

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 months ended March 31, 2007 to the three months ended March 31, 2006.

Revenues

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2007	2006	\$ Change	% Change
Transmission	327	298	29	10
Distribution	944	856	88	10
Other	7	6	1	17
	1,278	1,160	118	10
Average Ontario 60-minute peak demand (MW) ¹	23,480	22,382	1,098	5
Distribution - units distributed to customers (TWh) ¹	8.6	8.0	0.6	8

¹System-related statistics are preliminary

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

Transmission

Transmission revenues consist predominantly 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 with sufficient capacity to accommodate maximum expected demand, which 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.

Our transmission tariff revenues increased by \$29 million, or 10%, during the first quarter of 2007 compared to the same period last year. On March 30, 2007, the Ontario Energy Board (OEB) issued a decision ordering that the transmission earnings sharing mechanism cease effective January 1, 2007. This decision had the effect of increasing transmission revenues by \$15 million in the quarter as compared to the same period last year. In addition, the monthly peak demands were higher during the first quarter of 2007, reflecting the colder weather experienced in the winter. Consequently, tariff revenues increased by \$14 million compared to the same period last year.

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.

Distribution revenues increased by \$88 million, or 10%, during the first quarter of 2007 compared to the same period last year, primarily as a result of the recovery of increased purchased power costs of \$43 million, as described below under "Purchased Power." In addition, on April 12, 2006, after reviewing our oral and written evidence, the OEB approved increases in tariff rates for the distribution businesses conducted by our subsidiaries, Hydro One Networks Inc. (Hydro One Networks) and Hydro One Brampton Networks Inc. (Hydro One Brampton Networks), effective May 1, 2006. We also received OEB approval for low-voltage rates for services provided to local distribution companies that are embedded within our service territory. These tariff rate increases support the maintenance and investment requirements of our distribution system, enabling the safe and reliable delivery of electricity to our customers throughout Ontario, and resulted in higher distribution revenues of \$33 million. Higher energy consumption resulting from the colder winter weather this year increased distribution revenues by an additional \$8 million. The remaining increase reflects marginally higher ancillary revenues.

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

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. The commodity cost of energy for certain low-volume and designated customers is based on 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 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 RPP is provided below.

Summary of RPP				
Effective Date	Tier Threshold (kWh)		Tier Rates (cents/kWh)	
	Residential	Non-Residential	First Tier	Second Tier
November 1, 2005	1,000	750	5.0	5.8
May 1, 2006	600	750	5.8	6.7
November 1, 2006	1,000	750	5.5	6.4

Purchased power costs increased by \$43 million, or 7%, to \$641 million compared to the first quarter of 2006. This increase primarily reflects higher demand for electricity of \$34 million due to the colder weather experienced during the winter, an increase in wholesale market service charges levied by the IESO of \$8 million, and an increase associated with the OEB's RPP for residential and other eligible customers of \$2 million, partially offset lower wholesale commodity prices of \$1 million for customers who are not eligible for the RPP.

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.

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

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2007	2006	\$ Change	% Change
Transmission	99	93	6	6
Distribution	128	86	42	49
Other	7	6	1	17
	234	185	49	26

Transmission

Operation, maintenance and administration expenditures incurred to sustain our high-voltage transmission stations, lines and rights-of-way increased by \$6 million, or by 6%, in the quarter compared to the same period last year. Within our work programs, we continued our investments to ensure the operation of a safe and reliable transmission system. We experienced higher work program expenditures of approximately \$4 million, primarily related to increased maintenance within our stations resulting from an earlier commencement of planned program work. This increase was partially offset by lower line clearing and brush control expenditures. In addition, we experienced marginally higher support expenditures this quarter, primarily related to the commencement of a major business systems and processes project.

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Distribution

Operation, maintenance and administration expenditures necessary to maintain our low-voltage system increased by \$42 million, or 49%, relative to the comparative period in 2006. Our work program increased by \$40 million, primarily due to higher line clearing and brush control expenditures, consistent with our increased focus on these activities within our distribution business in the current period, as well as higher conservation and demand management (CDM) expenditures. In addition, pension costs within our distribution business were impacted by a 2006 OEB rate decision. Prior to May 1, 2006, all of our distribution-related pension costs were deferred as a regulatory asset. In addition to the increase in our work program, our other support expenditures increased marginally, primarily as a result of the commencement of a major business systems and processes project.

