1 # RATING AGENCY REPORTS

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3 Included in this Exhibit are copies of the most recent rating agency reports performed by
4 Dominion Bond Rating Service, Moody's Investor Service and Standard & Poor's.

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6 Attachment 1: Dominion Bond Rating Service, Report Dated: June 30, 2006
7 Attachment 2: Moody's Investor Service, Credit Opinion Dated: August 28, 2006
8 Attachment 3: Standard & Poor's, Report Dated: September 15, 2006
9 Attachment 4: Standard & Poor's, Research Update Dated: March 26, 2007
10 Attachment 5: Dominion Bond Rating Service, Report Dated: November 15, 2007
11 Attachment 6: Standard & Poor's, Report Dated: November 23, 2007
12 Attachment 7: Moody's Investor Service, Credit Opinion Dated: December 7, 2007

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Credit Rating Report

dbrs

Hydro One Inc.

Report Date: June 30, 2006
Press Released: June 23, 2006
Previous Report: February 4, 2005

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RATING

Rating	Trend	Rating Action	Debt Rated
R-1 (middle)	Stable	Upgraded	Commercial Paper
A (high)	Stable	Upgraded	Senior Unsecured Debentures

(All figures in Canadian dollars, unless otherwise noted.)

RATING HISTORY

	Current	2005	2004	2003	2002	2001	2000
Commercial Paper	R-1 (middle)	R-1 (low)	R-1 (low)	R-1 (low)	R-1 (low)	R-1 (low)	R-1 (low)
Senior Unsecured Debentures	A (high)	A	A	A	A	A	A

RATING UPDATE

On June 23, 2006, Dominion Bond Rating Service ("DBRS") upgraded the rating on the Senior Unsecured Debentures of Hydro One Inc. ("Hydro One" or the "Company") to A (high) with a Stable trend from "A" with a Positive trend, and upgraded the rating on Hydro One's Commercial Paper to R-1 (middle) from R-1 (low), also with a Stable trend. Key factors supporting the upgrade include: (1) improvements to the regulatory framework in Ontario in recent years; (2) the supportive political environment for the electricity industry; and (3) the expectation that Hydro One's financial profile, which has seen material improvement since 2002, will remain strong over the medium to longer term.

The regulatory framework in Ontario has stabilized over the past two years, and recent decisions by the Ontario Energy Board ("OEB") have been supportive of Hydro One's regulated operations. For example, in its latest decision on Hydro One's transmission operations (February 21, 2006), the OEB stated that it is mindful of the fact that heavy handed regulation is not good for investor confidence. This is an important consideration at a time when Hydro One will experience increased capital investment requirements to address transmission system constraints that have been identified by the Independent Electricity System Operator ("IESO"). In addition, for the first time since 1999, Hydro One's distribution rate base has been adjusted to reflect investments made over the past five years. While there is a level of uncertainty regarding the rate setting process beyond 2006, DBRS is of the view that the OEB will continue to be supportive and allow for full cost of service recovery and the ability to earn a fair market-based rate of return. DBRS is of the view that the current government is unlikely to interfere with the ratemaking process for regulated transmission and distribution operators as it has made a strong commitment to ensuring that ratepayers pay the full cost of electricity production and supply.

The key challenge for Hydro One will be managing potentially over $2.0 billion in transmission upgrades and conservation and demand management initiatives (i.e., smart meters) over the next five years. Cash flow from operations is expected to remain near $900 million annually over the next few years, but will be insufficient to fully fund capital expenditures and dividends. The annual shortfall will be funded with debt. Despite the cash flow shortfall, total adjusted debt-to-capital is expected to remain around 55% over the medium term as Hydro One's equity will experience modest growth through retained earnings. (Continued on page 2.)

RATING CONSIDERATIONS

Strengths:

- Involved primarily in regulated activities
- Attractive Ontario-based business franchise
- Strong and supportive shareholder – Province of Ontario

Challenges:

- Regulatory risk/risk of political intervention
- Low regulatory returns
- Lack of access to equity markets

FINANCIAL INFORMATION

	12 mos.	For the year ended December 30				
	Mar. 31, 2006	2005	2004	2003	2002	2001
Fixed-charges coverage (times)	3.07	3.05	2.92	2.75	2.33	2.44
Adjusted total debt-to-capital	54.0%	52.4%	54.1%	54.9%	56.4%	56.1%
Cash flow-to-adjusted total debt	17.7%	18.4%	17.5%	16.6%	13.8%	14.1%
Cash flow/capital expenditures (times)	1.34	1.37	1.27	1.43	1.27	1.25
Net income ($ millions) (adj. for non-recurring, after pfd.)	486	465	412	378	341	356
Cash flow from operations ($ millions)	962	946	920	855	725	708
Approved ROE	9.88%	9.88%	9.88%	9.88%	9.88%	9.88%
Deemed common equity in capital structure	36.0%	36.0%	36.0%	36.0%	36.0%	36.0%

THE COMPANY

Hydro One Inc., one of the successor companies of the former Ontario Hydro, holds and operates electricity transmission and distribution assets, as well as a fibre-optic network across most of Ontario. Hydro One is the largest transmission operator in Ontario (servicing 95% of the province's transmission throughput), is the second largest electricity distributor in Ontario based on distribution throughput, and is the largest based on the number of customers. The Company is wholly owned by the Province of Ontario (the "Province"), although the Province does not guarantee debt issued by Hydro One.

AUTHORIZED COMMERCIAL PAPER AMOUNT

Program limit is Cdn$750 million (authorized limit remains Cdn$1 billion).

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Rating Update Continued

Fixed charges coverage is expected to remain in the 2.75 times to 3.00 times range and cash flow-to-adjusted total debt is expected to be in the 16% to 18% range. As such, Hydro One's financial profile is expected to remain adequate to support an A (high) rating over the medium to longer term, given the Company's stable regulated transmission and distribution (T&D) operations in Ontario and barring any unforeseen negative changes to the regulatory framework, or political agendas. DBRS notes that a recent draft proposal by OEB staff to reduce the allowed ROE on distribution operations to below 9.0% would erode Hydro One's expected financial profile should this recommendation be ultimately adopted in future OEB decisions. However, impact on Hydro One's credit metrics cannot be assessed until the OEB's consultation process is complete and a final decision is made.

Regulation

Hydro One's electricity distribution and transmission subsidiary (Hydro One Networks) is regulated by the OEB under the *Electricity Act*, 1998 (the "Electricity Act"), with the following noteworthy amendments:

- The *Electricity Pricing, Conservation and Supply Act*, 2002 ("Bill 210") – December 9, 2002.
- The *Ontario Energy Board Amendment Act* (Electricity Pricing), 2003 ("Bill 4") – December 18, 2003.
- The *Electricity Restructuring Act*, 2004 ("Bill 100") – December 9, 2004.

Hydro One's deemed capital structure is 36% common equity, 4% preferred equity, and 60% debt. Revenues from distribution operations are based on a fixed service charge and a volumetric charge, whereas revenues from transmission operations are based on peak monthly demand. The following is a summary of the regulatory framework for Hydro One's transmission and distribution operations.

Transmission:

On February 21, 2006, the OEB released its latest decision on Hydro One's transmission operations. This rate decision did not address any change in transmission rates, in fact transmission rates are still based on Hydro One's 2000 revenue requirements for transmission. The purpose of this rate decision was to deal with what the OEB had viewed as over-earnings by Hydro One's transmission operations. This has been achieved through the establishment of an earnings sharing mechanism, which will remain in place until transmission rates are addressed with a full rate hearing, likely some time in 2007. Key highlights of this latest decision are:

- The allowed ROE of 9.88% for transmission operations will remain in place until a new rate is established, likely in 2007.
- Any excess earnings, above an ROE of 9.88%, will be shared 50/50 with customers.

Distribution:

On November 11, 2005, the OEB set the allowable ROE for all Ontario local distribution companies (LDCs) at 9.00% (down from 9.88% in 2005).

On April 12, 2006, the OEB issued its rate decision on Hydro One's 2006 distribution rate application, with new distribution rates becoming effective on May 1, 2006. Hydro One elected to use the 2006 test year in its 2006 distribution rate application. The following are highlights of this rate decision:

- An approved rate base for distribution operations of $3,711 million. This represents the first rate base increase since the Electricity Act was implemented, which was set based on Hydro One's 1999 distribution rate base of $2,637 million.
- An approved debt rate of 6.24% on long-term debt and 3.33% on short-term debt, equivalent to a blended debt rate of 5.93% (53.7% of Hydro One's deemed capital structure for distribution is comprised of long-term debt and 6.3% is comprised of unfunded short-term debt).
- A $0.30 per residential customer per month as a result of the OEB's generic decision on Smart Metering.
- The total approved revenue requirement for Hydro One's distribution operations is $965 million, an overall increase of $130 million from the previously approved revenue requirement.
- The OEB disallowed Hydro One's proposal to harmonize distribution rates amongst all its customers, including LDCs the Company acquired in 2001.

Generic Cost of Capital (Distribution):

- On April 27, 2006, the OEB indicated its intent to establish a multi-year electricity distribution rate-setting plan for all LDCs in Ontario, which will include:
  - A generic cost of capital to be used in adjusting annual revenue requirements for 2007 and beyond, and
  - A mechanistic incentive rate adjustment for the period.
- The initial term of the multi-year plan will be three years, beginning with the 2007 rate adjustment.
- On June 19, 2006, the OEB posted on its website a draft report of Board staff containing staff's initial proposals for both the cost of capital and the second generation incentive regulation mechanism. The OEB intends to issue a second draft on July 20, 2006.
- DBRS notes that Hydro One's recent ratings upgrade is premised on the Company's reduced business risk profile associated with improvements to the regulatory framework and the supportive political environment that has materialized in recent years, together with improved credit metrics. In its draft report, Board staff has recommended an allowed ROE range of well below 9.0% for distribution operations (in the range of 7.52% to 8.36%), which would have a material negative impact on cash flow-to-debt and interest coverage ratios for Hydro One, especially if the same ROE range subsequently gets adopted for transmission operations.

However, it is too early to determine the impact on credit metrics until the consultation and review process is completed and a final decision is made. Furthermore, DBRS notes that due to past government intervention in the regulatory process, Hydro One's distribution operations earned well below the previous 9.88% ROE.

RATING CONSIDERATIONS

Strengths: (1) Almost all of Hydro One's assets and earnings are in regulated electricity T&D operations. Despite political interference in the Ontario electricity sector in the past, the current regulatory framework is supportive of Hydro One's T&D operations and is expected to remain supportive over the near to medium term. As such, T&D operations are expected to continue to provide a high degree of stability to Hydro One's earnings and financial profile. DBRS highlights a statement in Hydro One's most recent transmission decision, whereby the OEB indicated that in formulating its rate decision it was mindful not to diminish investor confidence in the utility by heavy handed regulatory actions. This is an important consideration, given the investment that Hydro One will have to make in upgrading the Ontario transmission grid over the coming years.

(2) Hydro One's transmission franchise area is one of the strongest in Canada, given that it covers virtually all of Ontario. While the Company's distribution franchise is less attractive, as it includes a large geographic area (most of rural Ontario outside major urban centres) with a low population density/high cost of service, the acquisition of 88 municipal electric utilities in 2001 has reduced unit costs and the regulatory framework provides full cost of service recovery with a market-based rate of return.

(3) While Hydro One faced a high degree of political interference during the previous government's mandate, the Province of Ontario (currently rated AA with a Stable trend by DBRS) continues to be a strong and supportive shareholder to the Company. The Province's support has been demonstrated in the past by various actions, including the provision of a line of a credit in 2002 when Hydro One was unable to access the capital markets. DBRS notes, however, that the rating on Hydro One is a stand-alone rating and is not guaranteed by the Province.

Challenges: (1) The key challenge facing Hydro One is regulatory risk and the risk of political intervention. Regulatory risk is an inherent challenge for any regulated utility given that the regulatory framework essentially dictates the maximum profitability that can be achieved and the degree of protection to bondholders. While some uncertainty exists regarding the regulatory framework beyond 2006, DBRS expects the OEB to remain supportive by continuing to allow full cost of service recovery with a market-based rate of return on regulated T&D operations. The key risk with respect to political intervention would be the imposition of a rate freeze, as was seen in 2002, which was at a time of high electricity prices and near a provincial election. However, DBRS believes the risk of political intervention in the rate-setting process is relatively low under the current provincial government's tenure, as this government has made a strong commitment to passing along the full cost of power to electricity ratepayers.

(2) The ROE of 9.0% for Ontario electricity distribution and 9.88% for electricity transmission is low in comparison with similar regulated utilities in the U.S., which are typically in the 10% to 12% range. As such, cash flow and coverage ratios for regulated utilities in Ontario will typically be lower than for similarly regulated utilities in the United Staes. However, the regulated rates of return for Ontario utilities are currently in line with the lower rates of return typically granted to regulated utilities in Canada. DBRS notes, however, that the Board staff recommendation of an ROE in the range of 7.52% to 8.36% will be lower than any other jurisdiction in Canada, placing additional pressure on credit metrics. Furthermore, there is a risk that lower ROEs for regulated utilities in Canada may make access to capital more challenging in the future, given that foreign content limits for investors have been eliminated by the Canadian government.

(3) Hydro One does not have access to the equity capital markets, as it is 100%-owned by the Province of Ontario. This limits the Company's financial flexibility, especially given its significant capital development commitments with respect to improving the reliability of the transmission grid. However, given the support of the provincial government, DBRS would expect Hydro One to reduce its dividends to the Province in order to support its equity base.

EARNINGS AND OUTLOOK

Income Statement ($ millions)	12 mos. ended March 30, 2006	For the year ended December 31 (1) 2005	2004	2003	2002	2001
Net revenues	2,271	2,285	2,189	2,186	2,173	2,199
EBITDA	1,473	1,493	1,418	1,391	1,366	1,375
EBIT	990	1,006	938	937	955	991
Gross interest expense	296	303	294	315	381	378
Net income (adjusted for non-recurring items, before prefs.)	504	483	430	396	359	374
Net income (after preferred dividends)	486	465	480	378	326	356
Return on average common equity (before non-recurring)	11.1%	10.8%	11.8%	9.7%	8.7%	9.7%

Segmented Information ($ millions)	%	12 mos. ended March 30, 2006	For the year ended December 3 2005	2004	2003	2002	2001
Net revenues:							
Transmission	56%	1,280	1,310	1,262	1,298	1,317	1,259
Distribution	43%	969	954	910	862	824	893
Other	1%	22	21	17	26	32	47
Total net revenues		2,271	2,285	2,189	2,186	2,173	2,199
Earnings before interest and taxes:							
Transmission		680	711	665	688	741	686
Distribution		319	305	284	252	263	339
Other		(9)	(10)	(11)	(3)	(49)	(34)
Total EBIT		990	1,006	938	937	955	991
Transmission throughputs (TWh)		n/a	157.0	153.4	151.7	153.2	146.9
Distribution throughputs (TWh)		29.3	29.7	28.5	27.9	27.1	21.3

n/a = not applicable.

