

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
FINANCIAL STATEMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2008

**HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
AUDITORS' REPORT**

To the Shareholder of **Hydro One Networks Inc.**

We have audited the balance sheet of the Distribution Business (a business of Hydro One Networks Inc.), as at December 31, 2008, and the statements of operations and comprehensive income and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

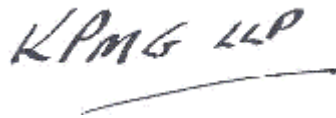
We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Distribution Business of Hydro One Networks Inc. as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

These financial statements are solely for the information and use of the Directors of Hydro One Networks Inc. for filing with the Ontario Energy Board. These financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

The Distribution Business has no separate legal status or existence (See Note 1).

The financial statements as at December 31, 2007 and for the year then ended were reported on by another firm of public accountants.

Handwritten signature of KPMG LLP in black ink, with a horizontal line underneath.

Chartered Accountants, Licensed Public Accountants

Toronto, Canada
April 21, 2009

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

<i>Year ended December 31 (Canadian dollars in millions)</i>	2008	2007
Revenues		
Energy sales	2,784	2,836
Rural rate protection (Note 14)	125	125
Other	47	44
	<u>2,956</u>	<u>3,005</u>
Costs		
Purchased power (Note 14)	1,905	1,964
Operation, maintenance and administration (Note 14)	487	503
Depreciation and amortization (Note 3)	266	254
	<u>2,658</u>	<u>2,721</u>
Income before financing charges and provision for payments in lieu of corporate income taxes	298	284
Financing charges (Notes 4 and 14)	119	120
Income before provision for payments in lieu of corporate income taxes	179	164
Provision for payments in lieu of corporate income taxes (Notes 5 and 14)	63	77
Net income	116	87
Other comprehensive income	-	1
Comprehensive Income	<u>116</u>	<u>88</u>

See accompanying notes to Financial Statements.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
BALANCE SHEETS

<i>December 31 (Canadian dollars in millions)</i>	2008	2007
Assets		
Current assets:		
Accounts receivable (net of allowance for doubtful accounts – \$21 million; 2007 - \$18 million) <i>(Note 14)</i>	574	571
Regulatory assets <i>(Note 7)</i>	51	73
Materials and supplies	5	9
Other	8	8
	638	661
Fixed assets <i>(Note 6)</i> :		
Fixed assets in service	6,556	6,097
Less: accumulated depreciation	2,450	2,305
	4,106	3,792
Construction in progress	194	150
Future use land, components and spares <i>(Note 2)</i>	36	20
	4,336	3,962
Other long-term assets:		
Regulatory assets <i>(Note 7)</i>	160	80
Goodwill	73	73
Long-term accounts receivable and other assets	7	1
	240	154
Total assets	5,214	4,777

See accompanying notes to Financial Statements.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
BALANCE SHEETS (continued)

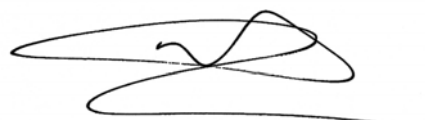
<i>December 31 (Canadian dollars in millions)</i>	2008	2007
Liabilities		
Current liabilities:		
Inter-company demand facility (Note 14)	44	158
Accounts payable and accrued charges (Note 14)	485	431
Regulatory liabilities (Note 7)	30	-
Accrued interest	24	21
Long-term debt payable within one year (Notes 8, 9 and 14)	132	224
	<u>715</u>	<u>834</u>
Long-term debt (Notes 8, 9 and 14)	2,160	1,864
Other long-term liabilities:		
Employee future benefits other than pension (Note 11)	504	475
Environmental liabilities (Note 12)	115	34
Regulatory liabilities (Note 7)	84	43
Long-term accounts payable and accrued charges	4	4
	<u>707</u>	<u>556</u>
Total liabilities	3,582	3,254
Contingencies and commitments (Notes 16 and 17)		
Excess of assets over liabilities	1,632	1,523
Total liabilities and excess of assets over liabilities	5,214	4,777

See accompanying notes to Financial Statements.

On behalf of the Board:



Laura Formusa
Chair



Sandy Struthers
Director

**HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
STATEMENTS OF CASH FLOWS**

<i>Year ended December 31 (Canadian dollars in millions)</i>	2008	2007
Operating activities		
Net income	116	87
Environmental expenditures	(9)	(6)
Adjustments for non-cash items:		
Depreciation and amortization (excluding removal costs)	234	226
Regulatory liability refund account	30	38
Other regulatory asset and liability accounts	41	26
Revenue recovery account	(25)	-
	387	371
Changes in non-cash balances related to operations <i>(Note 15)</i>	86	66
Net cash from operating activities	473	437
Investing activities		
Capital expenditures	(542)	(477)
Other assets	(9)	5
Net cash used in investing activities	(551)	(472)
Financing activities		
Allocated long-term debt issued	420	235
Allocated long-term debt retired	(224)	(237)
Payments to Hydro One to finance dividends	(7)	(57)
Other	3	4
Net cash from (used in) financing activities	192	(55)
Net change in inter-company demand facility	114	(90)
Inter-company demand facility, January 1	(158)	(68)
Inter-company demand facility, December 31	(44)	(158)

See accompanying notes to Financial Statements.

**HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
NOTES TO FINANCIAL STATEMENTS**

1. DESCRIPTION OF THE DISTRIBUTION BUSINESS

Hydro One Inc. (Hydro One) was incorporated on December 1, 1998, under the *Business Corporations Act* (Ontario) and is wholly owned by the Province of Ontario (the Province). The principal businesses of Hydro One are the transmission and distribution of electricity to customers within Ontario. These businesses are regulated by the Ontario Energy Board (OEB).

Hydro One Networks Inc. (Hydro One Networks or the Company) was incorporated on March 4, 1999 under the *Business Corporations Act* (Ontario) and is a wholly owned subsidiary of Hydro One. The Company owns and operates Hydro One's regulated transmission and distribution businesses. The regulated distribution business (the Distribution Business) operates a low-voltage electrical distribution network that distributes electricity from the transmission system, or directly from generators, to customers within Ontario. Distribution customers include small local distribution companies and large industrial customers with loads of less than 5 MW.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The financial statements have been prepared in accordance with accounting principles generally accepted in Canada (Canadian GAAP). The financial statements have been prepared for the specific use of the OEB. Consolidated financial statements of Hydro One for the year ended December 31, 2008 have been prepared and are publicly available.

These financial statements have been prepared on a carve-out basis to provide the financial position, results of operations and cash flows of the Company's regulated Distribution Business on a basis approved by the OEB. The financial statements are considered by management to be a reasonable representation, prepared on a rational, systematic and consistent basis, of the financial results of that business. As a result of this basis of accounting, these financial statements may not necessarily be identical to the financial position and results of operations that would have resulted had the Distribution Business historically operated on a stand-alone basis.

The financial statements have been constructed primarily through specific identification of assets, liabilities (other than debt), revenues and expenses that relate to the Distribution Business. The Company's long-term debt is allocated based on the respective borrowing requirements of the Company's transmission and distribution businesses. A portion of the Company's shared functions and services costs are allocated to the Distribution Business on a fully allocated cost basis, consistent with OEB-approved independent studies. Payments in lieu of corporate income taxes have been recorded at effective rates based on income taxes as reported in the Statements of Operations as though the Distribution Business was a separate tax paying entity. Certain other amounts presented in these financial statements represent allocations subject to review and approval by the OEB.

Rate-setting

The rates of the Company's electricity distribution business are subject to regulation by the OEB.

In 2006, the OEB initiated a process of establishing an Incentive Regulation Mechanism (IRM) for the years 2007 to 2010. The process included a formulaic approach to establishing 2007 rates with a rate re-basing approach to be staggered across all Ontario distributors between 2008 and 2010. The Company applied for distribution rate adjustments in February 2007, based on an OEB-approved formula that considers inflation and efficiency targets. In April 2007, the OEB approved the Company's submissions and the revised rates were implemented effective May 1, 2007.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
NOTES TO FINANCIAL STATEMENTS (continued)

In accordance with the OEB's multi-year distribution rate-setting plan, Hydro One Networks submitted the revenue requirement portion of its 2008 cost of service application on August 15, 2007. This application sought the approval of a revenue requirement of \$1,067 million based on a rate of return of 8.64% for 2008, and included a plan to reduce the number of rate classes for its customers and consolidate or harmonize the rates for its existing rate classes to the new proposed rate classes.

On December 18, 2008, the OEB issued a decision approving substantially all work program expenditures effective May 1, 2008, for implementation on February 1, 2009. The OEB also approved recovery of our smart meter expenditures made prior to the end of 2007. Subsequent expenditures will continue to be tracked in deferral accounts for future recovery. The decision approved the establishment of the Revenue Recovery Account (RRA) to record the revenue differential between existing distribution rates and new rates. The RRA will be recovered over a 27-month period commencing February 1, 2009 and ending April 30, 2011. The decision also approved the rate harmonization plan and the ROE was set at 8.57% based on the application of the OEB's provincial formula.

The OEB has the general authority to include or exclude costs, revenues, losses or gains in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have applied in an unregulated company. Such change in timing gives rise to the recognition of regulatory assets and liabilities. The Distribution Business' regulatory assets represent certain amounts receivable from future customers and costs that have been deferred for accounting purposes because it is probable that they will be recovered in future rates. In addition, the Distribution Business has recorded regulatory liabilities, which represents amounts incurred in different periods than would be the case had the Distribution Business been unregulated. The Company continually assesses the likelihood of recovery of each of its regulatory assets and continues to believe that it is probable that the OEB will factor its regulatory assets and liabilities into the setting of future rates. If, at some future date, the Company judges that it is no longer probable that the OEB will include a regulatory asset or liability in future rates, the appropriate carrying amount will be reflected in results of operations in the period that the assessment is made. The specific regulatory assets and liabilities recognized at December 31, 2008 are disclosed in Note 7.

