, including the impact of the OEB's transmission earnings sharing mechanism. We also experienced a higher effective tax rate in the quarter due to timing differences. The impact of these factors was partially offset by higher distribution tariff revenues associated with OEB-approved tariff rate increases and, for the year-to-date, a reduction in our effective tax rate. This tax rate reduction resulted from the relative size of tax benefits recognized in the first quarter of 2006 and in the second quarter of 2005.

**QUARTERLY RESULTS OF OPERATIONS**

The following table sets forth unaudited quarterly information for each of the eight quarters ended December 31, 2004 through September 30, 2006. This information has been derived from our unaudited interim Consolidated Financial Statements which, in the opinion of our management, have been prepared on a basis consistent with the audited annual Consolidated Financial Statements and includes all adjustments, consisting only of normal recurring adjustments, necessary for fair presentation of our financial position and results of operations for those periods. These operating results are not necessarily indicative of results for any future period and should not be relied upon to predict our future performance.

<i>(Canadian dollars in millions)</i>	<b>2006</b>				<b>2005</b>			<b>2004</b>
	<b>Sep. 30</b>	<b>Jun. 30</b>	<b>Mar. 31</b>	<b>Dec. 31</b>	<b>Sep. 30</b>	<b>Jun. 30</b>	<b>Mar. 31</b>	<b>Dec. 31</b>
Quarter ended								
Total revenue <sup>1, 2, 4</sup>	1,165	1,078	1,160	1,025	1,179	1,018	1,194	1,074
Net income <sup>1, 2, 3, 4</sup>	103	99	152	104	133	115	131	186
Net income to common shareholder <sup>1, 2, 3, 4</sup>	99	94	148	99	129	110	127	181

<sup>1</sup> The demand for electricity generally follows normal weather-related variations, and therefore our electricity-related revenues and profit, all other things being equal, would tend to be higher in the first and third quarters than in the second and fourth quarters.

<sup>2</sup> Under a regulation issued in October 2005, RPP customers received a one-time *Ontario Price Credit* reflecting a lower cost of power than the fixed commodity price between April 1, 2004 and March 31, 2005. In the fourth quarter of 2005, revenue and cost of power were both reduced by approximately \$140 million. The application of the one-time credit did not result in any adjustment to net income in the period or in previously reported periods.

<sup>3</sup> As a result of submitted oral and written evidence, on December 9, 2004 the OEB issued a ruling citing prudence and approving recovery of amounts, previously delayed by the *Electricity Pricing, Conservation and Supply Act, 2002*, relating to regulatory deferral account balances sought in our May 31, 2004 submission. Consequently, net income for the fourth quarter of 2004 includes a regulatory recovery of \$91 million.

<sup>4</sup> Effective January 1, 2006, the OEB applied an earnings sharing mechanism to any transmission earnings in excess of the approved rate of return of 9.88% until new rates are set.

**LIQUIDITY AND CAPITAL RESOURCES**

Our primary sources of liquidity and capital resources are funds generated from operations, debt capital market borrowings and bank financing. These resources will be used to satisfy our capital resource requirements, which continue to include capital expenditures, servicing and repayment of our debt, payments related to our outsourcing arrangements, investing activities, and dividends.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Summary of Sources and Uses of Cash	Three months ended		Nine months ended	
	September 30		September 30	
(Canadian dollars in millions)	2006	2005	2006	2005
<b>Operating activities</b>	351	337	715	794
<b>Financing activities</b>				
Long-term debt issued	150	-	700	500
Long-term debt retired	-	-	(448)	(200)
Short-term notes payable	(130)	-	-	(40)
Dividends paid	(63)	(72)	(286)	(218)
<b>Investing activities</b>				
Capital expenditures	(218)	(144)	(593)	(481)
<b>Other investing and financing activities</b>	4	(5)	9	-
<b>Net change in cash and cash equivalents</b>	<b>94</b>	<b>116</b>	<b>97</b>	<b>355</b>

**Operating Activities**

Net cash from operating activities increased by \$14 million to \$351 million in the third quarter and decreased by \$79 million to \$715 million in the first nine months compared to 2005 results. The reduction in the year-to-date period primarily reflects higher working capital requirements reflecting the impact of higher electricity prices charged to RPP customers. The impact of providing RPP customers with the *Ontario Price Credit* in early 2006, pursuant to regulation, also increased our requirements. Funding for the credit was received from the IESO in early December 2005. The increase in the quarter reflects lower working capital requirements due to the timing of tax installment payments, partially offset by lower net income.