Summary:

- The increase in EBIT in 2005 was largely a result of: Higher transmission revenues due to higher monthly peak demand in 2005 resulting from an abnormally hot summer, and
  - Earnings from distribution operations that were also positively impacted by weather as well as the collection of various regulatory deferrals.
- In general, EBIT has remained relatively stable over the past five years, in the $935 million to $1 billion range, which is reflective of the company's regulated operations.
- Interest expense has remained largely unchanged over the past three years, reflective of the Company's relatively stable debt levels.

Outlook:

- EBIT is expected to drop to near the $900 million range for 2006, under a more normal weather scenario (versus the more extreme weather experienced in 2005), and grow at a modest pace along with growth in rate base.
  - Also contributing to the lower EBIT is higher OM&A, resulting from an increase in pension contributions and increased spending on reliability-related maintenance.
- Furthermore, the earnings sharing mechanism for transmission operations will have a modestly negative impact on earnings in comparison to previous years.
- Earnings from one year to the next will continue to be sensitive to changes in monthly peak demand for electricity given the current regulatory framework for transmission.
- While there is a level of uncertainty regarding the rate setting process beyond 2006, DBRS is of the view that the OEB will continue to be supportive and allow for full cost of service recovery and the ability to earn a fair market-based rate of return.

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FINANCIAL PROFILE

Statement of Cash Flow	12 mos. ended	For the year ended December 31				
($ millions)	March 31, 2006	2005	2004	2003	2002	2001
Net income adjusted for non-recurring items, after pfd.	486	465	412	378	341	356
Depreciation & amortization	446	446	446	417	384	352
Amortization of debt re-couponing	55	59	62	60	-	-
Other recurring non-cash items	(25)	(24)	-	-	-	-
Cash Flow From Operations	962	946	920	855	725	708
Capital expenditures	(719)	(691)	(727)	(597)	(570)	(566)
Common dividends	(343)	(273)	(247)	(226)	(174)	(240)
Free Cash Flow Before Working Capital Changes	(100)	(18)	(54)	32	(19)	(98)
Change in working capital	88	194	(33)	138	(199)	188
Net Free Cash Flow	(12)	176	(87)	170	(218)	90
Other investments/acquisitions/disposition	9	9	19	3	27	(447)
Other non-recurring adjust., incl. retail settlement variance	2	2	6	21	(52)	-
Net debt financing	121	(188)	83	(184)	232	357
Net equity/other financing	1	1	7	(12)	-	-
Net change in cash	121	0	28	(2)	(11)	0
Fixed charges coverage (times)	3.07	3.05	2.92	2.75	2.33	2.44
Adjusted debt-to-capital*	54.0%	52.4%	54.1%	54.9%	56.4%	56.1%
Cash flow/adjusted total debt (times)*	17.7%	18.4%	17.5%	16.6%	13.8%	14.1%
Cash flow/capital expenditures (times)	1.34	1.37	1.27	1.43	1.27	1.25

*Adjusted for equity treatment of preferred shares.

Summary:

- Cash flow from operations improved modestly in 2005 and for the 12-months ended March 31, 2006, but remained insufficient to fully fund capital expenditure requirements and dividends.
- However, a significant positive change in working capital funded the shortfall in 2006, as well as $188 million in net debt repayment.
- Cash flow-to-debt and interest coverage ratios have continued to improve over the past few years, and are well within the range of an A (high) T&D utility with a supportive regulatory framework.

Outlook:

- Cash flow from operations is expected to remain near $900 million annually over the next few years, but will remain insufficient to fully fund capital expenditures and dividends. The shortfall is expected to be funded with debt.
  - Annual capital expenditures (maintenance and upgrades) are expected to be in the $750 million to $800 million range as Hydro One continues to focus on transmission upgrades to mitigate critical system constraints, and
  - Dividends will likely be in the $250 million to $275 million range.
- Despite the cash flow shortfall, total adjusted debt-to-capital is expected to remain around 55% over the medium term as Hydro One's equity will experience modest growth through retained earnings.
- Fixed charges coverage is expected to remain in the 2.75 times to 3.00 times range and cash flow-to-adjusted total debt is expected to remain in the 16% to 18% range.
- As such, Hydro One's financial profile is expected to remain adequate to continue to support the A (high) rating over the medium term, given the Company's stable regulated T&D operations in Ontario.

LONG-TERM DEBT MATURITIES AND BANK LINES

As of June 30, 2006

	2006	2007	2008	2009	2010	2011-2015	2016 & thereafter	Total
$ (millions)	141	395	500	400	400	850	2,500	5,185
Avg. coupon	4.2%	4.4%	4.0%	4.0%	7.2%	6.0%	6.6%	5.6%

Long-Term Debt:

- Hydro One currently has available $1.95 billion on its $2.5 billion MTN Shelf, which was established in June 2005. The majority of funds received from the issuance of MTNs under its Shelf have been used to refinance maturing debt.
- Hydro One faces a manageable level of term debt maturities over the next five years. Maturities will likely be refinanced with debt issued under the above-noted Shelf.

Bank Lines and Commercial Paper:

- In August 2004, Hydro One reduced its syndicated committed bank lines to $750 million from $1 billion and, consequently, reduced the limit on its commercial paper program to $750 million.
  - However, the authorized Board limit on its commercial paper program remains $1 billion.
  - Hydro One has a $750 million committed 364-day revolving credit facility, maturing in August 2006. DBRS expects this to be extended.
- As at March 31, 2006, Hydro One had $40 million of commercial paper outstanding.

Hydro One Inc.

Balance Sheet
($ millions)

Assets	Mar. 31, 2006	As at December 31 2005	2004	**Liabilities & Equity**	Mar. 31, 2006	As at December 31 2005	2004
Cash + short-term investments	119	-	-	Short-term debt	10	9	49
Accounts receivable	724	622	707	L.t. debt due one year	589	589	539
Material and supplies	62	56	47	A/P + accr'ds	691	743	674
Current Assets	905	678	754	**Current Liabilities**	1,290	1,341	1,262
Net fixed assets	10,197	10,116	9,813	Long-term debt	4,778	4,466	4,613
Post-employment benefits	433	449	534	Post-employ. benefits	739	716	654
Def'd debt costs + long-term rec.	35	43	48	L.t. pay. + other liab.	613	610	672
Regulatory asset	426	430	443	Preferred shares	323	323	323
Goodwill	133	133	133	Shareholders' equity	4,386	4,393	4,201
Total	12,129	11,849	11,725	**Total**	12,129	11,849	11,725

Ratio Analysis	12 mos.	For the year ended December 31						
Liquidity Ratios	Mar. 31, 2006	2005	2004	2003	2002	2001	2000	1999
Current ratio	0.70	0.51	0.60	0.55	0.37	0.37	0.55	0.58
Acc. depreciation/gross fixed assets	36.7%	36.5%	35.8%	35.3%	34.5%	33.6%	32.5%	31.5%
Cash flow/total debt (1)	17.9%	18.7%	17.7%	16.9%	13.9%	14.3%	14.9%	15.1%
Cash flow/adj. total debt (1)	17.7%	18.4%	17.5%	16.6%	13.8%	14.1%	14.7%	15.1%
Adj. total debt/EBITDA	3.69	3.44	3.71	3.69	3.86	3.65	3.65	3.62
Cash flow/capital expenditures	1.34	1.37	1.27	1.43	1.27	1.25	1.54	1.39
Cash flow-dividends/capital expenditures	0.86	0.97	0.93	1.05	0.97	0.83	0.71	1.39
Total debt-to-capital (1)	53.3%	51.8%	53.5%	54.2%	55.7%	55.4%	53.5%	54.6%
Total adjusted debt-to-capital (1)	54.0%	52.4%	54.1%	54.9%	56.4%	56.1%	54.2%	54.6%
Average coupon on long-term debt	5.62%	5.61%	5.60%	5.50%	7.60%	8.05%	8.13%	7.70%
Hybrids/common equity	7.4%	7.4%	7.7%	8.1%	8.5%	8.8%	8.8%	0.0%
Deemed common equity	36.0%	36.0%	36.0%	36.0%	36.0%	36.0%	36.0%	36.0%
Common dividend payout (before extras.)	70.6%	58.7%	60.0%	59.8%	51.0%	67.4%	58.7%	38.6%
Coverage Ratios (2)								
EBIT interest coverage	3.36	3.34	3.20	3.00	2.51	2.63	2.50	2.45
EBITDA interest coverage	4.99	4.94	4.83	4.44	3.59	3.65	3.42	3.29
Fixed-charges coverage	3.07	3.05	2.92	2.75	2.33	2.44	2.30	2.32
Earnings Quality/Operating Efficiencies & Statistics								
Operating margin	43.6%	44.0%	42.9%	42.9%	43.9%	45.1%	43.5%	45.6%
Net margin (before extras., after pfd.)	21.4%	20.4%	18.8%	17.3%	15.7%	16.2%	17.0%	18.7%
Return on avg. common equity (before extras.)	11.1%	10.8%	10.1%	9.7%	9.1%	9.7%	9.4%	12.7%
Approved ROE	9.88%	9.88%	9.88%	9.88%	9.88%	9.88%	9.88%	9.35%
Rate base - transmission ($ millions)	5,718	5,718	5,718	5,718	5,718	5,718	5,718	5,638
Rate base - distribution ($ millions)	2,637	2,637	2,637	2,637	2,637	2,637	2,445	2,467
Distribution lines (km)	n/a	122,118	121,736	121,285	120,767	120,448	113,880	113,400
Transmission lines (km)	n/a	28,547	28,643	28,621	28,492	28,387	28,490	28,889
Transmission throughputs (TWh)	n/a	157.0	153.4	151.7	153.2	146.9	146.9	144.1
Distribution throughputs (TWh)	29.3	29.7	28.5	27.9	27.1	21.3	17.6	18.1

(1) Adjusted for equity treatment of preferred shares.
(2) EBIT includes interest income; interest expense is gross interest expense.

n/a = not applicable.

Credit Opinion: Hydro One Inc.

Hydro One Inc.

Toronto, Ontario, Canada

Ratings

Category	**Moody's Rating**
Outlook	Stable
Senior Unsecured -Dom Curr	Aa3
Commercial Paper	P-1

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Key Indicators

Hydro One Inc.

	[1]**LTM**	**2005**	**2004**	**2003**	**2002**
(CFO Pre-W/C + Interest) / Interest Expense [2]	**3.4x**	**3.3x**	**3.3x**	**3.2x**	**2.6x**
(CFO Pre-W/C) / Debt	**15.4%**	**16.2%**	**15.4%**	**16.0%**	**11.2%**
(CFO Pre-W/C - Dividends) / Debt	**9.9%**	**11.7%**	**11.4%**	**12.1%**	**8.4%**
(CFO Pre-W/C - Dividends) / Capex	**90.8%**	**107.9%**	**102.2%**	**121.5%**	**88.5%**
Debt / Book Capitalization	**63.5%**	**62.8%**	**64.2%**	**63.6%**	**67.0%**
EBITA Margin %	**25.0%**	**26.4%**	**25.3%**	**27.0%**	**24.3%**

[1] Last 12 months to June 30, 2006 [2] CFO pre-W/C, which is also referred to as FFO in the Global Regulated Electric Utilities Rating Methodology, is equal to net cash flow from operations less net changes in working capital items

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Company Profile

Hydro One Inc. (HOI) is wholly owned by the Province of Ontario. Its revenues and cash flows are almost completely derived from its transmission and distribution businesses, both of which are regulated by the Ontario Energy Board (OEB). HOI owns and operates virtually all of Ontario's electricity transmission system, and is responsible for a substantial portion of regulated electricity distribution in the province.

Recent Developments

HOI's Aa3 senior unsecured rating reflects the application of Moody's July 2006 rating methodology update for government-related issuers (GRIs), which describes the publication of baseline credit assessments (BCAs) on a 1-21 scale. Please refer to Moody's Rating Methodology entitled "The Application of Joint Default Analysis to Government-Related Issuers", published in April 2005, and its accompanying press release, for further background, as well as Moody's July 2005 Special Comment entitled "Rating Government-Related Issuers in Americas Corporate Finance" for a detailed discussion of the application of joint default analysis to GRI's in the Americas.

Rating Rationale

In accordance with Moody's GRI rating methodology, the Aa3 ratings of HOI reflect the combination of the following inputs:

- BCA in the range of 5 to 7 (on a scale of 1 to 21, where 1 represents the equivalent risk of a Aaa, 2 a Aa1, 3 a Aa2 and so forth)

- Aa2 local currency rating of the province of Ontario

- High dependence

- High support

The BCA range of 5 to 7 reflects HOI's stable and predictable cash flows and the low business risk of its regulated wires businesses. The BCA also reflects HOI's limited ability to raise equity and the potential that HOI can be utilized as an instrument of public policy. As demonstrated by the rate cap provisions of Bill 210 introduced in 2002, public policy goals are not always completely aligned with the interests of debtholders. HOI's financial metrics are consistent with those of other regulated utilities with a BCA of 5 to 7 in the low business risk category.

Going forward, HOI faces potentially significant credit challenges in terms of the evolution of the regulatory environment, capital spending pressures and an aging labour force. While a measure of relative regulatory and political stability has emerged over the last few years, the company is currently in the midst of two regulatory processes, the outcomes of which could have significant impact on the company's financial condition. Firstly, as part of the OEB's multi-year electricity distribution rate setting plan, OEB staff have tabled a discussion paper setting forth staff's proposal for establishing the cost of capital for rate-making purposes and establishing a 2nd generation incentive regulation mechanism (2nd Generation IRM) applicable to Ontario's electricity distributors (LDCs). Moody's notes that staff's cost of capital proposal is subject to change following stakeholder consultation and ultimately review by the OEB panel. However, if staff's cost of capital proposal, and in particular its allowed ROE formula, is adopted without change, Moody's believes it would likely result in a weakening of HOI's cash flow credit metrics which could place downward pressure on the company's BCA. Staff's proposal contemplates a capital structure common to all LDCs which would be comprised of 40% common equity and 60% debt. However, any actual preferred equity outstanding up to 4% of rate base would be captured within the 40% common equity component. Assuming that over time HOI's preferred equity will represent a diminishing portion of the capital structure, staff's proposal would allow HOI to increase its common equity thickness relative to the 36% common equity component currently used in determining HOI's distribution rates. However, Moody's believes that any benefit of thicker equity would be more than offset by an ROE that could be 50 to 100 bps below those of other regulated utilities in Canada. The staff proposal also outlines an annual adjustment to the cost of capital calculation which would be one component of the price cap mechanism for annually adjusting distribution rates under the 2nd generation IRM. In Moody's view, the benefits of transparent mechanisms for the adjustment of ROE, cost of capital and distribution rates would be more than offset by the reduced cash flows that staff's cost of capital proposal implies.