Revenue Recognition

Revenues attributable to the delivery of electricity are based on OEB-approved distribution tariff rates and are recognized as electricity is delivered to customers. The Company estimates the monthly revenue for the period based on wholesale power purchases because customer meters are not generally read at the end of each month. Unbilled revenue included within accounts receivable as at December 31, 2008 amounted to \$355 million (2007 - \$382 million).

Revenue also includes an amount relating to rate protection for rural residential customers, which is received from the Independent Electricity System Operator (IESO) based on a standardized customer rate that is approved by the OEB. The current legislation provides rate protection for prescribed classes of rural residential customers by reducing the electricity rates that would otherwise apply.

Revenues also include amounts related to sales of other services and equipment. Such revenue is recognized as services are rendered or as equipment is delivered.

Corporate Income and Capital Taxes

Under the *Electricity Act, 1998*, the Company is required to make payments in lieu of corporate income taxes to the Ontario Electricity Financial Corporation (OEFC). These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the *Income Tax Act (Canada)* and the *Corporations Tax Act (Ontario)* as modified by the *Electricity Act, 1998*, and related regulations.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
NOTES TO FINANCIAL STATEMENTS (continued)

The Distribution Business provides for its share of the Company's payments in lieu of corporate income taxes using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from Distribution Business customers at that time.

Inter-Company Demand Facility

Hydro One maintains pooled bank accounts for its use and for the use of its subsidiaries and, implicitly, by the regulated businesses of these subsidiaries. The inter-company demand facility represents the cumulative net effect of all deposits and withdrawals made by the Distribution Business to and from the pooled cash accounts. Interest is earned on positive inter-company balances based on the average of the bankers' acceptance rate at the beginning and end of the month, less 0.02%. Interest is charged on overdraft inter-company balances based on the same bankers' acceptance rate, plus 0.15%.

Materials and Supplies

Materials and supplies represent consumables, spare parts and construction material held for internal construction and maintenance of fixed assets. These assets are carried at lower of average cost or net realizable value.

Effective January 1, 2008, the Company retrospectively adopted Canadian Institute of Chartered Accountants' (CICA) Handbook Section 3031, *Inventories*, with reclassification of comparative prior period amounts. This new section requires that certain major spare parts and standby equipment be reclassified from inventory to fixed assets. The new Handbook section also allows previously recorded impairment losses taken on inventory to be reversed if there is evidence that the net realizable value has subsequently recovered.

The Company already included certain major standby equipment as in-service fixed assets and depreciates these assets over their useful lives. Upon adoption of the new section in the first quarter of 2008, the Company reclassified certain other asset components and equipment previously classified as materials and supplies inventory. Concurrent with the above reclassification, the Company also reclassified future use land from "fixed assets in service" to "future use land, components and spares." Future use land, components and spares are not depreciated until they are transferred to active capital projects and those projects are placed in-service.

Fixed Assets

Fixed assets are capitalized at cost, which comprises materials, labour, engineering costs, overheads, depreciation on service equipment and the approved allowance for funds used during construction applicable to capital construction activities.

Fixed assets in service consist of distribution, communication, administration and service assets and easements. Fixed assets also include future use assets such as land, major components and spare parts, and capitalized development costs associated with deferred capital projects.

Some distribution assets, particularly those located on unowned easements and rights-of-way may have asset retirement obligations, conditional or otherwise. The majority of the Company's easements and rights-of-way are either of perpetual duration or are automatically renewed annually. Land rights with finite terms are generally subject to extension or renewal. As the Company expects to use the majority of its installed assets for an indefinite period, no removal date can be determined and consequently a reasonable estimate of the fair value of any related asset retirement obligations cannot be made at this time. If, at some future date, it becomes possible to estimate the fair value cost of removing assets that the Company is legally required to remove, an asset retirement obligation will be recognized at that time.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
NOTES TO FINANCIAL STATEMENTS (continued)

Distribution

Distribution assets comprise assets related to the distribution of low-voltage electricity, including lines, poles, switches, transformers, protective devices and metering systems.

Communication, Administration and Service

Communication, administration and service assets include telecommunications equipment, towers, associated buildings, administrative buildings, major computer systems, personal computers, transport and work equipment, and tools, vehicles and minor fixed assets.

Easements

Easements include amounts incurred for easements and other access rights.

Construction in Progress

Overhead costs, including corporate functions and services costs, are capitalized on a fully allocated basis, consistent with an OEB-approved methodology. Financing costs are capitalized on fixed assets under construction based on the OEB's approved allowance for funds used during construction (2008 – 5.32%; 2007 – 4.95%).

Depreciation

The capital costs of fixed assets are depreciated on a straight-line basis, except for transport and work equipment, which is depreciated on a declining balance basis.