**Investing Activities**

Cash used for investing activities primarily represents capital expenditures for each of our three business segments as follows:

(Canadian dollars in millions)	Three months ended September 30				Nine months ended September 30			
	2006	2005	Change	%	2006	2005	Change	%
Transmission	93	53	40	75	290	229	61	27
Distribution	123	90	33	37	298	250	48	19
Other	2	1	1	100	5	2	3	150
	218	144	74	51	593	481	112	23

**Transmission**

Transmission capital expenditures increased by \$40 million in the third quarter and by \$61 million in the first nine months compared to the same periods last year. Expenditures made to expand and reinforce the transmission system were higher by \$34 million in the quarter and by \$56 million for the year-to-date. These increased development investments primarily reflect the construction of two critical transmission projects being constructed in the public interest: the Niagara Reinforcement Project, which will reinforce the transmission system in the Niagara region and provide access to new sources of generation, and our Downtown Toronto Cable Project, which will involve the construction of two underground cable circuits to reinforce our electricity transmission facilities. The completion of our Niagara Reinforcement Project continues to be delayed by the aboriginal land dispute in the Caledonia area. Discussions continue between the affected aboriginal peoples and the various government entities involved. Expenditure increases over the comparative periods last year also reflect our substantial completion of the Parkway Transformer Station and the Cooksville Transformer Station refurbishment projects in 2005, both of which were carried out to accommodate the closure of the Lakeview Generating Station. Our expenditures made to sustain the existing transmission system increased by \$10 million in both the quarter and the year-to-date periods compared to last year's levels, and included additional expenditures associated with the replacement of storm damaged equipment. The year-to-date increase reflects necessary expenditures to refurbish or replace end-of-life assets in our lines and

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**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

stations, as well as the impact of last year's labour disruption. Other transmission capital expenditures decreased by \$4 million in the quarter and, on a year-over-year basis, by \$5 million.

***Distribution***

Distribution capital expenditures increased by \$33 million in the quarter and by \$48 million over the first nine months compared to the same periods in 2005. Expenditures made to sustain our low-voltage distribution system increased by \$28 million in the third quarter and by \$42 million in the year-to-date period. In the quarter, expenditures required to replace components damaged by storms increased by \$30 million to \$38 million. As a result of three significant storms this summer, we replaced more than 1,500 distribution poles and 180 kilometres of line. These expenditures to sustain the distribution system were partially offset by marginally lower expenditures across our stations and transportation and work equipment programs. On a year-to-date basis, expenditures associated with storm restoration increased by \$32 million to \$48 million, and also included the impact of a significant storm front that hit north-central Ontario in early February. Expenditures for the first nine months also reflect higher planned replacements of end-of-life assets, unplanned asset replacements and line relocations, as well as the impact of last year's labour disruption. Capital expenditures to expand and reinforce our distribution network increased by \$6 million in the quarter and by the same amount on a year-to-date basis. These increases primarily reflect our continued deployment of smart meters during the quarter. Our other distribution capital expenditures decreased by \$1 million in the quarter compared to last year but were unchanged on a year-to-date basis.

**Future Capital Expenditures**

Capital expenditures are expected to increase significantly over the medium-term and are anticipated to exceed \$1.2 billion in each of 2007 and 2008. These investment levels will address new development and supply enhancement initiatives, including system expansions, generation requirements and load connections, and the needs of our aging transmission system under continued challenging conditions of tight generation supply. Our transmission rate application, which was filed in the third quarter of 2006, reflected these prudent transmission infrastructure project investments in a secure and reliable transmission system, consistent with the public interest. Within our distribution business, we are planning for the mass deployment of smart meters to begin in 2007.

The Ontario Power Authority (OPA) is responsible for developing the Integrated Power System Plan (IPSP) and submitting it to the OEB for review and approval. The OPA has recently announced it will submit the IPSP to the OEB in March 2007 and has issued a discussion paper on transmission requirements. While we will continue to work closely with the OPA, we will proceed with some transmission projects in the short-term because of pressing need, consistent with our transmission rate application. The IPSP is expected to influence the timing and amount of our future capital expenditures.

**Financing Activities**

Short-term liquidity is provided through funds from operations and our commercial paper program, under which we are authorized to issue up to \$1 billion in short-term notes with a term to maturity of less than 365 days. As at September 30, 2006, no short-term notes were outstanding. The commercial paper program is supported by a \$750 million committed revolving credit facility with a syndicate of banks which matures in August 2007 and which has a two-year extension option. The short-term liquidity under this program and anticipated levels of funds from operations should be sufficient to fund our normal operating requirements. Long-term financing is provided by our access to the debt markets, including our medium-term note program. Our notes and debentures mature between 2006 and 2043. We currently plan to refinance maturing debt principally through our medium-term note program. The maximum authorized principal amount of medium-term notes issuable under this program is \$2,500 million. As at September 30, 2006, \$1,800 million remained available until July 2007.