Depreciation and Amortization

Depreciation and amortization expense for the first quarter increased by \$7 million, or 6%, to \$125 million compared to the same period last year. This increase was primarily due to higher amortization of our regulatory assets resulting from the April 12, 2006 OEB rate decision, effective May 1, 2006. In addition, our depreciation expense was higher this year due to increased assets in-service, consistent with our capital expenditures programs.

Financing Charges

Financing charges for the first three months of the year were unchanged from the same period last year at \$73 million. Our interest on long-term debt was lower by approximately \$5 million, reflecting lower interest rates. This impact was offset by lower interest capitalization on our regulatory assets combined with the impact of interest on our refund of payments in lieu of property taxes in the first quarter of last year.

Provision for Payments in Lieu of Corporate Income Taxes

The provision for payments in lieu of corporate income taxes increased by \$22 million, or 65%, to \$56 million in the first three months of this year compared to last year. This increase was primarily due to last year's recognition of a \$30 million tax benefit related to the recovery of payments in lieu of corporate taxes from prior years, combined with higher pre-tax income this year. These impacts were partially offset by increased temporary differences, primarily related to higher capital cost allowance.

Net Income

Net income of \$149 million was lower by \$3 million, or 2%, compared to 2006 first quarter results. We experienced higher tariff revenues this year, primarily as a result of OEB decisions removing the transmission earnings sharing mechanism effective January 1, 2007 and approving new distribution rates effective May 1, 2006. However, these increases were more than offset by the impact of an increase in our effective tax rate in the period due to the recognition of a tax benefit in the first quarter of last year, combined with higher operation, maintenance and administration expenditures on our work programs and the impact of a 2006 OEB decision on our distribution-related pension expenditures.

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

Quarterly Results of Operations

The following table sets forth unaudited quarterly information for each of the eight quarters from June 30, 2005 through March 31, 2007. 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 which include 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>	2007		2006		2005			
	Mar. 31	Dec. 31	Sep. 30	Jun. 30	Mar. 31	Dec. 31	Sep. 30	Jun. 30
<i>Quarter ended</i>								
Total revenues ^{1,2,3}	1,278	1,142	1,165	1,078	1,160	1,025	1,179	1,018
Net income ^{1,2,3}	149	101	103	99	152	104	133	115
Net income to common shareholder ^{1,2,3}	145	96	99	94	148	99	129	110

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

² Under a new regulation issued in October 2005, RPP customers received a one-time 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.

³ During 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. This is expected to occur later in 2007.

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.

Summary of Sources and Uses of Cash

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2007	2006
Operating activities	299	146
Financing activities		
Long-term debt issued	400	300
Short-term notes payable	(60)	-
Dividends paid	(107)	(159)
Investing activities		
Capital expenditures	(187)	(177)
Other financing and investing activities	(1)	8
Net change in cash and cash equivalents	344	118

Operating Activities

Net cash generated from operating activities increased in the first quarter by \$153 million to \$299 million relative to the comparative period. This increase reflects lower working capital requirements this year, primarily attributable to the impact of issuing the *Ontario Price Credit* to RPP customers in early 2006, pursuant to regulation. Our working capital requirements in the quarter also decreased as a result of the timing of tax installment payments.

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

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 March 31, 2007, we had no short-term notes 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 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 2007 and 2046. 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 March 31, 2007, \$1,325 million remained available until July 2007.

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

¹ On March 26, 2007, Standard & Poor's Ratings Services Inc. affirmed our "A" long-term debt rating and revised its outlook on the company to positive from stable.

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 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 first quarter of 2007, we issued \$400 million in long-term debt under our Medium-Term Note Program and had no maturities and no short-term notes outstanding at the balance sheet date. During the same period in 2006, we issued \$300 million in long-term debt and also had no maturities or short-term notes outstanding.