The Company periodically undergoes an external review of its fixed asset depreciation rates, as required by the OEB. The last review resulted in changes to rates effective January 1, 2007. A summary of depreciation rates for the various classes of assets is included below:

	Depreciation rates (%)	
	Range	Average
Distribution	1% - 5%	2%
Communication, Administration and Service	1% - 15%	8%
Easements	1%	1%

In accordance with group depreciation practices, the original cost of normal fixed asset retirements is charged to accumulated depreciation, with no gain or loss reflected in results of operations. Gains and losses on sales of fixed assets and losses on premature retirements are charged to results of operations as adjustments to depreciation expense. Depreciation expense also includes the costs incurred to remove fixed assets.

The estimated service lives of fixed assets are subject to periodic review. Any changes arising out of such a review are implemented on a remaining service life basis consistent with their inclusion in rates.

Goodwill

Goodwill represents the cost of acquired local distribution companies in excess of fair value of the net identifiable assets purchased and is evaluated for impairment on an annual basis, or more frequently if circumstances require. Goodwill impairment is assessed based on a comparison of the fair value of the reporting unit to the underlying carrying value of the reporting unit's net assets, including goodwill, with any write-down of the carrying value of goodwill being charged against results of operations. The Company has determined that goodwill is not impaired.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
NOTES TO FINANCIAL STATEMENTS (continued)

Discounts and Premiums on Debt

Discounts and premiums are amortized over the period of the related debt using the effective interest rate method.

Financial Instruments

Comprehensive Income

Comprehensive income is composed of the Company's net income and other comprehensive income (OCI). OCI includes the amortization of net unamortized hedging losses on cash flow hedges, and the change in fair value on existing cash flow hedges to the extent that the hedge is effective. The Company amortizes its unamortized hedging losses on discontinued cash flow hedges to financing charges using the effective interest method over the term of the allocated hedged debt.

Financial Assets and Liabilities

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

Accounts receivable	Loans and receivables
Fixed-to-floating interest rate swap	Not classified
Long-term accounts receivable	Loans and receivables
Inter-company demand facility	Other liabilities
Accounts payable	Other liabilities
Long-term debt (unless otherwise specified)	Other liabilities
\$14 million note	Designated as held-for-trading
\$100 million note due March 3, 2011	Not classified

The \$14 million note was a step-up coupon note which matured on May 15, 2008. Where there is an economic hedge, as in the case of the \$14 million note and associated interest rate swap, the Company applied the fair value option without hedge accounting.

Where long-term debt is designated as part of a hedging relationship, as in the case of the \$100 million note, the long-term debt is not classified.

All financial instrument transactions are recorded at trade date.

Derivatives and Hedge Accounting

All derivative instruments, including embedded derivatives, are carried at fair value on the Balance Sheet unless exempted from derivative treatment as a normal purchase and sale or when it is deemed that the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. All changes in fair value are recorded in financing charges unless cash flow hedge accounting is used, in which case changes in fair value are recorded in OCI to the extent that the hedge is effective.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
NOTES TO FINANCIAL STATEMENTS (continued)

The Company periodically develops hedging strategies for execution taking into account risk management objectives. At the inception of a hedging relationship, the Company's documentation includes its risk management objective for establishing the hedging relationship, the identification of the hedged and hedging item, the nature of the specific risk exposure being hedged and the method for assessing effectiveness of the hedging relationship. The Company also assesses, both at the inception of the hedge and on an ongoing basis, whether the hedged items that are used are effective in offsetting changes in fair values or cash flows of hedged items.

Transaction Costs

Transaction costs related to Hydro One Networks' proportionate share of the relevant Hydro One transaction, for financial assets and liabilities that are other than held-for-trading, are added to the carrying value of the asset or liability and then amortized over the expected life of the instrument using the effective interest method.

Financial Instrument Disclosures and Presentation

Effective January 1, 2008, the Company adopted two new accounting standards comprising CICA Handbook Sections 3862, *Financial Instruments Disclosures*; and 3863, *Financial Instruments Presentation*. The adoption of the new disclosure standard required an increased emphasis on disclosure about the risks associated with recognized and unrecognized financial instruments. These additional disclosures are provided in Note 9. The adoption of the new standard on presentation carried forward unchanged the presentation requirements from Section 3861, *Financial Instruments Disclosure and Presentation*, and therefore adoption of this new standard did not have any impact on the Financial Statements.

Capital Disclosure

Effective January 1, 2008, the Company adopted a new accounting standard comprising CICA Handbook Section 1535, *Capital Disclosures*. The adoption of the new standard required the disclosure of qualitative and quantitative information about the Company's capital and how it is managed. These disclosures are provided in Note 10.

Employee Future Benefits

Employee future benefits provided by Hydro One and its subsidiaries include pension, group life insurance, health care and long-term disability.