The second major regulatory process is HOI's 2007-2008 transmission rate application which is expected to be filed in the third quarter of 2006. While the outcome of that hearing cannot be determined at this time, it would seem likely that OEB staff would propose an allowed ROE/cost of capital mechanism for HOI's transmission business that is similar to that which it proposes for Ontario's electricity distributors. Given that HOI's transmission business represents approximately 65% of the company's assets and operating profit, Moody's would be concerned about the potential for material weakening of HOI's cash flows.

HOI expects to have large capital expenditure needs for a number of years. In addition to ongoing maintenance capital expenditures, the company expects to incur significant capex in support of the Ontario Power Authority's (OPA) pending Integrated Power System Plan (IPSP) and the provincial government's smart meter initiative. The OPA's IPSP, which is scheduled to be published in March 2007, is expected to call for significant expansion/reinforcement of Ontario's transmission grid in support of the government's objectives concerning generation supply mix, increased renewables generation and increased grid efficiency/congestion reduction. In addition, HOI anticipates that it will be required to spend between $600 million and $1.2 billion between 2007 and 2010 to fulfill its role in achieving the government's objective of installing smart meters in all Ontario homes and businesses by 2010. During 2007 and 2008 the company forecasts capital expenditures in excess of approximately $1.2 billion per year. Moody's estimates that approximately $1.4 billion will be required for transmission capital expenditures in 2007 and 2008. The balance of roughly $1 billion will be spent on the distribution side with approximately 40% being spent on smart metering. HOI's smart meter expenditures are currently being recorded in a regulatory deferral account. While Moody's expects that HOI will be afforded the opportunity to fully recover its smart meter costs, the timing of cost recovery is uncertain, as the period over which these cost are recovered has yet to be determined. Moody's notes that to some degree both the quantum and the timing of IPSP and smart meter expenditures are outside of HOI's control. HOI anticipates that it will fund a portion of the forecast capital expenditures with internally generated cash flows and the balance with debt. Given the province's ownership of HOI, the company has limited access to additional equity. Moody's estimates that, in the absence of a significant reduction in its dividend payout, HOI's FFO interest coverage and FFO/Debt ratios could come under pressure as a result of the company's capital expenditure needs.

The extent of HOI's capital expenditures over the next few years highlights another challenge that HOI and many other utilities face: that of an aging workforce. According to the company, approximately 25% of its workforce is

eligible for retirement by 2008. The availability and cost of skilled labour necessary to successfully complete the work required under the forthcoming IPSP and the province's smart meter plan as well as HOI's ongoing system operation and maintenance could prove to be a challenge.

High dependence reflects the importance of the issuer to the provincial economy and its operating and financial proximity to the government.

High support reflects the strategic importance of the issuer to the province, the government's history of providing support through dividend deferrals in its capacity as a shareholder of the company and the government's history of intervening in the electricity sector.

Rating Outlook

The stable outlook is based on the predictable cash flow generated by HOI's regulated transmission and distribution businesses.

What Could Change the Rating - Up

- While considered unlikely at this time, a sustainable improvement in cash flow metrics (FFO interest coverage exceeding 4.5x and FFO/Debt exceeding 20%) related to increases in the deemed equity component and allowed ROE could result in a positive rating action

What Could Change the Rating - Down

- Reduced support level

- Downward revisions in ROE, undue reliance on debt to finance capital expenditures or other factors which lead to a sustained weakening of cash flow metrics (FFO interest coverage below 3.0x and FFO/Debt below the mid-teens)

- Actions on the part of the shareholder that impede the company's ability to act in a commercial manner

- Material changes in the ownership, governance or management structures

- Further restructuring of the electricity sector that increases HOI's business or financial risk profiles

Rating Factors

Hydro One Inc.

Select Key Ratios for Global Regulated Electric Utilities

Rating	Aa	Aa	A	A	Baa	Baa	Ba	Ba
Level of Business Risk	**Medium**	**Low**	**Medium**	**Low**	**Medium**	**Low**	**Medium**	**Low**
CFO pre-W/C + Interest to Interest (x) [1]	>6	>5	3.5-6.0	3.0-5.7	2.7-5.0	2-4.0	<2.5	<2
CFO pre-W/C to Debt (%) [1]	>30	>22	22-30	12-22	13-25	5-13	<13	<5
CFO pre-W/C - Dividends to Debt (%) [1]	>25	>20	13-25	9-20	8-20	3-10	<10	<3
Total Debt to Book Capitalization (%)	<40	<50	40-60	50-70	50-70	60-75	>60	>70

[1] CFO pre-W/C, which is also referred to as FFO in the Global Regulated Electric Utilities Rating Methodology, is equal to net cash flow from operations less net changes in working capital items

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STANDARD & POOR'S

CORPORATE RATINGS

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RatingsDirect
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Corporate Credit Rating

A/Stable/A-1

Financial risk profile:

Moderate

Debt maturities:*

2006 C$589 mil.
2007 C$395 mil.
2008 C$500 mil.
2009 C$400 mil.
2010 C$400 mil.
2011 C$250 mil.
2012 C$600 mil.
2030 and beyond C$1,950 mil.
*Maturities as of Dec. 31, 2005

Major Rating Factors

Strengths:

- Low-risk electricity transmission and distribution network businesses
- Monopoly position
- Regulated cash flows
- Supportive shareholder

Weaknesses:

- Moderate financial profile
- Large capital expenditure program

- Transmission and distribution revenues subject to some volumetric risk

Rationale

The ratings on Hydro One Inc. reflect the company's monopoly electricity transmission and distribution networks, relatively stable and secure cash flows, improved financial profile, and the support of its owner, the Province of Ontario (AA/Stable/A-1+). These strengths are offset by regulatory uncertainty, and the financial and operational risks associated with the company's large capital expenditure program.

Toronto-based Hydro One is the incumbent electricity transmission business and largest distributor of electricity in Ontario. The company owns and operates more than 97% of the province's transmission network as measured by revenue, and its distribution network service territory covers about 75% of the province. Hydro One's monopoly position and regulatory restrictions limit the risk of network bypass.

Hydro One's debt-servicing capacity is supported by the regulated returns it receives from its network businesses. The company's relatively secure and predictable earnings, which provide 99% of cash flows, reflect its low-risk assets. The regulated cash flows are determined on a cost-of-service and rate-of-return methodology such that the company recovers all prudent costs and a return on its capital investment.

Hydro One's funds from operations (FFO) interest and debt coverages are not expected to show improvement and could weaken in the next few years. In the four-year period from 2005-2008, the company will recover C$144 million in regulatory costs. FFO cash interest coverage is expected to remain substantially the same, at about 4.3x. FFO interest coverage could decline in the next few years from its three-year average and 2005 levels of 3.7x to 3.4x, respectively, assuming financially unfavorable outcomes of upcoming regulatory decisions and the eventual approval and execution of increased capital spending. The tempering effect of the refinancing of higher cost debt maturing in 2006 and 2007, and at today's lower interest rates, is factored into these projections. In the next two to three years, FFO-to-average total debt is also expected to decrease to about 15% from its 2005 level of 19%; incremental debt will be required to partially fund upcoming capital expenditures, some of which will not immediately contribute to cash flow. The company is expected to debt finance 20% or more of forecast capital expenditure in the next several years. Hydro One's leverage, as measured by total debt-to-total capital, is likely to creep back up to its historical level of 55%, as compared with 52% in 2005. The fall to 52% in 2005 was due in part to the redemption in late 2005 of C$109 million of notes due in January 2006.

The province's ownership of Hydro One enhances the utility's credit quality. Although the province does not formally guarantee Hydro One's debt obligations, the strategic nature of the company within the provincial economy and the government's demonstrated willingness to financially assist the business under extraordinary circumstances in the past bode well for future support.

Hydro One's operational and financial performance is subject to regulatory risk. The transparency, predictability, and stability of the regulatory regime governing the company's electricity transmission and distribution operations continue to improve. Nevertheless, political interference in the regulatory process in recent years and the transitioning nature of the regulatory environment pose ongoing risks for the company's cash flows. The outcome of the Ontario Energy Board's (OEB) ongoing generic cost-of-capital review will be used to determine rates for 2007 and beyond, and could affect the cash flow strength of Hydro One's distribution segment. Both the allowed returns and the regulatory capital structure are being examined by the regulator; a decision is expected before year-end.

Hydro One's underlying annual capital expenditure program carries financial and operational risk. Although predominantly funded from internal sources, expected capital expenditure (including smart meter investment) in

the C$800 million-C$1.2 billion range per year in the next few years will be a drain on the company's cash flow and reduce its financial flexibility. Total capital expenditure of C$691 million in 2005 was below budget but is expected to rebound in 2006 and increase further in 2007 to the higher end of the forecast range. Capital spending estimates include the cost of installing smart meters for all distribution customers by 2010 as well as expected upgrades and expansion of the transmission system to accommodate growth in domestic demand, new generation facilities, and to facilitate increased imports and exports. A decision by the OEB earlier this year clarified that, like its other infrastructure investments, Hydro One's estimated C$600 million-C$1.2 billion investment in smart meters in the next four years will also be added to its revenue-generating regulated asset base.

Short-term credit factors

The short-term rating on Hydro One is 'A-1'. The company has adequate liquidity to meet debt maturities, capital expenditure requirements, and dividend commitments in 2006. Unused and committed bank lines, together with expected strong cash flows, ready access to the debt capital markets, and discretionary spending on capital expenditure, provide Hydro One with sufficient liquidity and the financial flexibility to meet its annual capital expenditure estimate of C$800 million-C$1.2 billion, annual dividend payments of C$250 million-C$300 million, and C$141 million of debt maturing in the remainder of 2006. As of June 30, 2006, the company had C$130 million short-term notes outstanding through its board-approved C$1 billion short-term note program.

In support of Hydro One's liquidity, the company can draw on:

- Committed and largely available bank lines estimated at about C$620 million as of June 30, 2006;
- Expected annual regulated cash flows in 2006, as represented by FFO, of about C$900 million;
- Its well-supported MTN shelf program, which had C$1.95 billion of available credit as of June 30, 2006; and
- Discretionary capital expenditure for 2006 estimated at about 15% of forecast.

Hydro One's bank lines consist of a C$750 million committed demand line of credit, with a syndicate of banks, maturing in August 2007. The committed demand facility also has a two-year term-out option. The bank line is used for general corporate purposes and to support its C$1 billion Canadian CP program.

The company is well within its banking covenant of total debt-to-total capital of 75% and has no material adverse change clauses that could trigger a default. A potential call on liquidity would happen in the event the credit rating on Hydro One fell to the 'BBB' category. This would trigger a tripling of Hydro One's prudential support to the independent market operator by way of bank LOCs, which can vary throughout the year from C$10 million-C$25 million.

Outlook

The stable outlook reflects the low-risk nature of the company's business and greater transparency and predictability of outcomes within the Ontario regulatory environment. Regulatory autonomy also has improved, although the potential for political intervention to override regulatory decisions remains. There are currently no forecast or expected scenarios within the current environment that would result in either a ratings downgrade or upgrade. Significant deterioration in the company's financial and operational performance could put pressure on the ratings, but such a scenario is relatively unlikely. Given the supportive and stable shareholder relationship, modest lowering of allowed returns in future regulatory determinations on the company's cash flow strength and the pressures of upcoming increased capital spending are not expected to lead to a negative outlook. A

positive outlook or rating upgrade, although currently not forecast given upcoming capital spending plans, could result from a prolonged period of no political intervention in the regulatory environment governing the company's operations.

Business Description

Hydro One's operations primarily center on its low-risk electricity transmission and distribution operations that account for 99% of its consolidated assets and generate virtually all of its FFO. As part of its distribution operations, the company also undertakes regulated delivery of electricity to 1.3 million customers. In addition, the company markets surplus fiber optic capacity. Hydro One's 28,500-kilometer (km) high voltage provincial transmission grid accounts for about 55% of consolidated assets and is the second largest in Canada and is interconnected to neighboring Canadian provinces and northern states of the U.S. The company's 122,100-km distribution operation is also one of the country's largest. The distribution system covers approximately 75% of Ontario and delivers about 15% of the province's demand load.

The company is wholly owned by the Province of Ontario, which holds all the common and preferred shares outstanding. Hydro One's board of directors is appointed by the province and although the company's business plan and dividend policy are set by the board, they are reviewed by the government before implementation. The company's close relationship with its owner has been demonstrated through the provision of financial support in the past and, although no financial support can be assured in the future, the strategic importance of Hydro One to the economy of Ontario would suggest it is appropriate to factor into the ratings an element of implied support from Hydro One's higher rated owner.

Business Risk Profile

A stable regulatory regime supports credit quality

The OEB undertakes regulatory oversight of Hydro One's monopoly distribution and transmission operations. Hydro One's regulated cash flows are determined on a cost-of-service and rate-of-return methodology and although the relatively low allowed returns limit upside in cash flows and are subject to regulatory lag, nevertheless, they provide relative predictability and security of cash flow. The company's allowed economic return is based on a deemed (for regulatory purposes) equity component in its capital structure of 36%, on which an ROE (currently 9.0% for distribution and 9.88% for transmission in 2006, as compared with 9.88% for both in 2005) is allowed. Indications are that the ROE allowed for in Hydro One's rates for 2007 and beyond could drop further if OEB staff recommendations are adopted by the OEB in its upcoming generic cost-of-capital decision. Hydro One is also permitted to hold 4.0% of its capital in preferred equity on which a dividend rate of 5.5% is earned.

There is a long history of regulated entities in both Ontario and Canada being allowed to recoup unforeseen previously incurred costs (or regulatory assets) after the fact through rate riders. The cash recovery of these costs is subject to a prudency review and regulatory approval. For Hydro One, the current recovery of regulatory assets means additional annual cash flows in the period 2005-2007 of about C$35 million.

The regulatory regime in Ontario has shown signs of improved stability and predictability in recent times but remains subject to the risk of political intervention. The existing regime continues to provide for ministerial intervention, with the Minister of Energy retaining the ability to override decisions of the OEB, which is what occurred under the previous government. The political risk associated with the tariff-setting process weakens

the supportive nature of the price regulation and continues to present a risk to the cash flows of electricity network operators such as Hydro One.