<b>Rating Agency</b>	<b>Rating</b>	
	<b>Short-term Debt</b>	<b>Long-term Debt</b>
Standard & Poor's Rating Services Inc.	A-1	A
Dominion Bond Rating Service Inc.	R-1 (middle)	A (high)
Moody's Investors Service Inc.	Prime-1	Aa3

We have customary covenants normally associated with long-term debt. Among other things, our long-term debt covenants limit our permissible debt as a percentage of our total capitalization, limit our ability to sell assets and impose a negative pledge provision, subject to customary exceptions. The credit agreement related to our \$750 million credit facility has no material adverse change clauses that could trigger default. However, the credit agreement requires that we provide notice to

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**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

the lenders of any material adverse change within three business days of the occurrence. The agreement also provides limitations that debt cannot exceed 75% of total capitalization and that debt issued by our subsidiaries cannot exceed 10% of the total book value of our assets. We are in compliance with all of these covenants and limitations.

During the third quarter of 2006, we issued \$150 million in long-term debt under our medium-term note program and decreased our short-term notes by \$130 million. We did not issue or retire any short or long-term debt during the comparative quarter.

On a year-to-date basis, we issued \$700 million in long-term debt under our medium-term note program and repaid \$448 million in maturing long-term debt. In comparison, during the same period in 2005, we issued \$500 million in long-term debt under our medium-term note program, repaid \$200 million in maturing long-term debt and reduced our short-term notes by \$40 million.

In the third quarter of 2006, we paid dividends to the Province of Ontario in the amount of \$63 million, consisting of \$59 million in common dividends and \$4 million in preferred dividends. In the comparative period, we paid common dividends of \$68 million and preferred dividends of \$4 million. Year-to-date, we have paid common and preferred dividends totaling \$286 million, compared to \$218 million in 2005.

Common dividends are declared at the sole discretion of our Board of Directors, and are recommended by management based on results of operations, financial condition, cash requirements and other relevant factors such as industry practice, shareholder expectations, the level of net income and timing.

**Summary of Contractual Obligations and Other Commercial Commitments**

The following table presents a summary of our debt and other major contractual obligations as well as other major commercial commitments.

<i>September 30, 2006 (Canadian dollars in millions)</i>	<b>Total</b>	<b>2006<sup>1</sup></b>	<b>2007/2008</b>	<b>2009/2010</b>	<b>After 2011</b>
<b>Contractual Obligations (due by year)</b>					
Long-term debt	5,336	141	895	800	3,500
Inergi LP outsourcing agreement <sup>2</sup>	522	28	207	184	103
Operating lease commitments	16	2	9	4	1
<b>Total Contractual Obligations</b>	<b>5,874</b>	<b>171</b>	<b>1,111</b>	<b>988</b>	<b>3,604</b>
<b>Other Commercial Commitments (by year of expiry)</b>					
Bank line <sup>3</sup>	750	-	750	-	-
Letters of credit <sup>4</sup>	96	85	11	-	-
Guarantees <sup>4</sup>	275	275	-	-	-
Pension <sup>5</sup>	23	15	8	-	-
<b>Total Other Commercial Commitments</b>	<b>1,144</b>	<b>375</b>	<b>769</b>	<b>-</b>	<b>-</b>

<sup>1</sup> The amounts disclosed represent the balance due over the period October 1, 2006 to December 31, 2006.

<sup>2</sup> On March 1, 2002, Inergi LP began providing a range of services to us for a 10-year period, including information technology, customer care, supply chain and certain human resources and finance services.

<sup>3</sup> As a backstop to our commercial paper program, we have a \$750 million, 364-day revolving standby credit facility with a syndicate of banks that matures in August 2007, with a two year term out option.

<sup>4</sup> We currently have bank letters of credit of \$82 million outstanding relating to retirement compensation arrangements. We have also provided prudential support to the IESO as required by the Market Rules, using a combination of bank letters of credit of \$11 million and parental guarantees of \$275 million. The amount of prudential support that we provide in the form of bank letters of credit to the IESO is based on our highest long-term credit rating which is in the "Aa" category. The amount of bank letters of credit provided would need to increase if our highest credit rating deteriorated. For example, if our credit rating declined to "A" category, the amount of bank letters of credit required to meet our prudential support obligation would be 1.7 times our current amount, and if our credit rating declined to "BBB" category, the amount of bank letters of credit required to meet our prudential support obligation would be 3.3 times the current amount. The remaining letters of credit pertain to operating letters of credit and to surety bonds.