In accordance with the OEB's rate orders, pension costs are recorded when employer contributions are paid to the pension fund in accordance with the *Pension Benefits Act* (Ontario). Actuarial valuations are conducted at least every three years. Pension costs are also calculated on an accrual basis. Pension costs are actuarially determined using the projected benefit method prorated on service and based on assumptions that reflect management's best estimate of the effect of future events, including future compensation increases, on the actuarial present value of accrued pension benefits. Pension plan assets, consisting primarily of listed equity securities as well as corporate and government debt securities, are valued using fair values. Past service costs from plan amendments and all actuarial gains or losses are amortized on a straight-line basis over the expected average remaining service life of the employees covered.

Employee future benefits other than pension are recorded on an accrual basis. Costs are determined by independent actuaries using the projected benefit method prorated on service and based on assumptions that reflect management's best estimates. Past service costs from plan amendments and actuarial gains or losses are amortized on a straight-line basis over the expected average remaining service life of the employees covered.

Employee future benefit costs are attributed to labour and charged to operations or capitalized as part of the cost of fixed assets.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
NOTES TO FINANCIAL STATEMENTS (continued)

Environmental Costs

The Distribution Business recognizes a liability for estimated future expenditures associated with the assessment and remediation of contaminated lands and for the phase-out and destruction of polychlorinated biphenyl (PCB) contaminated mineral oil from electrical equipment, based on the present value of these estimated future expenditures. As the Company anticipates that the related expenditures will continue to be recoverable in future rates, a regulatory asset has been recognized to reflect the future recovery of these costs from customers. The Distribution Business reviews its estimates of future environmental expenditures on an ongoing basis.

Use of Estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from estimates, including changes as a result of future decisions made by the OEB or the Province.

Emerging Accounting Changes

Income Taxes

In August 2007, the Canadian Accounting Standards Board (AcSB) issued a decision, effective January 1, 2009, to withdraw the temporary exemption in CICA Handbook Section 1100, *Generally Accepted Accounting Principles*, which permits the recognition and measurement of assets and liabilities arising from rate regulation. Further, CICA Handbook Section 3465, *Income Taxes*, was amended to require the recognition of future income tax liabilities and assets for regulated enterprises that were previously not subject to these provisions. Consequently, the Company will be required to reflect on its Balance Sheet, the effect of applying the liability method when accounting for payments in lieu of corporate income taxes and a corresponding regulatory asset. The Company is currently assessing the impact of the AcSB's decision on its Financial Statements.

Goodwill and Intangibles

In November 2007, the AcSB approved new CICA Handbook Section 3064, *Goodwill and Intangible Assets*. The new section is applicable to the Company's Financial Statements for the 2009 fiscal year. The Company is currently evaluating the classification of certain of its assets to determine if they meet the definition of intangible assets. Management expects to reclassify certain software assets and amounts contributed to other entities as capital contributions. It is not anticipated that the new section will have any impact on goodwill or result in any impacts on the Company's results of operations.

3. DEPRECIATION AND AMORTIZATION

<i>Year ended December 31 (Canadian dollars in millions)</i>	2008	2007
Depreciation of fixed assets in service	173	153
Fixed asset removal costs	32	28
Amortization of regulatory and other assets	61	73
	266	254

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
NOTES TO FINANCIAL STATEMENTS (continued)

4. FINANCING CHARGES

<i>Year ended December 31 (Canadian dollars in millions)</i>	2008	2007
Interest on long-term debt payable	123	122
Interest on inter-company demand facility	3	4
Interest accreted on regulatory accounts	1	(3)
Other	-	2
Less: Interest capitalized on construction in progress	(8)	(5)
	119	120

5. PROVISION FOR PAYMENTS IN LIEU OF CORPORATE INCOME TAXES

The provision for payments in lieu of corporate income taxes (PILs) differs from the amount that would have been recorded using the combined Canadian Federal and Ontario statutory income tax rate. A reconciliation between the statutory and effective tax rate is provided as follows:

<i>Year ended December 31 (Canadian dollars in millions)</i>	2008	2007
Income before provision for PILs	179	164
Federal and Ontario statutory income tax rate	33.50%	36.12%
Provision for PILs at statutory rate	60	59

Increase (decrease) resulting from:

Net temporary differences:

Retail settlement variance accounts	13	13
Distribution amounts paid but not recognized for accounting purposes	(8)	-
Pension contributions in excess of pension expense	(8)	(8)
Capital cost allowance in excess of depreciation and amortization	5	14
Overheads capitalized for accounting purposes but deducted for tax purposes	(4)	(5)
Employee future benefits other than pension expense in excess of cash payments	3	4
Interest capitalized for accounting purposes but deducted for tax purposes	(3)	(3)
Environmental expenditures	(3)	(3)
Other	7	5
Net temporary differences	2	17
Net permanent differences	1	1
Provision for PILs	63	77
Effective income tax rate	35.20%	46.95%

Future income taxes have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 2008, future income tax liabilities of \$41 million (2007 - \$50 million), based on substantively enacted income tax rates, have not been recorded. In the absence of rate regulated accounting, the Distribution Business provision for PILs would have been recognized using the liability method rather than the taxes payable method. As a result, the provision for PILs would have been lower by approximately \$9 million (2007 - \$22 million) including the impact of a rate change in substantively enacted tax rates.