Hydro One's regulated retail services, undertaken as part of its distribution operations, are protected from commodity price and volume risk by OEB-regulated prices. The establishment of the government-sponsored Ontario Power Authority in 2004 to manage, among other functions, variance accounts for the regulated retail function of local distribution companies (LDCs) further removes a risk to Hydro One's cash flows and reduces demands on working capital. Customers not eligible for the regulated energy price pay the wholesale commodity price. Any regulatory or government action to remove the direct pass-through mechanism, or to require Hydro One to take on an obligation to ensure adequate supplies of energy to end-use customers, would have a negative influence on the ratings on Hydro One.

Ontario is Hydro One's primary market

Hydro One's primary market is the growing province of Ontario, which accounts for close to 40% of Canada's GDP. Although Hydro One's transmission operations service the entire province, the company's distribution business, apart from its Brampton network on the outskirts of Toronto, is largely rural based. Ontario's economy posted moderate growth of 2.8% in 2005 following 2.6% real GDP growth in 2004. The province is forecasting economic growth to remain in low gear, with real GDP expected to slow to 2.3% in 2006 and 2.5% in 2007, reflecting the impact of the sharp appreciation of the Canadian dollar, high oil prices, and deceleration of growth in the U.S. economy. GDP growth in Ontario, which has generally performed better than the national average, has also been reflected in higher throughput and growth in customer connections for Hydro One. Growth in distribution throughput was 4.0% in 2005 to 29,677 GWh, up from 2.0% growth experienced in 2004, while the company's distribution customer base of almost 1.3 million increased at a more modest rate of 1.2%, down slightly from 1.6% in 2004 and 2003.

The diversity of Hydro One's customer base supports the stability of its revenues and limits its exposure to any particular customer or customer class. A breakdown of contributors to the company's total revenue highlights the diversity of its customer base, with its province-wide transmission business contributing about 30% of revenues, residential customers of the distribution business contributing about 37%, commercial customers about 23%, and large industrials and embedded distributors about 3% and 6%, respectively. The company's top-10 customers are predominately LDCs and, although they account for a disproportionate percentage of energy delivered, their percentage of gross revenue is only about 2%. Furthermore, the vast majority of the larger LDCs supplied are investment-grade credits.

Operations are dominated by low-risk transmission and distribution

Hydro One's low-risk transmission and distribution businesses dominate its operations. The transmission business represents about 55% of fixed assets, and contributes about 60% of cash flow, while its distribution business largely comprises the remaining assets and cash flows. The company's regulated retail services, as part of its distribution operations, represent a small portion of assets and, despite contributing a significant amount of revenue, provide minimal cash flow benefits because of the direct pass-through of all energy costs to consumers. The company has a small telecommunications business that leases surplus fiber optic capacity. The telecommunications business represents only a minor part of Hydro One's operations, providing less than 1% of gross revenues and a similar portion of the company's fixed assets.

The operational performance of the company's transmission assets is quite good; however, the performance of its distribution assets is adversely affected by operational challenges not generally faced by more urban-

based utilities in the Canadian industry and generally underperform relative to comparable utilities in the industry, as measured by the Canadian Electricity Association composite index (see table 1). A mitigating factor for the cash flows of the distribution business is the absence of penalties for underperformance.

Table 1

Hydro One Inc. Operational Performance—Reliability Measures

	2005	2004	2003*	2002	2001	2000
Distribution network						
CAIDI (minutes)	223.2	129.0	258.0	228.0	174.0	156.0
CEA composite index (minutes)	N.A.	120.0	130.0	102.0	90.0	84.0
SAIDI (minutes)	867.6	414.0	906.0	750.0	522.0	450.0
CEA composite index (minutes)	N.A.	237.0	307.0	246.0	222.0	192.0
SAIFI (interruptions)	3.9	3.2	3.5	3.2	3.0	2.9
CEA composite index (interruptions)	N.A.	2.0	2.4	2.3	2.4	2.3
Distribution energy losses (%)	6.8	6.9	6.8	7.2	7.5	N.A.
Transmission network						
SAIDI (minutes)	57.7	42.3	53.1	70.9	59.1	38.6
SAIFI (interruptions)¶	1.3	1.3	1.6	1.5	1.4	1.4
CEA composite index (interruptions)¶	N.A.	1.5	2.1	2.0	2.0	N.A.
System unavailability (%)	1.6	1.7	2.0	N.A.	N.A.	N.A.
Unsupplied energy (minutes)	13.7	12.9	18.2	N.A.	N.A.	N.A.
Transmission energy losses (%)	2.6	2.5	2.5	2.8	2.9	N.A.

*Hydro One's distribution network's reliability measures exclude Aug. 14, 2003, blackout. CEA's reliability measures exclude significant events, i.e., Aug. 14, 2003, blackout and Hurricane Juan. CAIDI—Customer average interruption duration index. ¶Figures reflect momentary and sustained interruptions. CEA—Canadian Electricity Association. SAIDI—System average interruption duration index. SAIFI—System average interruption frequency index. N.A.—Not available.

Hydro One's capital expenditure could increase about 1.5x in the next several years, from about C$800 million in 2006 to in excess of C$1.2 billion in 2007 and 2008, with about 55% being spent on its transmission assets. The focus of the capital expenditure is on developing, upgrading, and reinforcing the transmission and distribution systems, and on ensuring safety and reliability. Although the timing of these projects remains uncertain and the spending is significant, the company is not expected to undertake major projects without previous regulatory approval.

With a transmission network tariff levied on the basis of peak load, and its distribution tariff levied on per unit of energy delivered, a risk to Hydro One's cash flows is fluctuations in volumes of energy delivered. This risk has been highlighted in recent years with weather-induced reductions in volume contributing to falls in expected revenues. Although the variability in gross revenues is not overly significant relative to the company's total cash flows, the government's push for greater demand-side management has the potential to lower peak demand and slow down growth in electricity distributed, leading to marginally lower returns for the business.

A medium- to long-term risk to Hydro One's business and financial profiles is the impact of potential rationalization within the Ontario LDC sector in the coming years. Although not viewed as an immediate issue for the rating, Hydro One's expected active participation in such a scenario could present future financing, execution, and integration risks.

Asset-intensive nature of Hydro One's monopoly business reduces competitive risk

Although some competitive pressures exist, Hydro One's natural monopoly transmission system is largely shielded from direct competition. The company does not hold a legal monopoly over its service territory and there is no restriction on other transmission businesses building and operating transmission networks in Ontario; however, the company's cost-reflective pricing and the capital cost involved in large-scale duplication of the network reduce the risk of bypass. Furthermore, the OEB-approved uniform transmission pricing across Ontario mitigates the risk of bypass from competing transmitters and should a bypass occur, tariffs would be rebalanced across remaining customers with minimal financial impact on the company. Of greater concern is the company's exposure to the risk of lost revenue from embedded generation arising from high wholesale electricity prices.

Noncontiguous service territories of LDCs expose Hydro One to competition for new services in nondesignated areas adjacent to its distribution service territories. The issue presents a competitive challenge for the company, but a decision by the OEB in mid-2004 would appear to limit the risk to greenfield development at the border of existing service territories and not put at risk cash flows secured by Hydro One's existing network.

Profitability largely dictated by regulatory directives

Given the cost-plus nature of its regulatory framework, Hydro One's profitability is largely dictated by regulatory directives that currently provide the company with the ability to earn an ROE on a stable capital structure. The equity returns allowed for in the determination of rates are already low by international benchmarks and, subject to an OEB hearing in the fall of 2006, could decrease further and pressure the company's cash flow interest and debt coverages. Unlike its distribution network business, which has typically not earned its allowed ROE, the company's transmission assets have historically achieved more than the allowed ROE. An earnings sharing mechanism for the transmission business only was introduced by the regulator in 2006 with the utility to split, on a 50-50 basis, excess earnings above its allowed rate of ROA.

Financial Risk Profile

Accounting—it's business as usual

Hydro One's consolidated financial statements are prepared in accordance with Canadian GAAP. No material changes to Canadian GAAP or the accounting policies adopted by Hydro One are expected in the foreseeable future that would materially alter the financial statements as presented by Hydro One. Standard & Poor's Ratings Services treats Hydro One's C$323 million 5.5% cumulative preferred shares as equity. The shares are held by the province, and are entitled to an annual cumulative dividend of C$18 million. The shares rank in priority above the common shares upon liquidation. The adjusted interest coverage ratios (as presented in tables 2 and 3) reflect an interest expense that includes C$58 million in amortization of a refinancing discount, representing about 18% of total interest expense. In its analysis, Standard & Poor's removes the amortization expense from the interest expense to capture the cash cost of the interest paid.

Table 2

Hydro One Inc.—Peer Comparison*

Industry Sector: Electric Utilities—Canada

—Average of past three fiscal years—					
	Sector Median¶	**Hydro One Inc.**	**Toronto Hydro Corp.**	**Hamilton Utilities Corp.**	**Hydro Ottawa Holding Inc.**
Rating		A/Stable/A-1	A-/Stable/—	A/Stable/—	A-/Stable/—
(Mil. C$)					
Sales	901.6	4,209.0	2,445.7	452.2	639.4
Net income from cont. oper.	85.8	459.0	96.0	10.5	13.6
Funds from oper. (FFO)	215.0	938.0	233.6	29.1	44.3
Capital expenditures	124.7	671.7	141.9	22.1	73.1
Total debt	1,213.0	5,131.0	1,217.2	105.2	230.3
Preferred shares	7.3	323.0	N/A	N/A	N/A
Total capital	2,398.3	9,641.3	2,023.8	280.6	450.0
Ratios					
EBIT interest coverage (x)	2.6	2.7	3.0	3.3	2.1
FFO interest coverage (x)	3.3	3.5	3.8	4.8	3.8
Return on common equity	10.0	10.7	12.4	6.5	6.3
NCF/capital expenditures (%)	83.6	100.3	135.6	89.2	60.3
FFO/total debt (%)	18.7	18.3	19.3	27.7	18.9
Total debt/capital (%)	52.9	53.2	60.1	37.5	51.2

*Adjusted by capital operating leases. ¶For the fiscal years ended 2001-2004. N/A—Not applicable. NCF—Net cash flow.

Table 3

Hydro One Inc.—Financial Statistics*

Industry Sector: Electric Utilities—Canada

	—Average of past three fiscal years—	2005	2004	2003	2002	2001
Rating		A/Stable/A-1	A/Stable/A-2	A-/Negative/A-2	A/Watch Neg/A-1	AA-/Stable/A-1+
(Mil. C$)						
Sales	4,209.0	4,416.0	4,153.0	4,058.0	4,044.0	3,466.0
Net income from cont. oper.	459.0	483.0	498.0	396.0	344.0	374.0
Funds from oper. (FFO)	938.0	976.0	944.0	894.0	691.0	726.0
Capital expenditures	671.7	691.0	727.0	597.0	570.0	566.0
Total debt	5,131.0	5,078.7	5,218.9	5,095.4	5,214.3	5,010.5
Preferred shares	323.0	323.0	323.0	323.0	323.0	323.0
Total capital	9,641.3	9,794.7	9,742.9	9,386.4	9,353.3	9,004.5
Ratios						
EBIT interest coverage (x)	2.7	2.9	2.8	2.5	2.4	2.6
FFO interest coverage (x)	3.5	3.7	3.6	3.3	2.9	3.0
Return on common equity	10.7	10.8	11.6	9.7	8.5	9.6
NCF/capital expenditures (%)	100.3	99.6	94.0	108.6	93.1	84.6
FFO/total debt (%)	18.3	19.0	18.4	17.5	13.7	15.3
Total debt/capital (%)	53.2	51.9	53.6	54.3	55.7	55.6

*Adjusted by capital operating leases. NCF—Net cash flow.

Cash flow adequacy

Hydro One's annual FFO of close to C$900 million is sufficient to meet its expected dividend payments of close to C$300 million and the bulk of the company's capital expenditure program in 2006. The company's annual capital expenditure, however, is expected to increase from about C$800 million to C$1.3 billion in the next few years and will require partial debt funding. The company's net cash flow-to-capital expenditure is expected to range between 70%-80%.

Capital structure and financial flexibility

Hydro One's move to address structural deficiencies in its debt portfolio in recent times has reduced the level of financing risk the company faces. As of Dec. 31, 2005, 62% (C$3.1 billion) of Hydro One's debt still had a maturity date of up to seven years, with the remaining 38% maturing in 24 years or more. Maturing debt in any one year, however, does not represent more than 15% of the company's total long-term debt outstanding of C$5.2 billion as of June 30, 2006. The company's liability management strategy is to target an average term for its debt portfolio of 10 to 15 years. In the past few years, the company has increased its previously short, average term for its debt of about four years to the current weighted-average term of 14 years.

Further reducing financial risk for the company is its policy of hedging interest rate and foreign exchange exposure. The company generally maintains less than 20% of debt (including debt maturing within the year) at floating rates and carries no material foreign exchange exposure, with all debt in Canadian dollars. The weighted-average coupon rate of Hydro One's debt at year-end 2005 was 5.6%.

The lack of diversity of Hydro One's funding sources is not a ratings concern. The company relies heavily on the Canadian debt capital markets as its main funding source and although such reliance poses a concentration risk, the company's well-supported position in the market mitigates this somewhat. The debt capital markets provide the vast majority of Hydro One's financing, with the company relying on bank facilities largely for general corporate purposes and as a backup to its CP program. Maturing debt is to be financed through the company's C$2.5 billion MTN shelf program. As of June 30, 2006, C$1.95 billion remained available until July 2007.

As it has done since 1999, Hydro One's leverage, as measured by total debt-to-total capital, is expected to remain stable in the next few years at about 54%. Debt could increase annually by as much as C$300 million-C$700 million in the period 2007-2008, as it will be used to partially fund capital expenditure. All debt is unsecured and supported by a negative pledge. As of mid-2006, the company's capital structure comprised C$5.3 billion in debt, C$4.4 billion in common shares and retained earnings, and C$323 million in preferred shares.

Ease of access to the debt capital markets and bank debt, an ability to defer a portion of capital expenditure, and the company's close relationship with its owner support Hydro One's financing flexibility. The company has good access to the debt funding through its C$1 billion CP program, its committed but unused bank lines, and the remaining availability on its MTN shelf program. In addition to its ability to tap debt markets, Hydro One can defer about C$100 million of forecast capital expenditure per year, close to one-third of its annual interest expense. The government, as shareholder, is a further potential source of financing and provider of backup liquidity for the company. Hydro One is unlikely to have ready access to new equity in the form of cash injections; however, the flexibility afforded to it to defer annual common dividend payments of as much as C$300 million mitigates this financing constraint somewhat. The deferral of the dividend and discretionary capital expenditure is more than sufficient to meet forecast annual cash interest costs of about C$300 million-C$330 million.