<sup>5</sup> Contributions to the pension fund are made one-month in arrears. Contributions after 2006 will be based on an actuarial valuation no later than December 31, 2006 and will depend on future investment returns, changes in benefits or actuarial assumptions. Based on current factors, we currently estimate annual pension contributions for 2007 and beyond to be in the range of \$100 million.

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### **MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

The amounts in the above table under long-term debt are not charged to our results of operations, but are reflected on our balance sheet and statement of cash flows. Interest associated with this debt is recorded under financing charges on our statement of operations or in our capital programs, but these financing charges are not reflected in the above table. Payments in respect of operating leases and our outsourcing agreement with Inergi LP are recorded under operation, maintenance and administration costs on our statement of operations or in our capital programs.

#### **RECENT DEVELOPMENTS**

##### ***NERC Readiness Audit***

In September, the North American Electric Reliability Council (NERC) gave our transmission operations facilities, work processes and staff a grading of excellence for their abilities to reliably operate and maintain Ontario's electricity transmission system. The report singled out our industry leading physical security procedures, infrastructure and program management as well as our innovative and fully integrated, multi-functional communications system. The NERC's ongoing mandate is to ensure that the bulk electric system in North America is reliable, adequate and secure.

##### ***OPA Discussion Papers***

On November 13, 2006, the OPA issued a discussion paper for comment which focuses on specific areas of need and options for reinforcing and expanding Ontario's transmission system. A companion integration discussion paper, which will form the basis of the preliminary IPSP, is also anticipated and is expected to discuss the specific transmission initiatives that will be included in the IPSP. The discussion paper notes that significant investments in transmission will be required over the 20-year planning horizon of the IPSP. We are currently assessing the impacts of the discussion paper and will provide comments accordingly.

##### ***Hydro-Québec Interconnection***

On October 16, 2006, we signed an agreement with Hydro-Québec TransÉnergie for the construction of a new 1,250 MW interconnection between our systems that will allow us to commence construction before the end of 2006. This project provides Ontario with more reliability and flexibility in supply with access to emission-free hydroelectric power, in support of government policy. The Ontario side of the new interconnection will involve upgrading and installing new equipment at Hawthorne Transformer Station, replacing the existing 115kV and 230kV single circuit transmission lines with a new 230kV double circuit transmission line, and constructing an additional 230kV double circuit line.

##### ***Michigan Interconnection***

In October, we rebuilt a two-kilometre 230kV interconnection circuit to the U.S. that was removed after gale-force winds brought down a transmission tower in the Sarnia, Ontario area. This interconnection will provide about 100 MW of import capacity to our transmission system.

##### ***Hurontario Station and Transmission Line Reinforcement***

On September 29, 2006, we filed an application with the OEB to build a new double circuit 230kV transmission line from Cardiff Transformer Station in Brampton to a new switching station to be constructed in Mississauga. This new Hurontario Switching Station is required to maintain reliability and improve system performance in the western Greater Toronto Area. On October 16, 2006, the OEB issued a Notice of Application and Hearing. OEB approval is anticipated in early 2007 and the project is expected to be complete early in 2009.

##### ***Southern Georgian Bay Transmission Reinforcement***

On October 31, 2006, we filed an application with the OEB to rebuild a 27 km single-circuit 115kV line as a double circuit 230kV transmission line. The current line runs from Essa Transformer Station outside Barrie to Stayner Transformer Station west of Barrie. The Stayner station will be upgraded to accommodate the rebuilt line and to meet local needs. We have requested a written hearing and OEB approval is expected in early 2007. The planned in-service date for this project is Spring 2009.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

***Purchases and Sales of Electricity Distributors***

On October 17, 2006, the Ontario Government announced that publicly-owned utilities will be exempt for two years from paying electricity transfer tax when they sell electricity assets to other publicly-owned utilities in Ontario. In addition, the Government has lifted a moratorium on our purchase or sale of electricity distribution assets. We will be open to voluntary and commercially beneficial opportunities.

***OEB RPP Price Change***

On October 11, 2006, the OEB announced a decrease in electricity prices for RPP customers. Beginning November 1, 2006, the electricity price has been reduced from 5.8 cents to 5.5 cents per kilowatt hour for customers consuming up to certain thresholds, depending on the type of customer, and from 6.7 cents to 6.4 cents for kilowatt hours exceeding the thresholds.

***Debt Issue***

On October 19, 2006, we issued \$75 million of 40 year notes under our medium-term note program at a coupon rate of 5.00%, a maturity date of October 19, 2046, and at a yield of 5.01%.