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
NOTES TO FINANCIAL STATEMENTS (continued)

6. FIXED ASSETS

<i>December 31 (Canadian dollars in millions)</i>	Fixed Assets	Accumulated Depreciation	Construction in Progress	Total
2008				
Distribution	5,867	2,043	161	3,985
Communication, administration and service	717	403	33	347
Easements	8	4	-	4
	<u>6,592</u>	<u>2,450</u>	<u>194</u>	<u>4,336</u>
2007				
Distribution	5,476	1,926	110	3,660
Communication, administration and service	633	376	40	297
Easements	8	3	-	5
	<u>6,117</u>	<u>2,305</u>	<u>150</u>	<u>3,962</u>

Financing costs capitalized on fixed assets under construction using the allowance for funds used during construction were \$8 million in 2008 (2007 - \$5 million).

7. REGULATORY ASSETS AND LIABILITIES

Regulatory assets and liabilities arise as a result of the rate-making process. The Distribution Business has recorded the following regulatory assets and liabilities:

<i>December 31 (Canadian dollars in millions)</i>	2008	2007
Regulatory assets:		
Environmental	124	41
Regulatory asset recovery account II	43	66
Revenue recovery account	25	-
Rural and remote rate protection variance account	17	4
Employee future benefits other than pension	-	24
Regulatory asset recovery account I	-	18
Other	2	-
Total regulatory assets	<u>211</u>	<u>153</u>
Less: current portion	<u>51</u>	<u>73</u>
	<u>160</u>	<u>80</u>
Regulatory liabilities:		
Regulatory liability refund account	73	43
Retail settlement variance accounts	21	-
Regulatory asset recovery account I	19	-
Other	1	-
Total regulatory liabilities	<u>114</u>	<u>43</u>
Less: current portion	<u>30</u>	<u>-</u>
	<u>84</u>	<u>43</u>

HYDRO ONE NETWORKS INC.
DISTRIBUTION BUSINESS
NOTES TO FINANCIAL STATEMENTS (continued)

Regulatory assets

Environmental

The Company records a liability for the estimated future expenditures required to remediate past environmental contamination (See Note 12). Because such expenditures are expected to be recoverable in future rates, the Company has recognized an equivalent amount as a regulatory asset, including the additional amount recorded in 2008 as a result of final PCB regulations. This regulatory asset is expected to be amortized to results of operations on a basis consistent with the pattern of actual expenditures expected to be incurred up to the year 2025. The OEB has the discretion to examine and assess the prudence and the timing of recovery of all of the Company's future regulatory expenditures. In the absence of rate regulated accounting, operation, maintenance and administration expenses would have been higher by \$88 million (2007 – lower by \$1 million). In addition, amortization expense in 2008 would have been lower by \$9 million (2007 - \$6 million) and financing charges would have been higher by \$4 million (2007 - \$3 million).

Regulatory asset recovery account II (RARA II)

On April 12, 2006, the OEB announced its decision regarding the Company's rate application in respect of the Distribution Business. As part of this decision, the OEB also approved the distribution-related deferral account balances sought by Hydro One Networks. The OEB ordered that the approved balances be recovered on a straight-line basis over a four year period from May 1, 2006 to April 30, 2010. The RARA II includes retail settlement and cost variance amounts and distribution low-voltage service amounts, plus accrued interest. In the absence of rate regulated accounting, amortization expense in 2008 would have been lower by \$23 million (2007 - \$23 million). In addition, related financing charges would have been higher by \$2 million (2007 - \$3 million).

Revenue recovery account (RRA)

On December 18, 2008, the OEB announced its decision regarding the Company's rate application in respect of the Distribution Business. The approved rates are effective May 1, 2008 with an implementation date of February 1, 2009. The OEB approved the establishment of the RRA to record the revenue differential between existing distribution rates and the new rates. The OEB ordered that the approved revenue requirement be retroactively recovered, through rate riders, over a period of 27 months commencing February 1, 2009 and ending April 30, 2011.

Rural and remote rate protection variance account (RRRP)

Hydro One receives rural rate protection amounts from the IESO. A portion of these amounts is provided to retail customers of Hydro One Networks's Distribution Business who are eligible for rate protection. In 2002, the OEB approved a mechanism to collect the RRRP through the Wholesale Market Service Charge. Variances between the amounts remitted by the IESO to Hydro One and the fixed entitlements defined in the regulation are tracked by the Company in the RRRP variance account to be disposed of at a later date.