Ratings List

Hydro One Inc.

Sr unsecd debt	
Local currency	A
CP	
Local currency	A-1

Ontario (Province of)

Corporate Credit Rating	AA/Stable/A-1+
Sr unsecd debt	AA

Ontario Electricity Financial Corp.

Ontario Power Generation Inc.

Corporate Credit Rating	BBB+/Positive/—
CP	
Local currency	A-2

Corporate Credit Rating History

Feb. 22, 2002	A+/A-1
Apr. 1, 2002	A/A-1
Feb. 21, 2003	A-/A-2
Apr. 22, 2004	A/A-2
July 15, 2005	A/A-1

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Filed: August 15, 2007
EB-2007-0681
Exhibit A-11-1
Attachment 4, Page 1 of 3

STANDARD &POOR'S RatingsDirect

RESEARCH

Research Update:

Hydro One Inc. Outlook Revised To Positive; 'A' Ratings Affirmed

Publication date: 26-Mar-2007
Primary Credit Analyst: Nicole Martin, Toronto (1) 416-507-2560; nicole_martin@standardandpoors.com
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Rationale

On March 26, 2007, Standard & Poor's Ratings Services revised its outlook on utility holding company, Hydro One Inc., to positive from stable. At the same time, Standard & Poor's affirmed its 'A' long-term corporate credit rating and senior unsecured debt ratings on Hydro One. The revised outlook primarily reflects clearer evidence of regulatory stability and no expectation of disruptive market restructuring that would affect its local distribution company (LDC) credit quality. An outlook is not necessarily a precursor of a rating change. (For more details on the credit positive trends affecting the sector please refer to our commentary "Shining A Light On The Positive Outlook For Ontario Electricity Distributors" to be published following this research update, on RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis.)

The ratings reflect the company's low-risk monopoly electricity transmission and distribution networks, secure and relatively predictable regulated cash flows, and the support of its owner, the Province of Ontario (AA/Stable/A-1+). These strengths are offset by an intermediate financial profile that will be further challenged by the company's large capital expenditure program in the next several years. Hydro One had C$5.2 billion in long-term debt outstanding as of Dec. 31, 2006.

Hydro One's monopoly position, the asset intensive nature of its businesses, and regulatory oversight limit competitive risk. Toronto-based Hydro One is the incumbent electricity transmission business and largest distributor of electricity in Ontario. The company owns and operates more than 97% of the province's transmission network as measured by revenue, and its distribution network service territory covers about 75% of the province.

Hydro One's debt-servicing capacity is supported by the regulated returns it receives from its electricity delivery businesses. Secure and relatively predictable regulated cash flows are supported by cost-of-service and rate-of-return regulation. The company can expect to recover all prudent costs incurred and earn a modest return on its capital investment. Furthermore, the company faces limited risk related to commodity price and volume variability. Although Hydro One's distribution business bills customers for the cost of the commodity consumed, the company has no obligation to ensure adequate electricity supply.

The province's ownership of Hydro One enhances the utility's credit quality. Although Ontario does not formally guarantee Hydro One's debt obligations, the strategic nature of the company within the provincial economy and the government's demonstrated willingness to financially assist the business under extraordinary circumstances in the past bode well for future support.

Hydro One has an intermediate financial profile and cash flow interest and debt coverages could weaken in the next few years. Pension-adjusted funds from operations (FFO) interest coverage of 4.7x in 2006 was up from 4.4x in 2005 largely as a result of distribution rate increases in 2005 and 2006. AFFO interest coverage could drift downward in the next several years but is not

Filed: August 15, 2007
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expected to fall below 4.0x. Cash flow strength in coming years will depend on: the outcome of an upcoming transmission rate hearing, regulatory approvals of budgeted capital expenditures, and the impact of weather variability on revenue. FFO-to-total debt is expected to remain with the 15%-20% range as compared with its 2006 level of 20%. The company is expected to debt finance 20% or more of forecast capital expenditure during the upcoming period of significant expansion. Hydro One's leverage, as measured by pension-adjusted total debt-to-total capital, is also likely to creep back up to the historical level of about 65%, compared with 60% in 2006.

Although predominantly funded from internal sources, capital spending during the next few years will be a drain on the company's cash flow and reduce its financial flexibility. Capital expenditure of C$1.2 billion is budgeted for 2007, a 40% increase compared with the C$863 million spent in 2006, and higher-than-historical average. This period of increased capital spending is a result of planned upgrades and expansion of the transmission system to accommodate: growth in domestic demand, new generation facilities, and facilitate increased imports and exports. The 2007 capital program also includes a portion of the estimated C$600 million-C$1.2 billion investment that Hydro One will make in smart meters for all distribution customers by 2010 in the next four years. Subject to a prudency review and like its other infrastructure investments, Hydro One's investment in smart meters will also be added to its revenue-generating regulated asset base.

Short-term credit factors

The short-term rating on Hydro One is 'A-1'. Unused and committed bank lines, together with strong cash flow from operations and ready access to the debt capital markets, provide Hydro One with sufficient liquidity and the financial flexibility to meet its forecast capital expenditure estimate of C$1.25 billion, annual dividend payments of C$250 million to C$350 million, and C$395 million of debt maturing in 2007. As of Dec. 31, 2006, C$60 million had been drawn from the company's C$1 billion short-term note program. The company remains well within its banking covenant of total debt-to-total capital of 75% and has no material adverse change clauses that could trigger a default.

In support of Hydro One's liquidity, the company can draw on:

- A committed C$750 million bank line of which C$690 million was available as of Dec. 31, 2006. The bank line is used for general corporate purposes and to support its C$1 billion Canadian CP program. The line matures in August 2007 and has a two-year term-out option;
- Its expected annual regulated cash flows in 2007, as represented by unadjusted FFO, of about C$860 million;
- An MTN shelf program, maturing in July 2007, which had C$1.725 billion of available credit as of Dec. 31, 2006; and
- Discretionary capital expenditure estimated in the range of C$150 million- C$200 million in 2007.

Outlook

The positive outlook reflects a steady improvement in Hydro One's business risk profile. The improvement is largely a result of steadily increasing clarity and stability with regards to regulatory methodology and timetables that influence both the transmission and distribution business, and the continued absence of disruptive market restructuring and political involvement in the regulatory process. Should this trend continue it could result in a positive rating action, but more than a single-notch improvement is highly unlikely. Given the supportive and stable shareholder relationship, the expected temporary downward pressure on the company's cash flow strength due to the pressures of upcoming increased capital spending should not lead to a revised outlook. A negative rating action could result from a material change in the company's financial or business risk profile, possibly from an adverse regulatory ruling, market restructuring, or its shareholder relationship.

Ratings List

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Hydro One Inc.

Outlook Revised To Positive	To	From
Corporate credit rating	A/Positive/A-1	A/Stable/A-1
Ratings Affirmed		
Senior unsecured	A	
Commercial paper		
Global scale	A-1	
Canadian scale	A-1(Mid)	

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Insight beyond the rating.

Rating Report

Report Date:
November 15, 2007

Previous Report:
June 30, 2006

Hydro One Inc.

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The Company
Hydro One Inc., through its wholly owned subsidiaries, owns and operates electric transmission and distribution assets, as well as a fibre-optic network across most of Ontario. Hydro One is the largest transmission and distribution operator in Ontario (servicing over 95% of the Province's transmission throughput). The Company is wholly owned by the Province of Ontario (rated AA).

Commercial Paper: Authorized Limit of $1 Billion

Recent Actions
June 23, 2006
Upgraded

January 31, 2005
Confirmed & Trend Change

Rating

Debt Rated	Rating	Rating Action	Trend
Commercial Paper	R-1 (middle)	Confirmed	Stable
Senior Unsecured Debentures	A (high)	Confirmed	Stable

Rating Rationale

DBRS has confirmed the rating of Hydro One Inc.'s (Hydro One or the Company) Commercial Paper at R-1 (middle) and its Senior Unsecured Debentures at A (high), both with Stable trends. The rating confirmations reflect Hydro One's low level of business risk stemming from its regulated electric transmission and distribution operations, accompanied by a solid financial profile underpinned by its robust balance sheet and strong credit metrics. The rating confirmations also consider the aggressive capital expenditure program being implemented throughout Hydro One's system, combined with the negative impact from the recent transmission rate decision in which the Ontario Energy Board (OEB) reduced the regulatory-approved return on equity (ROE) by 153 basis points to 8.35% from 9.88% in 2006, for both F2007 and F2008. However, Hydro One's rate base was increased by 11% to $6,344 million ($5,718 million in 2006), and its equity thickness was increased by 4% to 40%. Overall, DBRS expects transmission rate charges to be reduced by approximately $80 million to $100 million, which is approximately a 7% reduction from F2006 net revenues. This will place temporary pressure on interest coverage ratios, with a 35 to 45 basis point reduction in EBIT/interest anticipated from the rate order, but a measurable change in the Company's financial profile is not expected. DBRS anticipates a number of Hydro One's regulatory-approved capital projects to be completed and in service by the 2009/2010 rate years, thereby increasing the rate base and, subsequently, its earnings profile. (Continued on page 2.)

Rating Considerations

Strengths
(1) Low-risk, regulated electric transmission and distribution businesses
(2) Solid balance sheet and credit metrics
(3) Strong and extensive transmission and distribution franchise area
(4) Top quartile for transmission reliability

Challenges
(1) Substantial capital expenditure program
(2) Significant external financing required
(3) Approved ROE sensitive to interest rates
(4) Earnings sensitive to monthly peak demand for electricity and, to a lesser extent, to the volume of electricity sold
(5) Managing construction execution risk with large capital projects
(6) Lack of access to equity capital markets

Financial Information

	12 mos ended	For the year ended December 30			
(CAD millions)	Sept. 2007 *	2006	2005	2004	2003
Cash flow from operations **	903	930	945	920	855
EBIT gross interest coverage (1)	2.77	2.77	2.78	2.63	2.49
Fixed charge coverage (1)	2.57	2.57	2.59	2.44	2.34
Total adjusted debt-to-capital (%) (1)	53.7%	53.3%	52.6%	54.3%	55.0%
Cash flow-to-total adjusted debt (%) (1)	16.2%	17.1%	18.3%	17.4%	16.6%
Cash flow/capital expenditures (times)	0.91	1.13	1.37	1.27	1.43
Gross free cash flow ***	(390)	(225)	(19)	(54)	32
Return on average equity (before non-recurring items) (%)	9.3%	9.8%	10.8%	10.1%	9.7%
Approved ROE - Distribution	9.00%	9.00%	9.88%	9.88%	9.88%
Approved ROE - Transmission	8.35%	9.88%	9.88%	9.88%	9.88%

(1) DBRS-adjusted for operating lease debt and interest expense equivalents. DBRS-adjusted for preferred shares (20% debt/ 80% equity).
* DBRS adjusted Transmission earnings for non-cash items to normalize impact from OEB rate decision.
** CFO before working capital.*** Gross free cash flow = CFO - capital expenditures - dividends.

Rating Rationale (Continued from page 1.)

Despite the impact to earnings, the decision remains in line and reasonably consistent with previous decisions rendered for electric distribution companies (LDCs), with respect to regulatory treatment of equity thickness and ROE methodology. The regulatory-approved ROE methodology highlights the formulaic sensitivity to long-term interest rate volatility, which could continue to challenge ROE levels and subsequently earnings and cash flows going forward if rates move downward.

Furthermore, on the regulatory front, DBRS expects Hydro One's distribution operations to file a rate application for a mid-year rate adjustment in 2008, outlining its capital plan while addressing the additional capital investment currently not included in its rate base. The regulatory framework for LDCs under the 2nd Generation Incentive Regulation Mechanism (IRM) and Cost of Capital is viewed by DBRS as reasonable, providing sufficient earnings and cash flow stability.

Hydro One is entering a significant capital investment cycle, driven primarily by the increasing reliability needs, replacement of aging assets and changing supply-mix initiatives in Ontario. As a result, DBRS expects capital expenditures to remain elevated over the medium term, averaging between $1.1 billion to $1.5 billion, which, combined with dividends, is expected to exceed operating cash flows by approximately $500 million to $800 million per year. These free cash flow deficits are expected to be entirely debt financed, which will put temporary pressure on the Company's balance sheet and coverage ratios, as the invested capital is not included in the rate base until the completion of the projects. Also, given that a material portion of Hydro One's capital expenditures are for large transmission projects that involve lengthy construction times and there is potential for delays caused by the intervenor process, timely project completion within budget is important to maintain the Company's financial health.

DBRS views the expected pressure on the Company's earnings and balance sheet as temporary, and expects Hydro One's financial metrics to remain within a range supportive of the assigned ratings, given its low level of business risk, solid financial profile, strong balance sheet and experienced management team.

Rating Considerations Details

Strengths

(1) Hydro One is a regulated electric transmission and distribution utility. As such, the Company's business risk profile is low, due to the following factors: (1) Hydro One can recover all prudently incurred operating costs and approved capital project costs within a reasonable time frame as revenue requirements are predetermined based on forward-looking cost of service; (2) the Company will not undertake large capital expenditures without a reasonable expectation of recovering them in its rates; and (3) the regulatory environment continues to become more transparent with respect to the regulatory treatment of equity thickness and ROE methodology. DBRS believes that the OEB will be supportive in the recovery of capital costs as well as operating expenses that are necessary for a safe and reliable electric system.

(2) Hydro One's credit metrics remain solid for an A (high) regulated utility: Debt-to-capital ratio is 53.7%, EBIT/interest coverage is 2.77 times and cash flow-to-debt is 16.2%. Although DBRS expects coverage ratios to experience some downward pressure given the lower approved revenue requirements for its transmission business coupled with higher overall capital expenditures driving sizable free cash flow deficits, the Company's financial metrics are expected to remain within a range that is consistent with its business risk level and the assigned ratings.

(3) Hydro One owns and operates substantially all of Ontario's electric transmission system and is linked to five adjoining jurisdictions, accommodating imports of about 4,000 MW and exports of approximately 5,800 MW of electricity. The Company's distribution system is the largest in Ontario and spans roughly 75% of the province, serving approximately 1.3 million rural and urban customers and 48 large industrial customers. The large geographic area and low population density translates into a higher rate of service for its distribution business relative to other electricity distribution companies.