**SELECTED FINANCIAL HIGHLIGHTS AND RATIOS**

<i>(Canadian dollars in millions) (except as otherwise noted)</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net income	103	133	354	379
Net cash from operating activities	351	337	715	794
Capital expenditures	218	144	593	481
Earnings per common share <i>(Canadian dollars)</i>	991	1,289	3,407	3,654
Earnings coverage ratio <sup>1</sup>			2.66	2.86
Net asset coverage on long-term debt <sup>2</sup>			1.90	1.93
Total debt to capitalization <sup>3</sup>			53%	52%

<sup>1</sup>The earnings coverage ratio has been presented for the twelve months ended September 30, 2006 and September 30, 2005, respectively and has been calculated as the sum of net income, provision for payments in lieu of corporate income taxes and financing charges divided by the sum of financing charges, capitalized interest and cumulative preferred dividends. The earnings coverage ratio for the twelve months ended September 30, 2005, excluding the impact of the \$91 million regulatory recovery recognized in 2004 as a result of the OEB's December 9, 2004 rate decision, was 2.60.

<sup>2</sup>The net asset coverage on long-term debt ratio has been presented as at September 30, 2006 and December 31, 2005 and has been calculated as total assets minus total liabilities excluding long-term debt (including current portion) divided by long-term debt (including current portion).

<sup>3</sup>Total debt to capitalization ratio has been presented as at September 30, 2006 and December 31, 2005 and has been calculated as total debt divided by total debt plus total shareholder's equity.

**FORWARD LOOKING STATEMENTS AND OTHER INFORMATION**

Our oral and written public communications, including this Management Discussion and Analysis (MD&A), often contain forward looking statements that are based on current expectations, estimates, forecasts and projections about our business and the industry in which we operate and include beliefs and assumptions made by the management of our company. Such statements include, but are not limited to words such as "expect," "anticipate," "intend," "attempt," "may," "plan," "will", "believe," "seek," "estimate," and variations of such words and similar expressions are intended to identify such forward looking statements. These statements are not guarantees of future performance and involve assumptions and risks and uncertainties that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed, implied or forecasted in such forward looking statements. We do not intend, and we disclaim any obligation to update any forward looking statements, whether written or oral, or whether as a result of new information, future events or otherwise.

**HYDRO ONE INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

These forward looking statements are based on a variety of factors and assumptions including, but not limited to the following:

- Our forecasted future capital expenditures of \$1.2 billion in each of 2007 and 2008 could be affected by approvals required from several regulatory bodies. Any such delays could also affect the reliability and quality of our services.
- We could face reductions in the allowable return on common equity of our regulated businesses. A lower return on common equity could affect our credit ratings and ability to attract necessary capital.
- We have forecasted \$100 million in contributions to our defined benefit pension plan for 2007. These contributions could be affected by, but not limited to, the expected return on pension assets, future interest rates and inflation.

These assumptions are based on information currently available to us, including information obtained from third-party industry analysts. Actual results may differ materially from those predicted by such forward looking statements. While we do not know what impact any of these differences may have, our business, results of operations, financial condition and our credit stability may be materially adversely affected.

We caution the reader that the above list of factors is not exhaustive.

This MD&A is dated as at November 14, 2006. Additional information about our company, including our annual information form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

**HYDRO ONE INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)**

<i>(Canadian dollars in millions)</i>	<b>Three months ended September 30</b>		<b>Nine months ended September 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Revenues</b>				
Transmission <i>(Note 3)</i>	331	356	945	991
Distribution <i>(Note 4)</i>	828	818	2,441	2,385
Other	6	5	17	15
	<u>1,165</u>	<u>1,179</u>	<u>3,403</u>	<u>3,391</u>
<b>Costs</b>				
Purchased power	564	581	1,667	1,683
Operation, maintenance and administration	233	197	652	567
Depreciation and amortization	132	120	377	361
	<u>929</u>	<u>898</u>	<u>2,696</u>	<u>2,611</u>
<b>Income before financing charges and provision for payments in lieu of corporate income taxes</b>				
	236	281	707	780
Financing charges	74	84	220	247
<b>Income before provision for payments in lieu of corporate income taxes</b>				
	162	197	487	533
Provision for payments in lieu of corporate income taxes <i>(Note 5)</i>	59	64	133	154
<b>Net income</b>	<u>103</u>	<u>133</u>	<u>354</u>	<u>379</u>
<b>Basic and fully diluted earnings per common share <i>(Canadian dollars)</i></b>				
	991	1,289	3,407	3,654

**CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (unaudited)**

<i>(Canadian dollars in millions)</i>	<b>Three months ended September 30</b>		<b>Nine months ended September 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Retained earnings, beginning of period</b>	1,107	987	1,079	887
Net income	103	133	354	379
Dividends <i>(Note 6)</i>	(63)	(72)	(286)	(218)
<b>Retained earnings, end of period</b>	<u>1,147</u>	<u>1,048</u>	<u>1,147</u>	<u>1,048</u>