Employee future benefits other than pension

Employee future benefits other than pension are recorded using the accrual method as required by Canadian GAAP. The OEB has allowed for the recovery of past service costs, which arose on the adoption of the accrual method, in the revenue requirement on a straight-line basis over a 10-year period. As a result, in 1999 the Distribution Business recorded a regulatory asset, with an original balance of \$236 million, to reflect this regulatory treatment. This regulatory asset has been fully recovered. In 2007, it had a remaining recovery period of 1 year and did not earn a return. In the absence of rate regulated accounting, amortization expense in 2008 would have been lower by \$24 million (2007 - \$24 million).

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Regulatory asset recovery account I (RARA I)

On December 9, 2004, the OEB issued a decision on the prudence of the distribution related deferral account balances for which recovery was sought by the Company in its May 31, 2004 application. Amounts for which recovery was approved represented balances incurred prior to December 31, 2003, plus associated interest. The OEB ordered that the approved amounts be aggregated into a single regulatory account to be recovered on a straight-line basis over the period ending April 30, 2008. The RARA I included distribution business low-voltage services amounts, deferred environmental expenditures incurred in 2001 and 2002, deferred market ready expenditures, retail settlement variance amounts, and other amounts primarily consisting of accrued interest. The Company has accumulated a net liability in its RARA I account since May 1, 2008 due to continuance of the rate rider, disposition of which will be subject to a future OEB review. In the absence of rate regulated accounting, amortization expense in 2008 would have been lower by \$5 million (2007 - \$20 million). In addition, related financing charges would have remained the same (2007 – higher by \$1 million).

Regulatory liabilities

Regulatory liability refund account (RLRA)

On December 18, 2008, the OEB announced its decision regarding the Company’s rate application. As part of the decision, the OEB also approved certain distribution-related deferral account balances sought by the Distribution Business in its application. Amounts for which recovery was approved represented balances incurred prior to April 30, 2008, plus associated interest. The OEB ordered that the approved balances be aggregated into a single regulatory account to be recovered over a 27-month period from February 1, 2009 to April 30, 2011. The RLRA includes retail settlement variance amounts and the deferred impacts of tax rate changes.

Retail settlement variance accounts (RSVA)

The Company has deferred certain retail settlement variance amounts under the provisions of Article 490 of the OEB’s *Accounting Procedures Handbook*. The OEB’s December 9, 2004 decision allowed for recovery of retail settlement variance amounts accumulated prior to December 31, 2003, inclusive of interest, within the RARA I. The OEB’s April 12, 2006 decision allowed for recovery of retail settlement variance amounts accumulated since January 1, 2004 and forecasted through to April 30, 2006, inclusive of interest, within the RARA II. The OEB’s December 18, 2008 decision allowed for recovery of retail settlement variance amounts accumulated since May 1, 2006 through to April 30, 2008, inclusive of interest, within the RRA. The Company has accumulated a net liability in its RSVA since May 1, 2008 and anticipates that the OEB will include the net balance of this regulatory account in future rates.

8. DEBT

Debt represents the Distribution Business’ share of various notes payable by Hydro One Networks to Hydro One.

<i>December 31 (Canadian dollars in millions)</i>	2008	2007
Long-term debt	2,285	2,089
Add: Unrealized hedged loss ¹	6	-
Less: Long-term debt payable within one year	(132)	(224)
Net unamortized premiums	11	8
Unamortized debt issuance costs	(10)	(9)
	2,160	1,864

¹ The unrealized hedged loss relates to \$100 million note, which is accounted for as a fair value hedge. The unrealized hedged loss is offset by the \$6 million unrealized gain on the related fixed-to-floating interest rate swap agreement.

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NOTES TO FINANCIAL STATEMENTS (continued)

The long-term debt is unsecured and denominated in Canadian dollars. Such debt is summarized by the number of years to maturity in Note 9.

9. CARRYING AND FAIR VALUE OF FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The carrying value of financial instruments as at December 31, 2008 is as follows:

<i>(Canadian dollars in millions)</i>	Derivatives Used for Hedging	Other Financial Instrument s Used for Hedging	Held- for- Trading	Loans and Receivables	Other Financial Liabilities
<i>Financial Assets</i>					
Accounts receivable	-	-	-	574	-
Long-term accounts receivable and other assets	6	-	-	1	-
<i>Financial Liabilities</i>					
Inter-company demand facility	-	-	-	-	44
Accounts payable and accrued charges ¹	-	-	-	-	480
Long-term debt	-	106	-	-	2,186

¹ Accounts payable and accrued charges do not include income taxes payable or dividends payable.

The carrying amounts of all financial instruments, except long-term debt, approximate fair value. The fair value of derivative financial instruments reflects the estimated amount that the Company, if required to settle an outstanding contract, would have been required to pay or would be entitled to receive at year end. The fair value of long-term debt, based on year end quoted market prices for the same or similar debt of the same remaining maturities, is provided in the following table:

<i>December 31 (Canadian dollars in millions)</i>	2008		2007	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt ¹	2,285	2,292	2,089	2,230

¹ The carrying value of long-term debt represents the par value of the notes and debentures, other than the \$14 million note, which is marked to market and the \$100 million note which is designated as part of a hedging relationship.