In the first quarter of 2007, we paid dividends to the Province of Ontario in the amount of \$107 million, consisting of \$103 million in common dividends and \$4 million in preferred dividends. In the comparative period, we paid common dividends of \$155 million and preferred dividends of \$4 million.

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 and shareholder expectations. Common dividends pertaining to the quarterly financial results are generally declared and paid in the immediately following quarter.

Investing Activities

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

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2007	2006	\$ Change	% Change
Transmission	95	100	(5)	(5)
Distribution	91	75	16	21
Other	1	2	(1)	(50)
	187	177	10	6

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Transmission

Transmission capital expenditures decreased by \$5 million, or 5%, to \$95 million, compared to the first quarter of 2006. Expenditures made to expand and reinforce our transmission system were \$48 million, a reduction of \$6 million from the comparative period in 2006. This reduction primarily reflects last year's substantive completion of our Niagara Reinforcement Project. Final completion 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. This impact was partially offset by increased development work related to the construction of our new inter-connection with Quebec, a major reconfiguration of our Lambton Transformer Station, and the continued construction of our downtown Toronto Cable Project. Expenditures to sustain our existing transmission system were relatively unchanged in the first three months compared to the same period last year at \$41 million, an increase of \$1 million. Our other transmission capital expenditures were unchanged compared to the first three months last year at \$6 million.

Distribution

Distribution business capital expenditures made during the first three months of this year were \$91 million, representing a \$16 million, or 21%, increase over last year's levels for the same period. Expenditures to sustain our distribution system were moderately higher at \$40 million, an increase of \$5 million in the quarter. This increase was primarily due to higher end of life planned replacement expenditures in our lines work program. Capital investments to expand and reinforce our distribution network were \$38 million, \$5 million higher than the comparative period. This increase primarily reflects our investments in smart meters. During the quarter, we installed about 29,000 smart meters, for a cumulative total of approximately 57,000. We plan to install approximately 240,000 smart meters in 2007. Other capital expenditures increased by \$6 million to \$13 million in the quarter as a result of higher information technology expenditures, including expenditures related to a significant business systems and processes project, and increased purchases of minor support assets.

Future Capital Expenditures

Our capital expenditures are planned to be about \$1.25 billion in 2007 and \$1.35 billion in 2008. These planned investments 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 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 plan to continue the mass deployment of smart meters begun in the first quarter of this year.

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 is expected to submit the IPSP to the OEB in 2007. We intend to 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 amount of our future capital expenditures. The timing of many of our development projects is dependent upon the final IPSP, the requirement for approvals from various regulatory bodies, and requirements for negotiations and consultations with customers, neighbouring utilities and other stakeholders and our ability to effectively resource these projects. We will not undertake large capital expenditures without a reasonable expectation of recovering them in our rates.

Our distribution investment plan includes the mass rollout of the smart metering program. Over the period 2007 to 2010, we anticipate installing over 1 million meters throughout our service territory. Consistent with the government policy, all homes and small businesses are to receive a smart meter by 2010. Total project costs are anticipated to be significant. In 2007, we plan to invest approximately \$75 million under our smart meter program. At the Province's request, we will review our implementation plan and associated costs for the period 2008 to 2010.

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

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>March 31, 2007 (Canadian dollars in millions)</i>	Total	2007¹	2008/2009	2010/2011	After 2011
Contractual Obligations (due by year)					
Long-term debt – principal repayments	5,670	395	900	650	3,725
Long-term debt – interest payments	5,324	269	563	487	4,005
Inergi LP outsourcing agreement ²	469	83	192	179	15
Operating lease commitments	15	4	9	1	1
Total Contractual Obligations	11,478	751	1,664	1,317	7,746
Other Commercial Commitments (by year of expiry)					
Bank line ³	750	750	-	-	-
Letters of credit ⁴	113	113	-	-	-
Guarantees ⁴	275	275	-	-	-
Pension ⁵	283	75	200	8	-
Total Other Commercial Commitments	1,421	1,213	200	8	-

¹ The amounts disclosed represent the balances due over the period April 1, 2007 to December 31, 2007.