*See accompanying notes to Consolidated Financial Statements.*

**HYDRO ONE INC.**  
**CONSOLIDATED BALANCE SHEETS (unaudited)**

<i>(Canadian dollars in millions)</i>	<b>September 30, 2006</b>	<b>December 31, 2005</b>
<b>Assets</b>		
Current assets		
Short-term investments	97	-
Accounts receivable (net of allowance for doubtful accounts)	702	622
Materials and supplies	58	56
Other	4	12
	<b>861</b>	<b>690</b>
Fixed assets		
Fixed assets in service	15,953	15,553
Less: accumulated depreciation	6,087	5,818
	<b>9,866</b>	<b>9,735</b>
Construction in progress	541	375
	<b>10,407</b>	<b>10,110</b>
Long-term assets		
Deferred pension asset	399	449
Regulatory assets	339	430
Goodwill	133	133
Deferred debt costs	24	23
Other	8	10
	<b>903</b>	<b>1,045</b>
<b>Total assets</b>	<b>12,171</b>	<b>11,845</b>
<b>Liabilities</b>		
Current liabilities		
Bank indebtedness	9	9
Accounts payable and accrued charges	627	694
Accrued interest	91	43
Long-term debt payable within one year (Note 7)	536	589
	<b>1,263</b>	<b>1,335</b>
Long-term debt (Note 7)	4,792	4,466
Other long-term liabilities		
Employee future benefits other than pension (Note 8)	782	716
Regulatory liabilities (Note 3)	474	525
Environmental liabilities	57	64
Long-term accounts payable and accrued charges	19	23
	<b>1,332</b>	<b>1,328</b>
<b>Total liabilities</b>	<b>7,387</b>	<b>7,129</b>
<b>Shareholder's equity</b>		
Preferred shares (authorized: unlimited; issued: 12,920,000)	323	323
Common shares (authorized: unlimited; issued: 100,000)	3,314	3,314
Retained earnings	1,147	1,079
<b>Total shareholder's equity</b>	<b>4,784</b>	<b>4,716</b>
<b>Total liabilities and shareholder's equity</b>	<b>12,171</b>	<b>11,845</b>

See accompanying notes to Consolidated Financial Statements.

**HYDRO ONE INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

<i>(Canadian dollars in millions)</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Operating activities</b>				
Net income	103	133	354	379
Adjustments for non-cash items:				
Depreciation and amortization (net of removal costs)	120	111	347	331
Transmission earnings sharing mechanism	6	-	24	-
Amortization of discount	5	15	23	45
Low-voltage services	-	(7)	(8)	(19)
Retail settlement variance accounts	(5)	(10)	1	12
	229	242	741	748
Changes in non-cash balances related to operating activities	122	95	(26)	46
<b>Net cash from operating activities</b>	<b>351</b>	<b>337</b>	<b>715</b>	<b>794</b>
<b>Financing activities</b>				
Long-term debt issued	150	-	700	500
Long-term debt retired	-	-	(448)	(200)
Termination of forward sale	-	-	-	(10)
Short-term notes payable	(130)	-	-	(40)
Dividends paid	(63)	(72)	(286)	(218)
Other	-	2	(4)	1
<b>Net cash (used in) from financing activities</b>	<b>(43)</b>	<b>(70)</b>	<b>(38)</b>	<b>33</b>
<b>Investing activities</b>				
Fixed assets	(218)	(144)	(593)	(481)
Other assets	4	(7)	13	9
<b>Net cash used in investing activities</b>	<b>(214)</b>	<b>(151)</b>	<b>(580)</b>	<b>(472)</b>
<b>Net change in cash and cash equivalents</b>	<b>94</b>	<b>116</b>	<b>97</b>	<b>355</b>
Cash and cash equivalents, beginning of period	(6)	230	(9)	(9)
<b>Cash and cash equivalents, end of period</b>	<b>88</b>	<b>346</b>	<b>88</b>	<b>346</b>

See accompanying notes to Consolidated Financial Statements.

**HYDRO ONE INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)**

**1. BASIS OF PRESENTATION**

These interim Consolidated Financial Statements do not conform in all respects to the disclosure requirements of Canadian generally accepted accounting principles for annual financial statements and should, therefore, be read in conjunction with the annual Consolidated Financial Statements of Hydro One Inc. (Hydro One or the Company) which includes information necessary or useful to understanding the Company's business and financial statement presentation. In particular, the Company's significant accounting policies and practices are presented as Note 2 to the annual Consolidated Financial Statements, and have been consistently applied in the preparation of these interim Consolidated Financial Statements.