(4) Hydro One's transmission business continues to achieve top quartile reliability measures, which should facilitate a healthy relationship with the regulator going forward.

Challenges

(1) Hydro One is entering an aggressive build-out program over the next several years, in which DBRS expects a measurable increase in capital investment from present levels to a range of $1.1 billion to $1.5 billion per year through 2009. This, combined with dividends, is expected to cause a cash flow deficit of an estimated $500 million to $800 million per annum. These sizable free cash flow deficits, combined with lengthy construction times, will put temporary pressure on the balance sheet and coverage ratios during the build-out. DBRS notes that capital projects are spread out over time, which helps to minimize liquidity issues that accompany such large projects.

(2) Hydro One will have to go to the debt market in significant size to fund its considerable free cash flow deficits and refinance a heavy-but-manageable debt repayment schedule over the medium term. Maintaining adequate access to the public debt market and adequate availability under its credit facility ($750 million) is important during this build-out period.

(3) Regulatory-approved ROE levels are low and could continue to trend lower if long-term interest rates decline. Approved ROE for the transmission operation declined to 8.35% for both F2007 and F2008, from 9.88% in 2006, while the distribution segment remained at 9.00% in 2007, down 88 basis points from 9.88% in 2005.

(4) Earnings and cash flows for the transmission segment, and to a lesser extent distribution operations, are sensitive to monthly peak demand and volume of electricity sold, given that rates typically include a variable rate component. Seasonality, economic cyclicality, weather patterns and Conservation Demand Management (CDM) programs directly impact the volume of electricity sold or peak monthly electrical demand, and hence, revenue earned from electricity sales.

(5) The size and magnitude of Hydro One's upcoming designated projects (e.g., the Bruce Project, estimated at $613 million), combined with the continued increases in material and labour costs and the significant number of intervenors involved, could potentially expose Hydro One to rising project costs beyond the amount forecasted in its regulatory applications. There is no assurance that cost overruns beyond the regulatory-approved amounts will be recovered if deemed imprudent by the OEB. However, DBRS notes that Hydro One is experienced in managing projects and is focused on mitigating the risk of cost overruns.

(6) Due to provincial ownership, Hydro One is unable to access the equity capital markets. This limits the Company's financial flexibility, as free cash flow deficits will likely be financed through its $750 million Commercial Paper (CP) program (fully backstopped by a credit facility) or debt issuance under its remaining $2.2 billion medium-term notes (MTNs) program. Also, the Company has historically paid out a high level of dividends (a five-year average of 64% of net income). Given the increasing liquidity requirements, DBRS anticipates some dividend management may be required going forward as Hydro One is committed to investing heavily in its electricity system.

Regulation

Hydro One's electricity distribution operations are regulated by the OEB under the *Ontario Energy Board Act*, 1998 (the OEB Act), as modified by the following noteworthy amendments:
• The *Electricity Pricing, Conservation and Supply Act*, 2002 (Bill 210) – December 9, 2002.
• The *Ontario Energy Board Amendment Act* (Electricity Pricing), 2003 (Bill 4) – December 18, 2003.
• The *Electricity Restructuring Act*, 2004 (Bill 100) – December 9, 2004.

Currently, the capital structure and ROE methodology used by the OEB to establish transmission and distribution rates is based on a deemed debt-to-equity structure of 60-40 and the long Canada bond forecast rate.

Transmission
In August 2007, the OEB reduced Hydro One's base transmission rates, retroactive for the period January 1, 2007 to December 31, 2008, resulting in approximately a 7% reduction in base revenue requirements relative to F2006 net revenues. The methodology used by the OEB to establish the transmission rates was based on a rate base of $6,344 million ($5,718 million from 2000 to 2006), a deemed debt-to-equity structure of 60-40, an approved weighted-average debt rate of 5.80% and an allowed ROE of 8.35%. Also, the OEB approved Hydro One's operations, administration and capital expenditure budgets, along with the expensing and recovery of the carrying costs of the Niagara Reinforcement Project, until the project is completed and placed into service; however, the OEB did not approve the request for allowing certain capital expenditures into rate base before project completion. New transmission rates are retroactive to January 1, 2007, and were implemented on November 1, 2007 (with $85 million in over recovery from Jan. 1, 2007 to Oct. 31, 2007, allocated back on a monthly basis).

Distribution
Hydro One's distribution business operates under a performance-based incentive mechanism with a deemed ROE of 9.0% based on a forward-looking cost of service for the mid-year rate decision.

On December 20, 2006, the OEB issued a 2007 rate adjustment model (2nd Generation IRM and Cost of Capital) and corresponding instructions to distributors for the purpose of adjusting distributor rates effective May 1, 2007. As a result, base distributions rates, exclusive of rate riders, were adjusted formulaically to reflect an allowance for inflation of 1.9%, a fixed productivity offset of 1.0% and removal of the federal large corporation tax. As such, no major financial impact for distributors is expected due to the inflation factor generally being slightly higher than the productivity factor. In each of three subsequent years, one-third of the electricity distributors will have their distribution rates reviewed and reset by the OEB through a cost-of-service type of rate proceeding. LDCs re-based in 2008 will be subject to an IRM applied in succeeding years up to the 2010 rate year. By 2010, all electricity distributors in Ontario will have undergone a re-basing of rates.

The net effect of the OEB decision in 2007 was to provide for approximately a 0.5% increase in base distribution rates to all customer classes for the May 1, 2007 to April 30, 2008 period. DBRS notes that, as of May 1, 2007, the OEB approved an amount of $0.93 per month from metered customers as part of the delivery charge on their bill, related to the implementation of the province's Smart Meter Program. The delivery charge effectively pre-funds the Company's OM&A cost, while defraying a portion of its financing costs, until meters are installed and included in its rate base.

Earnings and Outlook

Segmented Information		12 mos. ended	For the year ended December 31			
(CAD millions)		Sept. 07 *	2006	2005	2004	2003
Net revenues						
Transmission	52.1%	1,273	1,245	1,310	1,262	1,298
Distribution	46.6%	1,137	1,052	954	910	862
Other	1.3%	32	27	21	17	26
Total net revenues		**2,442**	**2,324**	**2,285**	**2,189**	**2,186**
EBIT by segment						
Transmission	67.6%	634	614	711	665	688
Distribution	33.4%	313	323	305	284	252
Other	-1.0%	(9)	(8)	(10)	(11)	(3)
Total EBIT		**938**	**929**	**1,006**	**938**	**937**

Income Statement	12 mos. ended	For the year ended December 31			
(CAD millions)	Sept. 07 *	2006	2005	2004	2003
Net revenues	2,442	2,324	2,285	2,189	2,186
OM&A expense	984	880	792	771	795
EBITDA	1,458	1,444	1,493	1,418	1,391
EBIT	938	929	1,006	938	937
Interest expense (1)	310	307	303	294	315
Core net income (before non-recurring items and prefs)	434	455	483	430	396
Reported net income (after prefs)	416	461	465	480	378
Operating margin	38%	40%	44%	43%	43%
Return on average equity (before non-recurring items)	9.3%	9.8%	10.8%	10.1%	9.7%

(1) Interest expense on short-term and long-term debt balances, excludes deferred financing charges.

* DBRS adjusted Transmission earnings for non-cash items to normalize the impact from the recent OEB rate decision.

Summary

Despite higher year-over-year net revenues, EBITDA and EBIT remained relatively flat as modest earnings growth from Hydro One's distribution operations offset the negative impact from increasing overall maintenance-related expenditures and lower 2006 transmission earnings on the earnings sharing mechanism implemented by the OEB.

- Operating costs continue to trend higher, having increased approximately 10% per year since 2005, which highlights the increased work programs needed to maintain the current capability of the system as well as higher information technology requirements. DBRS expects operating costs to continue to trend higher over the medium term.
- During F2006, the OEB applied an earnings sharing mechanism (ESM) to any transmission earnings in excess of the approved rate of return of 9.88%. This had a negative impact on transmission EBIT, leading to a notable decline from the F2005 level. The ESM was discontinued for 2007.

Interest expense has incrementally trended upward, largely tracking higher debt levels.

Overall, earnings remain robust and relatively stable as Hydro One continues to earn its allowed ROE, underscoring continued focus on productivity and cost-effectiveness.

Outlook

Earnings are expected to be pressured over the near to medium term, stemming from the recent OEB rate decision, which is anticipated to impact transmission revenues by approximately $80 million to $100 million over each of the next two years. However, earnings should improve beyond 2008 from the reduced levels, reflecting the following factors:

- A number of regulatory-approved transmission projects are expected to be completed and in service by the 2009 rate year, thereby increasing the rate base and, subsequently, its earnings profile.
- Also, Hydro One will have its distribution rates reviewed and reset through a forward-looking cost-of-service type rate proceeding in 2008, with an IRM applied in succeeding years up to 2010. The rate base should reflect the additional capital expenditures over the next couple of years.

The paradigm of lower ROE levels and the subsequent impact on earnings should be largely offset by higher respective rate bases and increased equity thickness, going forward.

Financial Profile

Statement of Cash Flow	12 mos. ended	For the year ended December 31			
(CAD millions)	Sept. 07	2006	2005	2004	2003
Core net income, (before non-recurring, after pfd.)	416	437	465	412	378
Depreciation & amortization	477	474	446	446	417
Amortization of debt re-couponing	10	27	58	62	60
Other recurring non-cash items	0	(8)	(24)	0	0
Cash Flow from Operations	**903**	**930**	**945**	**920**	**855**
Capital expenditures	(995)	(823)	(691)	(727)	(597)
Common dividends	(298)	(332)	(273)	(247)	(226)
Free Cash Flow before Working Capital Changes	**(390)**	**(225)**	**(19)**	**(54)**	**32**
Change in working capital	65	(92)	194	(33)	138
Net Free Cash Flow	**(325)**	**(317)**	**175**	**(87)**	**170**
Other investments/acquisitions/disposition	21	15	9	19	3
Other non-recurring, incl. retail settlement variance	63	40	2	6	21
Cash flow before financing	**(241)**	**(262)**	**186**	**(62)**	**194**
Net debt financing	139	246	(188)	83	(183)
Equity financing	0	0	0	0	0
Other financing	(1)	(4)	2	7	(13)
Net change in cash	(103)	(20)	0	28	(2)
Total adjusted debt (CAD millions) (1)	5,574	5,427	5,156	5,293	5,165
Cash flow gross interest coverage (1)	3.90	4.01	4.10	4.11	3.70
Fixed charges coverage (times) (1)	2.57	2.57	2.59	2.44	2.34
Total adjusted debt-to-capital (%) (1)	53.7%	53.3%	52.6%	54.3%	55.0%
Cash flow/total adjusted debt (times) (1)	16.2%	17.1%	18.3%	17.4%	16.6%
Cash flow/capital expenditures (times)	0.91	1.13	1.37	1.27	1.43
Dividend payout ratio	68.7%	69.3%	56.5%	49.6%	57.1%

(1) DBRS-adjusted for operating lease debt and interest expense equivalents. DBRS-adjusted for preferred shares (20% debt/ 80% equity).

Summary

Operating cash flow has remained reasonably stable, with the recent modest decline largely tracking net income. However, the continued growth in sustaining and development capital spending, combined with dividends, has resulted in increasing gross free cash flow deficits over the last two years.

To date, the Company has effectively managed the size of its capital expenditure programs. However, the recent upward trend in capital investment is indicative of the growing reliability needs in Ontario as a number of Hydro One's assets are coming to the end of their useful life. This is further accentuated by the increasing cost of manufactured products for utility infrastructure, coupled with expenditures on higher required generation-related and load customer connection expenditures.

Working capital requirements continue to fluctuate with the timing of the Company receiving or paying a customer rebate (pass-through of the commodity cost of electricity) from the Independent Electricity System Operator (IESO).

Despite the increasing free cash flow deficits, key credit metrics remain relatively stable, as higher debt levels have been largely offset with a growing equity base. The credit metrics remain solidly within the current rating category for a low-risk regulated utility with debt-to-capital at 53.7%, fixed charge coverage at 2.57 times and cash flow-to-debt at 16.2%.

Outlook
Hydro One's financial profile is expected to deteriorate over the medium term, given the measurable growth in its capital expenditure budget, driving higher free cash flow deficits.

Cash flow from operations is expected to decrease modestly, as lower net income is partially offset by higher depreciation, trending in line with higher capital expenditures.

With Hydro One entering a significant capital build-out program, DBRS expects the following to occur:
- Annual capital expenditures are expected to average approximately $1.1 billion to $1.5 billion from 2007 to 2009, with the majority related to transmission development projects, smart meter deployment and replacement of aging assets. However, there continues to be some uncertainty around the timing and scope of these capital expenditures within this time horizon. DBRS notes that capital will not be committed unless Hydro One obtains regulatory approval for cost recovery.
- With the significant ongoing replacement of aging assets, the increases in future sustaining capital expenditures are expected to abate beyond 2008.
- Common dividends are declared at the sole discretion of the Hydro One board of directors and are recommended by management based on financial conditions and liquidity requirements, which should provide some flexibility for dividend management, as the Company is committed to investing heavily in its electricity system.
- As such, the Company's leverage is expected to increase over the medium term, as the substantial capital expenditure program and dividend policy will result in sizable free cash flow deficits. These deficits and the subsequent higher leverage in the capital structure – in a longer-term range of 55% to 58% – will temporarily pressure cash flow-to-debt and interest coverage ratios, from present levels. DBRS does not expect the Company's financial profile to change significantly, with credit metrics remaining adequate for the assigned ratings.

Capital Expenditures: Designated Projects

Source: OEB Transmission Rate Decision EB-2005-0501, Exhibit D1, Schedule 4, Tab 1

Designated Projects	Historic	Test	Total	
(CAD millions)	2004-2006	2007-2008	(including future years)	%
Bruce Project	0	57	613	69%
Quebec Intertie	1	113	115	13%
Static Var Compensators	0	10	54	6%
Niagara Reinforcement	97	2	101	11%
Total	**98**	**182**	**883**	**100%**

Niagara Reinforcement project reinforces the transmission system in the Niagara region and provides access to new sources of generation. The project was substantively completed in F2006, with final completion delayed by the aboriginal land dispute in the Caledonia area. The OEB has allowed Hydro One to recover its carrying cost of the project until the asset is in-service and included in the Company's rate base. DBRS expects this to occur in the 2009 rate application.

Québec Interconnection project, in which Hydro One is collaborating with Hydro-Québec, will allow the transfer of 1,250 MW between the two provinces when it is completed in 2010. The Hydro One and Hydro-Québec grids are not synchronous, so for power to be exchanged it must be converted to the requirements of the receiving grid. The total estimated project cost is $808 million, of which $115 million is earmarked for Hydro One's capital budget.