² On March 1, 2002, Inergi 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.

³ 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 extension option.

⁴ We currently have bank letters of credit of \$93 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 \$17 million and parental guarantees of \$275 million. Currently, 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 the "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 ratings 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 amounts included in letters of credit pertain to operating letters of credit and to surety bonds.

⁵ Contributions to the pension fund are made one month in arrears. Contributions for 2007 will be based on an actuarial valuation effective December 31, 2006 and will depend on future investment returns, changes in benefits or actuarial assumptions. Based on current factors, we currently estimate our annual pension contributions for 2007 and beyond to be up to \$100 million.

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.

RELATED PARTY TRANSACTIONS

Related party transactions primarily consist of our transmission revenues received from, and our power purchases payments made to, the IESO, which is a related party by virtue of its status as an agency of our shareholder the Province of Ontario. The year-over-year changes in these amounts are described more fully in our discussion of our transmission revenues and purchased power costs. Other significant related party transactions include our dividends which are paid to the Province and our payments in lieu of corporate income taxes which are paid or payable to the Ontario Electricity Financial Corporation.

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

RECENT DEVELOPMENTS

Bruce to Milton Transmission Reinforcement

On March 26, 2007, the OPA recommended commencement of the planning and approval process required to build a new 500kV transmission line on an existing transmission corridor that is to be widened between the Bruce region and our Milton Switching Station. The new line will provide transmission capability to reliably deliver an additional 3,000 MW of generation capacity. This project is the largest expansion of Ontario's transmission system in almost 20 years, and is critical to securing Ontario's clean and renewable energy future. On March 29, 2007, we filed a leave-to-construct application with the OEB. This project represents an investment of approximately \$635 million in Ontario's transmission system and is expected to be complete in late 2011.

Other Applications to Construct Facilities

On January 26, 2007 and January 31, 2007, the OEB issued decisions approving our leave-to-construct applications for our Southern Georgian Bay Transmission Line Reinforcement and Hurontario Station and Transmission Line Reinforcement projects, respectively. These facilities are required to maintain reliability and improve system performance.

On February 28, 2007, we filed an application with the OEB to build approximately three kilometers of 230kV underground transmission circuits to be located on an existing transmission line right of way between Jim Yarrow Transformer Station in Brampton and the proposed Hurontario Switching Station. The new circuits are required to improve the reliability and quality of service to consumers in the Western Brampton area.

On March 9, 2007, we filed an application with the OEB to build transmission line facilities in the Woodstock area. These facilities are required to increase transmission capacity to ensure the availability and quality of electricity supply to consumers in the area.

Transmission and Distribution Rate Applications

On March 26 and 27, 2007, a settlement conference was held in connection with Hydro One Networks' application seeking the approval of transmission rates and revenue requirement for implementation in 2007. On March 30, 2007, the OEB issued a decision ordering that the transmission earnings sharing mechanism cease effective January 1, 2007. After OEB review, the approved balance of this account, including interest, is expected to be incorporated into future rates to be set later in 2007. In its recent decision, the OEB also ordered Hydro One Networks to establish a new regulatory deferral account, effective January 1 2007, to record the revenue differential between existing transmission rates and the new rates that will be approved later in the year.

On April 20, 2007, the OEB released its decision regarding the 2007 rate application made by Hydro One Networks. The OEB approved the submission on the basis of its cost of capital and second generation incentive regulation mechanism policies. The revised rates, including an amount of 93 cents per month per metered customer for smart meters, were approved for implementation effective May 1, 2007. On April 12, 2007, the OEB issued a decision on the same basis in respect of the 2007 rate application made by our subsidiary Hydro One Brampton Networks. The new rates include an amount of 67 cents per month per metered customer for smart meters and were also approved for implementation effective May 1, 2007.

On April 4, 2007, the OEB announced that Hydro One Networks has been selected to have 2008 distribution rates rebased under the OEB's multi-year distribution rate-setting plan. Hydro One Brampton Networks filed a letter with the OEB requesting to be included in the 2010 distribution rate group for their cost of service review.