The demand for electricity generally follows normal weather-related variations, and therefore the Company's energy-related revenues, all other things being equal, will tend to be higher in the first and third quarters than in the second and fourth quarters.

**2. CONDITIONAL ASSET RETIREMENT OBLIGATIONS**

Effective April 1, 2006, Hydro One adopted the new accounting recommendations for "Conditional Asset Retirement Obligations" issued by the Emerging Issues Committee of the Canadian Institute of Chartered Accountants. Although Hydro One has identified several conditional asset retirement obligations, the Company expects to use the majority of the related assets for an indefinite period. As such, a removal date cannot be determined and a reasonable estimate of the fair value of related asset retirement obligations cannot be made at this time. The Company did determine that there is an immaterial liability associated with the disposal of treated wood utility poles. If at some future date, it becomes possible to estimate the fair value of the cost of disposing the other assets that the Company is legally required to dispose of, a related asset retirement obligation will be recognized at that time.

**3. TRANSMISSION EXCESS EARNINGS SHARING MECHANISM**

On October 26, 2005, the Ontario Energy Board (OEB) commenced a proceeding on its own motion to determine whether the rates of Hydro One's transmission business are just and reasonable, and to approve or fix revenue requirements for the transmission of electricity for the years 2006, 2007 and 2008. On February 21, 2006, the OEB announced a decision to apply an earnings sharing mechanism to equally share, between Hydro One's shareholder and its customers, any transmission earnings in excess of the approved return of 9.88%, for the period January 1, 2006 until new transmission rates are set. The earnings sharing amount will be based on the Company's audited transmission financial statements and will be held in a regulatory deferral account until disposed of by the OEB. As at September 30, 2006, \$24 million had been recorded in the regulatory liability account, inclusive of interest.

**4. DISTRIBUTION RATE DECISION**

On April 12, 2006, the OEB announced its decision regarding the Company's rate application in respect of the distribution business of Hydro One Networks Inc. On the basis of the written and oral evidence submitted, the OEB approved the requested increase in the revenue requirement based on a reduction in the approved rate of return, from 9.88% to 9.00%, effective May 1, 2006.

**5. PAYMENTS IN LIEU OF CORPORATE INCOME TAXES**

In the first quarter of 2006, Hydro One recognized a tax benefit of approximately \$30 million in respect of a recovery of payments in lieu of corporate income taxes from prior years. Future income taxes related to the regulated businesses are accounted for using the taxes payable method and have not been recorded in the accounts as they are expected to be recovered through future revenues. In the absence of rate regulated accounting, in the third quarter of 2006, Hydro One would have recorded a future income tax benefit of \$26 million related to the reduction of federal tax rates. As at September 30, 2006, after taking into account a reduction in the tax rate and additional temporary differences occurring in the first nine months of 2006, unrecognized future income tax liabilities amounted to approximately \$253 million (December 31, 2005 - \$265 million).

**HYDRO ONE INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)**

**6. DIVIDENDS**

During the three months ended September 30, 2006, preferred dividends in the amount of \$4 million (2005 - \$4 million) and common dividends in the amount of \$59 million (2005 - \$68 million) were declared. During the nine months ended September 30, 2006, preferred dividends in the amount of \$13 million (2005 - \$13 million) and common dividends in the amount of \$273 million (2005 - \$205 million) were declared.

**7. LONG-TERM DEBT**

On March 3, 2006, Hydro One issued notes under its Medium Term Note (MTN) program. The issue was comprised of medium term notes with a principal amount of \$300 million having a 10-year term with a coupon rate of 4.64%, and at a yield of 4.648%. The notes are due March 3, 2016.

On April 24, 2006, the Company issued \$250 million of 30-year notes under its MTN program at a coupon rate of 5.36%, a maturity date of May 20, 2036, and at a yield of 5.412%. This issue is a re-opening of the notes originally issued in May 2005.

On June 27, 2006, the maturity date of the Company's \$750 million standby revolving credit facility was extended to August 10, 2007.

On August 22, 2006, the Company issued \$150 million of 10-year notes under its MTN program at a coupon rate of 4.64%, a maturity date of March 3, 2016, and at a yield of 4.745%. This issue is a re-opening of the notes originally issued in March 2006.