Bruce to Milton project is in the preliminary stages of seeking the necessary provincial permits to have the estimated $613 million, 500 kV, 180 km line connection from the Bruce Power nuclear plants on Lake Huron to the Milton switching station west of Toronto. The proposed project could serve to deliver up to an additional 3,000 MW of generation capacity.

Hydro One Inc.

Report Date:
November 15, 2007

Long-Term Debt Maturities and Bank Lines

Long-term principal repayments as at September 30, 2007		
Year	%	(CAD millions)
2007	0.8%	40
2008	9.4%	500
2009	7.5%	400
2010	7.5%	400
2011	4.7%	250
Thereafter	70.1%	3,725
Total		5,315

(CAD millions) As at September 30, 2007	Committed	Outstanding	Available	Maturity
Commercial Paper backup facility*	750	161	589	8/10/2010

* Multi year revolving standby credit facility with a syndicate of banks.

Long-Term Debt

Hydro One finances its operations and capital programs with long-term debt (Senior Unsecured, $5.315 billion as at September 30, 2007) and a $750 million CP program (fully backed up by a credit facility).

- The debt repayment schedule is heavy but manageable over the next five years as Hydro One will have to refinance approximately 30% of its outstanding debt. Refinancing the debt should be well within Hydro One's financing capacity given its solid financial profile and good access to the public debt markets.
- DBRS anticipates that Hydro One will target a weighted-average long-term debt life between 12 and 18 years, with evenly spread out maturities, thus providing more flexibility while limiting refinancing risk.
- In June 2007, Hydro One filed a $2.5 billion MTNs program under the Preliminary Short-Form Base Shelf Prospectus. As at October 25, 2007, $2.2 billion was available.
- The Trust Indenture pertaining to all senior unsecured issuance includes the following covenants, subject to customary exceptions:
  - Any additional indebtedness is subject to a 75% capitalization ratio test.
  - Negative pledge clause.
  - Limitations on ability to sell principle properties.

Liquidity

Liquidity requirements will increase over the medium term to accommodate higher capital expenditures and regulatory working capital needs. DBRS notes that Hydro One has sufficient flexibility to accommodate the increasing liquidity needs, with its authorized CP program and availability under its MTNs program. However, the Company recently issued $300 million under its MTNs program to redeem the outstanding CP with the remainder for general corporate purposes. As of September 30, 2007, the Company currently has $589 million in unused capacity under the credit facility.

- As of August 1, 2007, Hydro One was able to meet prudential support obligations for power purchases through the IESO using only parental guarantees, which will further boost liquidity by releasing current $10 million letters of credit.
- Hydro One's board has authorized a CP limit of $1 billion; however, the Company has set the limit of its CP program at $750 million, matching the limit of the revolving credit facility.
- The credit facility is a multi-year facility that matures in 2010. The Company has the ability to increase the facility to $1 billion upon the mutual agreement with its lenders.

Hydro One Inc.

Report Date:
November 15, 2007

Hydro One Inc.

Balance Sheet
(CAD millions)

Assets	As at Sept. 30/07	As at December 31 2006	2005	Liabilities & Equity	As at Sept. 30/07	As at December 31 2006	2005
Cash + short-term investments	-	-	-	Short-term debt	175	89	9
Accounts receivable	748	777	628	L.t. debt due one year	540	395	589
Material, supplies & other	76	69	68	A/P + accr'ds	862	710	743
Current Assets	824	846	696	**Current Liabilities**	1,577	1,194	1,341
Net fixed assets	11,001	10,526	10,110	Long-term debt	4,764	4,848	4,466
Post-employment benefits	382	382	449	Post-employ. benefits	848	803	716
Def'd debt costs + long-term rec.	7	12	33	L.t. pay. + other liab.	530	544	582
Regulatory asset	238	311	400	Preferred shares	323	323	323
Goodwill	133	133	133	Shareholders' equity	4,543	4,498	4,393
Total	12,585	12,210	11,821	**Total**	12,585	12,210	11,821

Ratio Analysis	12 mos. ended	For the year ended December 31			
Liquidity Ratios	Sept. 30/07 *	2006	2005	2004	2003
Current ratio	0.52	0.71	0.52	0.60	0.55
Cash flow/total debt (1)	16.2%	17.1%	18.3%	17.4%	16.6%
Total adjusted debt-to-capital (1)	53.7%	53.3%	52.6%	54.3%	55.0%
Cash flow/capital expenditures	0.91	1.13	1.37	1.27	1.43
Cash flow-dividends/capital expenditures	0.61	0.73	0.97	0.93	1.05
Adj. total debt/EBITDA (1)	3.82	3.76	3.45	3.73	3.71
Hybrids in capital structure	3.1%	3.2%	3.3%	3.3%	3.4%
Deemed common equity	40.0%	36.0%	36.0%	36.0%	36.0%
Common dividend payout (before extras.)	71.6%	76.0%	58.7%	60.0%	59.8%
Coverage Ratios					
EBIT gross interest coverage (1)	2.77	2.77	2.78	2.63	2.49
EBIT net interest coverage (1)	3.14	3.14	3.09	2.83	2.69
EBITDA gross interest coverage (1)	4.31	4.31	4.12	3.97	3.70
EBITDA net interest coverage (1)	4.87	4.87	4.58	4.27	3.98
Fixed-charges coverage (1)	2.57	2.57	2.59	2.44	2.34
Earnings Quality/Operating Efficiencies & Statistics					
Operating margin	38.4%	40.0%	44.0%	42.9%	42.9%
Net margin (before non-recurring, after pfd.)	17.0%	18.8%	20.4%	18.8%	17.3%
Return on avg. equity (before non-recurring items)	9.3%	9.8%	10.8%	10.1%	9.7%
Approved ROE (Distribution)	9.0%	9.0%	9.88%	9.88%	9.88%
Approved ROE (Transmission)	8.35%	9.88%	9.88%	9.88%	9.88%
Rate base - distribution ($ millions)	3,711	3,711	2,637	2,637	2,637
Rate base - transmission ($ millions)	6,344	5,718	5,718	5,718	5,718
Transmission throughputs (TWh)	na	151.1	157.0	153.4	151.7
Distribution throughputs (TWh)	29.9	29.0	29.7	28.5	27.9
Average annual 60-minute peak demand (MWh)	27,435	27,005	26,160	24,979	24,753

(1) DBRS-adjusted for operating lease debt and interest expense equivalents. DBRS-adjusted for preferred shares (20% debt/ 80% equity).

* DBRS adjusted Transmission earnings for non-cash items to normalize the impact from the recent OEB rate decision.

Unit Costs and Revenues for Electricity Throughputs	12 mos. ended	For year ended December 31			
Distribution operations (cents/kWh)	Sept. 2007	2006	2005	2004	2003
Net revenues	3.80	3.63	3.21	3.19	3.09
OM&A	2.76	2.51	2.19	2.20	2.19
EBIT	1.05	1.11	1.03	1.00	0.90
Transmission operations (cents/kWh)					
Net revenues	na	0.82	0.83	0.82	0.86
OM&A	na	0.42	0.38	0.39	0.40
EBIT	na	0.41	0.45	0.43	0.45

Hydro One Inc.

Report Date:
November 15, 2007

Rating

Debt Rated	Rating	Rating Action	Trend
Commercial Paper	R-1 (middle)	Confirmed	Stable
Senior Unsecured Debentures	A (high)	Confirmed	Stable

Rating History

	Current	2006	2005	2004	2003	2002
Commercial Paper	R-1 (middle)	R-1 (middle)	R-1 (low)	R-1 (low)	R-1 (low)	R-1 (low)
Senior Unsecured Debentures	A (high)	A (high)	A	A	A	A

Related Research

- •October 16, 2007, Press Release: Rates Issue of $300 Million, 5.18% Medium-Term Notes at A (high)
- •March 9, 2007, Press Release: Rates Issue of $400 Million, 4.89% Medium-Term Notes at A (high)
- •October 19, 2006, Press Release: Rates Issue of $75 Million, 5.00% Medium-Term Notes at A (high)
- •August 22, 2006, Press Release: New Issue
- •June 30, 2006, Rating Report: Hydro One Inc.

Note:
All figures are in Canadian dollars unless otherwise noted.

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STANDARD
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COMMENTARY
REPORT

Hydro One Inc.

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Publication Date
Nov. 23, 2007

Rationale

The ratings on Ontario-based Hydro One Inc. reflect the company's low-risk monopoly electricity transmission and distribution networks, secure and relatively predictable regulated cash flows, and the support of its owner, the Province of Ontario (AA/Stable/A-1+). Offsetting these strengths is an intermediate financial risk profile that will face the challenges of a lower rate of return on its transmission rate base and the company's large capital expenditure program in the next several years. Hydro One had C$5.2 billion in long-term debt outstanding as of Dec. 31, 2006.

Hydro One's monopoly position, the asset intensive nature of its businesses, and regulatory oversight limit competitive risk. It is the key electricity transmission provider and largest distributor of electricity in the province. The company owns and operates more than 97% of Ontario's transmission network as measured by revenue, and its predominantly rural distribution service territory incorporates about 75% of the province as measured by surface area.

Hydro One's debt-servicing capacity relies on secure and relatively predictable regulated cash flows supported by cost-of-service plus rate-of-return regulation. The company can expect to recover all prudent costs incurred and earn a modest return on its capital investment. Furthermore, the company faces limited risk related to commodity price and volume variability. Although Hydro One's distribution business bills customers for the cost of the commodity consumed, the company has no obligation to ensure adequate electricity supply.

Provincial ownership enhances the utility's credit quality. Although Ontario does not formally guarantee Hydro One's debt obligations, the company's strategic nature within the provincial economy and the government's demonstrated willingness to financially assist the business under extraordinary circumstances in the past bode well for future support.

Hydro One has an intermediate financial risk profile. We expect weaker cash flow interest and debt coverage in the next few years due to a recent transmission revenue decision that

lowered the allowed ROE on transmission assets to 8.35% from 9.88%, further exacerbated by the upcoming period of higher-than-normal capital expenditures. Adjusted funds from operations (AFFO) interest coverage of 4.6x in 2006 was up from 4.4x in 2005 largely as a result of distribution rate increases in 2005 and 2006 and regulatory asset recovery. AFFO interest coverage will drift downward in the next several years, and could fall below 3.5x. AFFO-to-total debt could also weaken to the 14%-17% range, compared with its 2006 level of 20%. The extent of the deterioration will depend on the timing of regulatory approvals and execution of budgeted capital expenditures, and the impact of weather variability on revenue. The company expects to debt finance 20% or more of forecast capital expenditure during the upcoming period of significant expansion. During this period, Hydro One's leverage, as measured by adjusted total debt-to-total capital, could creep back up closer to the historical level of about 64%, compared with 60% in 2006.

Although predominantly funded from internal sources, capital spending during the next few years will be a drain on the company's cash flow and reduce its financial flexibility. Hydro One has budgeted C$1.4 billion in capital expenditure for 2008, a 70% increase compared with the C$823 million spent in 2006, and higher-than-historical average. This period of increased capital spending is a result of planned upgrades and expansion of the transmission system to accommodate: growth in domestic electricity demand, the connection of new generation facilities, and facilitate increased imports and exports. The 2008 capital program also includes a portion of the estimated C$700 million investment that Hydro One will make in smart meters for all distribution customers by 2010 in the next four years. Like its other infrastructure investments, Hydro One's investment in smart meters will also be added to its revenue-generating regulated asset base.

Short term credit factors

The short-term rating on Hydro One is 'A-1'. Unused and committed bank lines, together with strong cash flow from operations and ready access to the debt capital markets, provide the utility with sufficient liquidity and the financial flexibility to meet its forecast capital expenditure estimate of C$1.2 billion, annual dividend payments of C$250 million to C$350 million, and C$355 million of debt maturing in 2007. As of Sept. 30, 2007, C$161 million had been drawn from the company's C$1 billion short-term note program. The company remains well within its banking covenant of total debt-to-total capital of 75% and has no material adverse change clauses that could trigger a default.

In support of Hydro One's liquidity, the company can draw on:

- A committed C$750 million bank line of which C$589 million was available as of Sept. 30, 2007. The bank line is used for general corporate purposes and to support its C$1 billion Canadian CP program. The line matures in August 2010;
- Its expected annual regulated cash flows as represented by unadjusted FFO of about C$860 million in 2007;
- C$2.2 billion remaining capacity on a C$2.5 billion MTN shelf program, maturing in July 2009; and
- Discretionary capital expenditure estimated at C$150 million- C$200 million.

Outlook

The positive outlook reflects a steady improvement in Hydro One's business risk profile. The improvement is largely a result of steadily increasing clarity and stability with regards to regulatory

methodology and timetables that influence both the transmission and distribution business, and the continued absence of disruptive market restructuring and political involvement in the regulatory process. Should this trend continue it could result in a positive rating action, but more than a single-notch improvement is highly unlikely. Given the supportive and stable shareholder relationship, the temporary downward pressure on the company's cash flow strength due to the pressures of upcoming increased capital spending should not lead to a revised outlook. A negative rating action could result from a material change in the company's financial or business risk profile or its shareholder relationship, an adverse regulatory ruling, or unfavorable market restructuring.

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Moody's Investors Service

Global Credit Research
Credit Opinion
7 DEC 2007

Credit Opinion: Hydro One Inc.

Hydro One Inc.

Toronto, Ontario, Canada

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured -Dom Curr	Aa3
Commercial Paper	P-1

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Key Indicators

Hydro One Inc.

	LTM 9/07	2006	2005	2004	2003
(CFO Pre-W/C + Interest) / Interest Expense [1]	**3.8x**	**3.9x**	**3.4x**	**3.4x**	**3.3x**
(CFO Pre-W/C) / Debt [1]	**16.2%**	**17.8%**	**16.7%**	**15.9%**	**16.6%**
(CFO Pre-W/C - Dividends) / Debt [1]	**11.1%**	**11.9%**	**12.0%**	**11.7%**	**12.4%**
(CFO Pre-W/C - Dividends) / Capex [1]	**70.1%**	**89.7%**	**107.8%**	**102.2%**	**121.5%**
Debt / Book Capitalization	**58.7%**	**58.4%**	**61.1%**	**62.6%**	**61.8%**
EBITA Margin %	**18.8%**	**21.6%**	**24.9%**	**25.3%**	**27.0%**

[1] CFO pre-W/C, which is also referred to as FFO in the Global Regulated Electric Utilities Rating Methodology, is equal to net cash flow from operations less net changes in working capital items

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Company Profile

Hydro One Inc. (HOI) is wholly owned by the Province of Ontario. Its revenues and cash flows are almost completely derived from its transmission and distribution businesses, both of which are regulated by the Ontario Energy Board (OEB or the Board). HOI owns and operates virtually all of Ontario's electricity transmission system, and is responsible for a substantial portion of regulated electricity distribution in the province.