OEB RPP Price Change

On April 12, 2007, the OEB announced a decrease in electricity prices for RPP customers for the period May 1 to October 31, 2007. The electricity price has been reduced from 5.5 cents to 5.3 cents per kilowatt hour for customers consuming up to certain thresholds, depending on the type of customer, and from 6.4 cents to 6.2 cents for kilowatt hours exceeding the thresholds.

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

Conservation and Demand Management (CDM)

On April 2, 2007, we filed our 2006 CDM Annual Report with the OEB which highlights our results since the program's inception in 2005. To date, approximately 880,000 of our customers have participated in one or more of our 20 CDM initiatives and programs. The results of this participation include expected electricity savings over the lifetime of installed energy efficient equipment of 635 million kWh, or the annual consumption of over 53,000 homes. In addition to energy savings, the demand for electricity during peak periods has been reduced by almost 11 MW.

Purchases and Sales of Electricity Distributors

On October 17, 2006, the government of Ontario lifted the moratorium on the purchase and sale of our electricity distribution assets and customer service territories and required us to submit a rationalization strategy for approval. On March 19, 2007, the government approved our proposed rationalization strategy.

Debt Issue

On March 13, 2007, we issued \$400 million of 30-year notes at a coupon rate of 4.89% and with a maturity date of March 13, 2037 at a yield of 4.89%. This is our first issue under the Medium-Term Note Program in 2007.

Credit Rating

On March 26, 2007, Standard & Poor's Ratings Services Inc. affirmed our "A" long-term debt rating and revised its outlook on the company to positive from stable.

Society Negotiations

We commenced early bargaining for the next collective agreement with the Society of Energy Professionals to proactively address a number of operational challenges at this point in time. Discussions will continue through May with a mutually agreed deadline of May 31, 2007 set for reaching an agreement.

SELECTED FINANCIAL HIGHLIGHTS AND RATIOS

<i>Three months ended March 31 (Canadian dollars in millions) (except as otherwise noted)</i>	2007	2006
Net income	149	152
Net cash from operations	299	146
Capital expenditures	187	177
Earnings per common share (Canadian dollars)	1,446	1,474
Earnings coverage ratio ¹	2.74	2.69
Net asset coverage on long-term debt ratio ²	1.86	1.92
Total debt to capitalization ratio ³	54%	52%

¹The earnings coverage ratio has been presented for the twelve months ended March 31, 2007 and March 31, 2006, 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.

²The net asset coverage on long-term debt ratio has been presented as at March 31, 2007 and December 31, 2006 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).

³Total debt to capitalization ratio has been presented as at March 31, 2007 and December 31, 2006 and has been calculated as total debt divided by total debt plus total shareholder's equity.

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

FORWARD-LOOKING STATEMENTS AND INFORMATION

Our oral and written public communications, including this Management's Discussion and Analysis, 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 statements regarding future capital expenditures; statements about the installation and cost of smart meters; expectations surrounding future pension contributions; statements regarding potential incremental environmental expenditures; and expectations concerning the impact of new accounting standards. 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, except as required by law.

These forward looking statements are based on a variety of factors and assumptions including, but not limited to the following: no unforeseen changes in the legislative and operating framework for Ontario's electricity market; favourable decisions from the OEB and other regulatory bodies concerning outstanding rate and other applications; and no significant events occurring outside the ordinary course of business. 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. Factors that could cause actual results or outcomes to differ materially from the results expressed or implied by forward-looking statements include, among other things:

- the content of the final IPSP, as approved by the OEB;
- delays or denials of the requisite approvals for planned future capital expenditures;
- regulatory decisions regarding our revenue requirements and tariff rates; and
- future interest rates, inflation, changes in benefits and changes in actuarial assumptions.

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

This management's discussion and analysis is dated as at May10, 2007. Additional information about our company, including our annual information form, is available on SEDAR at www.sedar.com.