**8. EMPLOYEE FUTURE BENEFITS**

Total benefit costs are as follows:

<i>(Canadian dollars in millions)</i>	<b>Three months ended September 30</b>		<b>Nine months ended September 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Pension</b>				
Net periodic benefit cost	38	43	116	130
Pension fund contribution	22	20	66	63
Less: Portion attributable to labour and capitalized as part of the cost of fixed assets	8	6	25	22
Portion attributable to regulatory assets	-	4	11	18
Charged to results of operations	14	10	30	23
<b>Employee Future Benefits Other than Pension</b>				
Net periodic benefit cost	30	18	91	66
Less: Portion attributable to labour and capitalized as part of the cost of fixed assets	10	9	29	25
Charged to results of operations	20	9	62	41

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****9. SEGMENTED REPORTING**

Hydro One has three reportable segments:

- The transmission business, which comprises the core business of providing transportation and connection services, is responsible for transmitting electricity throughout the Ontario electricity grid;
- The distribution business, which comprises the core business of delivering and selling electricity to customers; and
- An "other" segment primarily consisting of telecommunication. The Company is currently in the process of assessing its strategy with respect to these operations.

The designation of segments has been based on a combination of regulatory status and the nature of the products and services provided. Segment information on the above basis is as follows:

<i>Three months ended September 30 (Canadian dollars in millions)</i>	<b>Transmission</b>	<b>Distribution</b>	<b>Other</b>	<b>Consolidated</b>
<b>2006</b>				
<b>Segment profit</b>				
Revenues	331	828	6	1,165
Purchased power	-	564	-	564
Operation, maintenance and administration	105	122	6	233
Depreciation and amortization	64	67	1	132
<b>Income (loss) before financing charges and provision for payments in lieu of corporate income taxes</b>				
	162	75	(1)	236
Financing charges				74
<b>Income before provision for payments in lieu of corporate income taxes</b>				
				162
<b>Capital expenditures</b>				
	93	123	2	218
<b>2005</b>				
<b>Segment profit</b>				
Revenues	356	818	5	1,179
Purchased power	-	581	-	581
Operation, maintenance and administration	91	100	6	197
Depreciation and amortization	59	59	2	120
<b>Income (loss) before financing charges and provision for payments in lieu of corporate income taxes</b>				
	206	78	(3)	281
Financing charges				84
<b>Income before provision for payments in lieu of corporate income taxes</b>				
				197
<b>Capital expenditures</b>				
	53	90	1	144

# HYDRO ONE INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

<i>Nine months ended September 30 (Canadian dollars in millions)</i>	<b>Transmission</b>	<b>Distribution</b>	<b>Other</b>	<b>Consolidated</b>
<b>2006</b>				
<b>Segment profit</b>				
Revenues	945	2,441	17	3,403
Purchased power	-	1,667	-	1,667
Operation, maintenance and administration	307	328	17	652
Depreciation and amortization	184	189	4	377
<b>Income (loss) before financing charges and provision for payments in lieu of corporate income taxes</b>				
	454	257	(4)	707
Financing charges				220
<b>Income before provision for payments in lieu of corporate income taxes</b>				
				487
<b>Capital expenditures</b>	290	298	5	593
<b>2005</b>				
<b>Segment profit</b>				
Revenues	991	2,385	15	3,391
Purchased power	-	1,683	-	1,683
Operation, maintenance and administration	261	288	18	567
Depreciation and amortization	182	175	4	361
<b>Income (loss) before financing charges and provision for payments in lieu of corporate income taxes</b>				
	548	239	(7)	780
Financing charges				247
<b>Income before provision for payments in lieu of corporate income taxes</b>				
				533
<b>Capital expenditures</b>	229	250	2	481

<i>(Canadian dollars in millions)</i>	<b>September 30, 2006</b>	<b>December 31, 2005</b>
<b>Total assets</b>		
Transmission	6,887	6,827
Distribution	5,096	4,926
Other	188	92
	12,171	11,845

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

### 10. SUBSEQUENT EVENTS

October 11, 2006, the OEB announced a decrease in electricity prices for Regulated Price Plan (RPP) customers. Beginning November 1, 2006, the electricity price has been reduced from 5.8 cents to 5.5 cents per kilowatt hour for customers consuming up to certain thresholds, depending on the type of customer, and from 6.7 cents to 6.4 cents for kilowatt hours exceeding the thresholds. Changes in the RPP do not impact net income.

On October 19, 2006, the Company issued \$75 million of 40-year notes under its MTN program at a coupon rate of 5.00%, a maturity date of October 19, 2046, and at a yield of 5.01%.

On October 31, 2006 the Superior Court of Ontario dismissed the legal claim against the Company by Torcom Communications Inc. (Torcom). This claim had sought \$150 million in damages, as well as specific performance of certain agreements and interim injunctive relief, and was originally filed by Torcom against Hydro One's predecessor corporation, Ontario Hydro, in 1995.

### 11. COMPARATIVE FIGURES

The comparative Consolidated Financial Statements have been reclassified from statements previously presented to conform to the presentation of the September 30, 2006 Consolidated Financial Statements.