Recent Developments

On August 16, 2007 the OEB rendered its decision with respect to HOI's transmission rates for 2007 and 2008. The decision resulted in a reduction in the transmission business' allowed ROE to 8.35% from the existing 9.88% and the 10.5% level sought in HOI's September 12, 2006 application. The decision was retroactive to January 1, 2007 with rate decreases taking effect November 1, 2007. Over-collections from January 1, 2007 to October 31, 2008 are to be returned to customers through rates by December 31, 2008. Moody's believes that this decision will have a significant negative impact on HOI's key credit metrics and could create downward pressure on HOI's Baseline Credit Assessment (BCA).

On August 15, 2007 HOI filed its cost-of-service distribution revenue requirement application for 2008 seeking a net distribution rate increase of approximately 4%. Moody's does not expect an OEB decision in this proceeding before the second quarter of 2008

In its 2007 Integrated Power System Plan (IPSP), the Ontario Power Authority (OPA) forecasts that approximately $4 billion in transmission capital expenditures will need to be made between 2010 and 2025 to facilitate the connection of renewable generation projects and promote system reliability. Although the OPA believes that in the near-term, transmission proponents will need to undertake development work in connection with the transmission projects recommended in the IPSP, it does not foresee significant expenditures in respect of these project until 2010 or later. While the OPA does not assign responsibility for future transmission projects, Moody's believes that HOI is ideally positioned for and will actively pursue the right to undertake a significant portion of these expenditures. Accordingly, Moody's expects that HOI's capital expenditures and financing requirements, which will be elevated in the near-term, are likely to remain at elevated levels through the medium-term.

On November 23, 2007, HOI's board of directors announced that Laura Formusa, Acting President and Chief Executive Officer since December 8, 2006, had been appointed President and Chief Executive Officer of HOI. In May 2007, the Agency Review Panel (ARP) published its report and recommendations on executive compensation at Ontario's government owned/created electricity sector institutions. In June 2007, the Ontario Government announced its acceptance of the ARP's recommendations including those that, over time, are expected to result in 25-30% reductions in senior management compensation at Ontario electricity sector institutions including HOI. Moody's believes that the appointment of Ms. Formusa and the Ontario Government's adoption of the ARP's recommendations are not likely to have a material impact on HOI's credit profile.

Rating Rationale

In accordance with Moody's Government Related Issuer (GRI) rating methodology, the Aa3 ratings of HOI reflect the combination of the following inputs:

- Baseline Credit Assessment (BCA) in the range of 5 to 7 (on a scale of 1 to 21, where 1 represents the equivalent risk of a Aaa, 2 a Aa1, 3 a Aa2 and so forth)

- Aa1 local currency rating of the province of Ontario

- High default dependence

- High probability of extraordinary support

The BCA range of 5 to 7 reflects the following key ratings drivers.

SIGNIFICANT BUSINESS POSITION IN A RELATIVELY STABLE LEGISLATIVE BUT EVOLVING REGULATORY ENVIRONMENT

Moody's considers HOI's regulatory and business positions to be in the A category, reflecting its stable and predictable cash flows and the low business risk of its regulated wires businesses. Virtually all of HOI's activities are regulated with the exception of its telecommunications business, which represents less than 1% of total assets. HOI is the largest transmission operator in Ontario, owning and operating roughly 96% of the province's transmission capacity. HOI is also the largest electricity distributor in Ontario with a geographically dispersed and largely rural service territory; however, the BCA also recognizes the potential that HOI, which is 100% owned by the Province of Ontario, can be utilized as an instrument of public policy. Moody's notes that public policy goals are not always completely aligned with the interests of debt holders.

HOI deals with a single provincial regulator, the OEB, which regulates both the transmission and distribution segments of its business. The legislative environment in Ontario has been relatively stable since 2005 but the regulatory framework continues to evolve and suffers from significant regulatory lag. HOI completed it first cost-of-service proceeding for the Transmission segment in 2007. The OEB's August 16th decision came almost a year after the company's application was filed. The decision is expected to have a materially negative impact on HOI's 2008 financial metrics due to its retroactive nature which goes back to January 1, 2007. With rate adjustments going into effect on November 1, 2007, Moody's expects HOI's 2008 metrics to be impacted not only by rising capital expenditures and the lower transmission rates applicable to 2008 but also by the refund in 2008 of over-collections related to 2007. As noted below, Moody's expects that HOI's future CFO pre-WC/Interest could be in the range of 3.5x while CFO pre-WC/Debt could fall to roughly 13%. Any deterioration of CFO pre-WC/Interest below 3.5x and/or CFO pre-WC/Debt below 13% would likely result in a decrease in HOI's BCA Rates in HOI's distribution segment will be established pursuant to a cost-of-service proceeding in 2008 following which rates are expected to be adjusted in accordance with the OEB's yet-to-be finalized 3rd Generation Incentive Regulation Mechanism (IRM). While the regulatory environment in Ontario continues to evolve, Moody's anticipates that there will be increased transparency and predictability of rate decisions for HOI after 2008 as we expect that the distribution rates will be established pursuant to a formula driven mechanism under the OEB's 3rd Generation IRM. Moody's also expects that the adoption of formula driven IRM should reduce or eliminate regulatory lag post-2008.

FLEXIBILITY TO RECOVER COSTS AND EARN RETURNS

Moody's considers HOI's flexibility to recover costs and earn returns to be in the A category. Within HOI's distribution segment (approximately 42% of total assets) commodity costs are a full pass-through to customers.

HOI filed a distribution rate application for its 2008 revenue requirement with the Board, on August 15, 2007. Moody's does not expect a decision in this proceeding until the second quarter of 2008. As previously noted, rates subsequent to 2008 are expected to be set in accordance with the OEB's 3rd Generation IRM subject to periodic rebasing.

DIVERSIFIED OPERATIONS WITHIN ONTARIO

Moody's considers HOI's diversification to be in the Baa category. While all of the company's operations are located in the Province of Ontario and are subject to regulation by a single regulator, HOI's transmission and distribution assets are substantial and geographically dispersed across Ontario. HOI's $7.2 billion transmission segment is comprised of a network of approximately 28,600 circuit-kilometres representing approximately 96% of Ontario's transmission capacity and servicing virtually every region of the province. It includes significant interties with adjacent jurisdictions such as Quebec, Manitoba, New York and Michigan. The $5.3 billion distribution segment is comprised of approximately 124,700 circuit-kilometres servicing approximately 1.3 million customers, predominantly in rural areas of the province.

VIRTUALLY NO UNREGULATED BUSINESS

Moody's considers HOI's unregulated business characteristics to be in the Aa category, reflecting the fact that virtually all of HOI's activities are regulated by the OEB. HOI's only unregulated operations consist of a small telecommunications operation representing less than 1% of total assets.

FINANCIAL METRICS EXPECTED TO WEAKEN WITH LOWER ROEs; LIQUIDITY CHALLENGED BY LARGE CAPEX PROGRAM

As a result of declining ROEs in both the distribution and transmission segments as well as undertaking increased capital expenditures, HOI's financial metrics are expected to weaken during 2008 and 2009. Moody's expects that CFO pre-WC/Interest could be in the range of 3.5x while CFO pre-WC/Debt could fall to roughly 13%. At these levels, Moody's would consider HOI's financial metrics to be in the low Baa/high Ba range and weak relative to HOI's current BCA which is in the range of 5 to 7. Any deterioration of CFO pre-WC/Interest below 3.5x and/or CFO pre-WC/Debt below 13% would likely result in a decrease in HOI's BCA.

HOI expects to have large capital expenditure needs for a number of years. Maintenance capital expenditures, particularly in the transmission segment, are expected to rise significantly in coming years reflecting the age of HOI's system and an increased proportion of end-of-life assets as well as rising materials and labour costs. HOI also expects to make significant growth capital expenditures in support of provincial policy objectives such as smart metering and increased renewable generation. Elevated levels of capital expenditures are expected to add to the stress on HOI's credit metrics caused by declining ROEs. Major projects require the investment of debt and equity capital in the near-term while it could be several years before they begin generating cash flow to service the invested capital. Given the province's ownership of HOI, the company has limited ability to raise equity. Moody's estimates that, in the absence of a significant reduction in its dividend payout, HOI's cash flow metrics will come under further pressure as a result of the company's capital expenditure plans.

In evaluating a company's liquidity, Moody's typically assumes that the company loses access to the capital markets (both short and long term) for a period of 12 months. In this context, we then evaluate the company's various sources and uses of cash including the flexibility to defer or reduce uses of cash such as capital expenditures and dividends. HOI's commercial paper (CP) program is rated Prime-1 (Aa) based on the stable cash flow generated by its regulated transmission and distribution operations. We anticipate that the company will generate funds from operations of approximately $1.8 billion in aggregate during 2008 and 2009. After dividends of about $500 million and capital expenditures and working capital changes of approximately $3 billion, Moody's expects the company to be free cash flow negative by approximately $1.7 billion over the 2008 to 2009 period. HOI intends to fund its free cash flow shortfalls and approximately $540 million of scheduled debt maturities in the next twelve months primarily with issuances under its $2.5 billion MTN shelf filed June 21, 2007. Following HOI's $300 million MTN issuance on October 18, 2007, $2.2 billion remained available under the shelf. Given scheduled debt matruities of $500 million in June 2009, Moody's expects that HOI will renew its MTN shelf prior to its July 2009 expiry.

In addition to the MTN shelf, HOI has a $1 billion CP program. In support of its CP program, the company maintains a syndicated committed $750 million 3-year bank facility which currently matures in August 2010. The facility contains a maximum debt to total capitalization ratio covenant of 75%. At September 30, 2007, availability under the company's bank facility was approximately $480 million, given approximately $160 million of outstanding CP, $15 million of drawn bank debt, and $93 million of LCs outstanding. While it is somewhat unusual that HOI's CP back-up facility is smaller than its CP program size, Moody's notes that HOI has stated that it will not issue more than $750 million under its CP program without increasing the size of the CP back-up line to ensure that it has 100% coverage of the CP outstandings.

Based on the company's forecasted capital expenditures Moody's estimates that HOI's borrowing requirements over the next twelve months could, without a significant reduction in the company's dividend payout or timely issuances of additional MTN debt, exceed the amount available under the company's committed credit facilities. In the normal course, Moody's expects that the company will proactively access the term debt markets and/or pursue other measures to ensure that it has sufficient short-term liquidity to support its Prime - 1 (Aa) short-term rating.

Moody's recognizes that HOI has some degree of flexibility in the timing of roughly $500 million of its planned operating and capital expenditures. These expenditures could be deferred for a period of time in the event that access to additional capital became constrained. However, Moody's notes that these OEB-approved expenditures can only be deferred for a finite period and that any such deferral would likely have adverse consequences for future system reliability and operating costs. Moody's also recognizes that some of the forecasted capital expenditures in future years have yet to be approved by either HOI's board or the OEB and, as such, might not materialize. Notwithstanding, Moody's believes most of the forecasted capital spending will be approved and will ultimately take place with the result that HOI's capital expenditures will remain elevated through the medium-term. Accordingly, Moody's believes that HOI's liquidity requirements have increased in a semi-permanent basis. Similarly, Moody's considers the company to be significantly more dependent upon continued access to the public debt markets than it has been in recent years.

CHALLENGES ASSOCIATED WITH AN AGING WORKFORCE

The extent of HOI's capital expenditures over the next few years highlights another challenge that HOI and many other utilities face: that of an aging workforce. At HOI's December 31, 2006 year-end, the company estimated that, approximately 25% of its workforce would become eligible for retirement by the end of 2008. The availability and cost of skilled labour necessary to successfully complete the work required under HOI's substantial capital expenditure plans as well its ongoing system operation and maintenance could prove to be a challenge.

DEFAULT DEPENDENCE HIGH

High default dependence reflects the importance of the issuer to the provincial economy and its operating and financial proximity to the government.

EXTRAORDINARY SUPPORT

Moody's expectation of high probability of extraordinary support reflects the strategic importance of the issuer to the province, the government's history of providing support through dividend deferrals in its capacity as the shareholder of the company and the government's history of intervening in the electricity sector.

Rating Outlook

The stable outlook reflects the fact that HOI's weak credit metrics are largely balanced by its low business risk profile and dominant business position in the Ontario electricity market. It also reflects Moody's expectation that HOI will significantly improve its liquidity resources in the context of its forecasted significant and growing capital expenditure profile.

What Could Change the Rating - Up

- While considered unlikely at this time, a sustainable improvement in cash flow metrics (CFO pre-WC/Interest exceeding 6.0x, CFO pre-WC/Debt exceeding 30% and (CFO pre-WC less Dividends)/Debt exceeding 25%) could result in an increase in both HOI's BCA and published rating.

What Could Change the Rating - Down

One or more of the following could result in a reduction of either HOI's BCA or its published rating:

- A material reduction in the perceived probability of extraordinary support

- A sustained weakening of cash flow metrics such as CFO pre-WC/Interest coverage below 3.5x, CFO pre-WC/Debt below 13% and/or CFO pre-WC/Debt below 9%

- Failure of the company to ensure sufficient sources of liquidity in support of its growing capital expenditure program

- Actions on the part of the shareholder that impede the company's ability to act in a commercial manner

- Material changes in the ownership, governance or management structures

- Further restructuring of the electricity sector that increases HOI's business or financial risk profiles

Rating Factors

Hydro One Inc.

Select Key Ratios for Global Regulated Electric Utilities

Rating	Aa	Aa	A	A	Baa	Baa	Ba	Ba
Level of Business Risk	**Medium**	**Low**	**Medium**	**Low**	**Medium**	**Low**	**Medium**	**Low**
CFO pre-W/C to Interest (x) [1]	>6	>5	3.5-6.0	3.0-5.7	2.7-5.0	2-4.0	<2.5	<2
CFO pre-W/C to Debt (%) [1]	>30	>22	22-30	12-22	13-25	5-13	<13	<5
CFO pre-W/C - Dividends to Debt (%) [1]	>25	>20	13-25	9-20	8-20	3-10	<10	<3
Total Debt to Book Capitalization (%)	<40	<50	40-60	50-70	50-70	60-75	>60	>70

[1] CFO pre-W/C, which is also referred to as FFO in the Global Regulated Electric Utilities Rating Methodology, is equal to net cash flow from operations less net changes in working capital items

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