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2007	2006
Revenues		
Transmission (Note 3)	327	298
Distribution	944	856
Other	7	6
	<u>1,278</u>	<u>1,160</u>
Costs		
Purchased power	641	598
Operation, maintenance and administration	234	185
Depreciation and amortization (Note 2)	125	118
	<u>1,000</u>	<u>901</u>
Income before financing charges and provision for payments in lieu of corporate income taxes	278	259
Financing charges	73	73
Income before provision for payments in lieu of corporate income taxes	205	186
Provision for payments in lieu of corporate income taxes	56	34
Net income and comprehensive income (Note 2)	<u>149</u>	<u>152</u>
Basic and fully diluted earnings per common share (Canadian dollars)	<u>1,446</u>	<u>1,474</u>

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (unaudited)

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2007	2006
Retained earnings, beginning of period	1,184	1,079
Net income	149	152
Dividends (Note 4)	(107)	(159)
Retained earnings, end of period	<u>1,226</u>	<u>1,072</u>

See accompanying notes to Consolidated Financial Statements.

HYDRO ONE INC.
CONSOLIDATED BALANCE SHEETS (unaudited)

<i>(Canadian dollars in millions)</i>	March 31, 2007	December 31, 2006
Assets		
Current assets		
Short-term investments	331	-
Accounts receivable (net of allowance for doubtful accounts)	842	777
Materials and supplies	61	56
Other	6	13
	1,240	846
Fixed assets		
Fixed assets in service	16,146	16,238
Less: accumulated depreciation	6,078	6,180
	10,068	10,058
Construction in progress	541	468
	10,609	10,526
Other long-term assets		
Deferred pension asset	382	382
Regulatory assets	289	311
Goodwill	133	133
Long-term accounts receivable and other assets	8	12
	812	838
Total assets	12,661	12,210
Liabilities		
Current liabilities		
Bank indebtedness	16	29
Accounts payable and accrued charges	663	661
Accrued interest	91	49
Short-term notes payable	-	60
Long-term debt payable within one year	395	395
	1,165	1,194
Long-term debt (Note 5)	5,262	4,848
Other long-term liabilities		
Regulatory liabilities (Note 3)	494	473
Employee future benefits other than pension (Note 6)	820	803
Environmental liabilities	53	55
Long-term accounts payable and other liabilities	16	16
	1,383	1,347
Total liabilities	7,810	7,389
Shareholder's equity		
Preferred shares (authorized: unlimited; issued: 12,920,000)	323	323
Common shares (authorized: unlimited; issued: 100,000)	3,314	3,314
Retained earnings	1,226	1,184
Accumulated other comprehensive income (Note 2)	(12)	-
Total shareholder's equity	4,851	4,821
Total liabilities and shareholder's equity	12,661	12,210

See accompanying notes to Consolidated Financial Statements.

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

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2007	2006
Operating activities		
Net income	149	152
Adjustments for non-cash items:		
Depreciation and amortization (net of removal costs)	115	109
Retail settlement variance accounts	16	3
Amortization of discount	3	11
Transmission earnings sharing	-	15
Low-voltage services	-	(6)
	283	284
Changes in non-cash balances related to operations	16	(138)
Net cash from operating activities	299	146
Financing activities		
Long-term debt issued	400	300
Short-term notes payable	(60)	-
Dividends paid	(107)	(159)
Other	(1)	-
Net cash from financing activities	232	141
Investing activities		
Capital expenditures	(187)	(177)
Other assets	-	8
Net cash used in investing activities	(187)	(169)
Net change in cash and cash equivalents	344	118
Cash and cash equivalents, beginning of period	(29)	(9)
Cash and cash equivalents, end of period	315	109

See accompanying notes to Consolidated Financial Statements.

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

1. BASIS OF PRESENTATION

The unaudited 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) for the year ending December 31, 2006, 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, except as described below in Note 2.

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. ACCOUNTING CHANGES

Change in Accounting Policy – Financial Instruments, Hedges and Comprehensive Income

Effective January 1, 2007, the Company adopted four new accounting standards comprising the Canadian Institute of Chartered Accountants' (CICA) Handbook Sections 1530, *Comprehensive Income*; 3855, *Financial Instruments – Recognition and Measurement*; 3861, *Financial Instruments – Disclosure and Presentation*; and 3865, *Hedges*. The adoption of these new standards required changes in the accounting for financial instruments and hedges, and the recognition of certain transition adjustments that are recorded in opening accumulated other comprehensive income (AOCI) as described below, consistent with the CICA Handbook sections. The comparative interim Consolidated Financial Statements have not been restated. The principal changes in the accounting for financial instruments and hedges due to the adoption of these accounting standards are described below.

(a) Comprehensive Income

Comprehensive income is composed of the Company's net income and other comprehensive income (OCI). OCI includes the amortization of unamortized hedging losses on cash flow hedges that had been discontinued prior to the transition date. The impact of this amortization is immaterial to the Statement of Operations.

(b) Financial Assets and Liabilities

Under the new standards, all financial instruments are classified into one of the following five categories: held-to-maturity investments, loans and receivables, held-for-trading, other liabilities or available-for-sale. All financial instruments, including derivatives, are carried at fair value on the consolidated balance sheet except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in financing charges in the period which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in OCI until the instrument is derecognized or impaired. The Company has classified its financial instruments as follows:

Short-term investments	Held-to-maturity
Long-term accounts receivable	Loans and receivables
Bank indebtedness	Other liabilities
Short-term notes payable	Held-to-maturity
Long-term debt (excluding MTN Series 8 Note)	Held-to-maturity
MTN Series 8 Note	Designated as held-for-trading

The MTN Series 8 Note is a step-up coupon note issuance with an initial maturity date in 2007, and with extended maturity dates up to 2011.

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

Where there is an economic hedge, as in the case of the MTN Series 8 note and associated interest rate swap, we have applied the fair value option without hedge accounting and the impact is not material.

All financial instrument transactions are recorded at trade date.

(c) Derivatives and Hedge Accounting

Derivatives

All derivative instruments, including embedded derivatives, are carried at fair value on the balance sheet unless exempted from derivative treatment as a normal purchase and sale. All changes in fair value are recorded in financing charges unless cash flow hedge accounting is used, in which case changes in fair value are recorded in OCI to the extent that the hedge is effective. The impact of the change in the accounting policy related to embedded derivatives was not material.

Hedge Accounting

The Company periodically develops hedging strategies for execution taking into account risk management objectives. At the inception of a hedging relationship, the Company documents the relationship between the hedging instrument and the hedged item. This would include linking all derivatives to specific assets and liabilities on the consolidated balance sheet or to specific firm commitments or forecasted transactions. The Company would also assess, both at the inception of the hedge and on an ongoing basis, whether the derivatives that are used are effective in offsetting changes in fair values or cash flows of hedged items.

Upon adoption of the new standards, the Company reclassified unamortized hedging losses on cash flow hedges that had been discontinued prior to the transition date to accumulated other comprehensive income. The hedging losses are amortized through OCI using the effective interest method over the term of the hedged debt.

(d) Transaction Costs

Transaction costs for financial assets and liabilities, classified as other than held-for-trading, are added to the carrying value of the asset or liability and then amortized over the expected life of the instrument using the effective interest method. The impact of the change in amortization method from an annuity basis to the effective interest method was not material.

Change in Accounting Estimate – Depreciation

Effective January 1, 2007, the Company prospectively revised its fixed asset depreciation rates resulting from a periodic external review required by the Ontario Energy Board (OEB). Capital costs of fixed assets are depreciated on a straight-line basis, except for transport and work equipment, which is depreciated on a declining balance basis. The estimated impact of the change in rates is a reduction in depreciation expense of approximately \$7 million per annum. A summary of the new rates for the various classes of assets is included below:

	Depreciation rates (%)	
	Range	Average
Transmission	1% - 4%	2%
Distribution	1% - 13%	2%
Communication	1% - 13%	5%
Administration and service	1% - 20%	8%

HYDRO ONE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

3. TRANSMISSION EXCESS EARNINGS SHARING MECHANISM

On March 30, 2007, the OEB issued a decision ordering that the transmission earnings sharing mechanism cease effective January 1, 2007. The balance of the account was \$35 million. After OEB review, the approved balance of this account, including interest, is expected to be incorporated into future rates to be set later in 2007. In its decision, the OEB also ordered that the Company establish a new regulatory deferral account to record the revenue differential between existing transmission rates and the new rates that are anticipated to be approved later in the year. The new deferral account will represent the revenue differential between existing and future rates for the period between January 1, 2007 and the date of the OEB's upcoming transmission rate decision. As the specifics of this decision cannot be foreseen, the value of this account cannot reasonably be determined at this time. Appropriate accounting recognition will be given to any revenue differential once the OEB renders its decision on our transmission rates.

4. DIVIDENDS

During the three months ended March 31, 2007, preferred dividends in the amount of \$4 million (2006 - \$4 million) and common dividends in the amount of \$103 million (2006 - \$155 million) were declared.

5. LONG-TERM DEBT

On March 13, 2007, Hydro One issued notes under the Company's medium term note program. The issue was comprised of medium term notes with a principal amount of \$400 million having a 30-year term with a coupon rate of 4.89%. The notes are due March 13, 2037.

6. EMPLOYEE FUTURE BENEFITS

Total benefit costs are as follows:

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2007	2006
Pension		
Net periodic benefit cost	25	38
Pension fund contribution	25	22
Less: Portion attributable to labour and capitalized as part of the cost of fixed assets	10	8
Portion attributable to regulatory assets	-	8
Charged to results of operations	15	6
Employee Future Benefits Other than Pension		
Net periodic benefit cost	27	30
Less: Portion attributable to labour and capitalized as part of the cost of fixed assets	10	10
Charged to results of operations	17	20

HYDRO ONE INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****7. 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 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:

Three months ended March 31
(Canadian dollars in millions)

	Transmission	Distribution	Other	Consolidated
2007				
Segment profit				
Revenues	327	944	7	1,278
Purchased power	-	641	-	641
Operation, maintenance and administration	99	128	7	234
Depreciation and amortization	60	64	1	125
Income (loss) before financing charges and provision for payments in lieu of corporate income taxes	168	111	(1)	278
Financing charges				73
Income before provision for payments in lieu of corporate income taxes				205
Capital expenditures	95	91	1	187

Three months ended March 31
(Canadian dollars in millions)

	Transmission	Distribution	Other	Consolidated
2006				
Segment profit				
Revenues	298	856	6	1,160
Purchased power	-	598	-	598
Operation, maintenance and administration	93	86	6	185
Depreciation and amortization	59	58	1	118
Income (loss) before financing charges and provision for payments in lieu of corporate income taxes	146	114	(1)	259
Financing charges				73
Income before provision for payments in lieu of corporate income taxes				186
Capital expenditures	100	75	2	177

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

<i>(Canadian dollars in millions)</i>	March 31, 2007	December 31, 2006
Total assets		
Transmission	6,978	6,950
Distribution	5,264	5,161
Other	419	99
	12,661	12,210

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

8. SUBSEQUENT EVENTS

On April 20, 2007 and April 12, 2007, the OEB released its decision regarding the 2007 rate applications made by the Company's subsidiaries Hydro One Networks Inc. and Hydro One Brampton Inc. respectively. The OEB approved the submissions on the basis of its cost of capital and second generation incentive regulation mechanism policies. The revised rates, including an amount of 93 cents and 67 cents per month per metered customer for smart meters, were approved for implementation effective May 1, 2007.

On April 12, 2007, the OEB announced a decrease in electricity prices for Regulated Price Plan customers. Beginning May 1, 2007, the electricity price has been reduced from 5.5 cents to 5.3 cents per kilowatt hour for customers consuming up to certain thresholds, depending on the type of customer, and from 6.4 cents to 6.2 cents for kilowatt hours exceeding the thresholds.

9. COMPARATIVE FIGURES

The comparative interim Consolidated Financial Statements have been reclassified from statements previously presented to conform to the presentation of the March 31, 2007 unaudited interim Consolidated Financial Statements.