Exposure to market risk, credit risk and liquidity risk arises in the normal course of the Company's business.

Market Risk

Market risk refers primarily to the risk of loss that results from changes in commodity prices, foreign exchange rates and interest rates. The Company does not have commodity risk. The Company does have foreign exchange risk as it enters into agreements to purchase materials and equipment associated with the Company's capital programs and projects that are settled in foreign currencies. This foreign exchange risk is not material, although Hydro One could in the future decide to issue foreign currency denominated debt which will be hedged back to Canadian dollars consistent with Hydro One's risk management policy. The Company is exposed to fluctuations in interest rates as the regulated rate of return for the Company's Distribution Business is derived using a formulaic approach which is in part based on the forecast for long-term Government of Canada bond yields. The Company estimates that a 1%

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NOTES TO FINANCIAL STATEMENTS (continued)

decrease in the forecast long-term Government of Canada bond yield used in the current OEB formula for determining the Company's rate of return on equity would reduce its Distribution Business' results of operations by approximately \$13 million.

Credit Risk

Financial assets create credit risk that a counter-party will fail to discharge an obligation, causing a financial loss. As at December 31, 2008, there were no significant concentrations of credit risk with respect to any class of financial assets. The Company's Distribution Business revenue is earned from a broad base of customers. As a result, the Company did not earn a significant amount of revenue from any individual customer. As at December 31, 2008, there were no significant balances of accounts receivable due from any single customer.

In the year, the Company's provision for bad debts increased by 17% to \$21 million (2007 - \$18 million). While the percentage increase is significant, the provisions are within an acceptable range relative to the total accounts receivable balance, representing 4% as at December 31, 2008 (2007 - 3%). Minor adjustments and write-offs were determined on the basis of a review of overdue accounts, taking into consideration historical experience. As at December 31, 2008, approximately 4% of the Company's accounts receivable was aged more than 60 days.

Hydro One manages its counter-party credit risk through various techniques including, entering into transactions with highly rated counter-parties, limiting total exposure levels with individual counterparties consistent with the Company's Board-approved Credit Risk Policy, entering into master agreements which enable net settlement and the contractual right of offset, and monitoring the financial condition of counterparties. The Company's credit risk for accounts receivable is limited to the carrying amount on the Balance Sheet.

The Company uses derivative financial instruments to manage interest rate risk. The Company may enter into derivative agreements such as forward starting pay fixed interest rate swap agreements, to hedge against the effect of future interest rate movements on long-term fixed rate borrowing requirements. No such agreements were outstanding as at December 31, 2008.

Derivative financial instruments result in exposure to credit risk since there is a risk of counter-party default. As at December 31, 2008, the only derivative instrument held by the Company was a \$100 million fixed-to-floating interest rate swap agreement to convert the 4.08% coupon maturing March 3, 2011 into a three month variable rate debt. The counter-party credit risk exposure on the fair value of this interest rate swap contract is \$6 million as at December 31, 2008. As at December 31, 2007, the Company had a pay floating interest rate swap agreement related to a step-up coupon note issuance that was accounted for using the fair value option without hedge accounting. Counter-party credit risk exposure was insignificant in 2007.

Liquidity Risk

Liquidity risk refers to the Company's ability to meet its financial obligations as they come due. Short-term liquidity is provided through the inter-company demand facility with Hydro One and funds from operations. The short-term liquidity available to the Company should be sufficient to fund normal operating requirements.

As at December 31, 2008, accounts payable and accrued charges in the amount of \$485 million are expected to be settled in cash at their carrying amounts within the next year. Long-term debt maturing over the next twelve months is \$132 million. Interest payments over the next twelve months on the Company's outstanding debt amount to \$126 million.

As at December 31, 2008, the Distribution Business' share of the long-term debt by Hydro One Networks to Hydro One is \$2,285 million and the required interest payments are \$1,902 million. Principal outstanding, interest payments and related weighted average interest rate are summarized by the number of years to maturity in the following table:

HYDRO ONE NETWORKS INC.
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NOTES TO FINANCIAL STATEMENTS (continued)

Years to Maturity	Principal Outstanding on Notes and Debentures (Canadian dollars in millions)	Interest Payments (Canadian dollars in millions)	Weighted Average Interest Rate (Percent)
1 year	132	126	4.0
2 years	162	119	6.4
3 years	176	111	5.1
4 years	324	104	5.8
5 years	160	86	4.9
	954	546	5.4
6 – 10 years	375	357	4.9
Over 10 years	956	999	6.2
	2,285	1,902	5.6

10. CAPITAL MANAGEMENT

The Company's objective is to manage its capital structure consistent with the deemed capital structure for rate making purposes as prescribed by the OEB as being appropriate for all distributors in its December 20, 2006 Cost of Capital Report. This deemed capital structure is 60% debt and 40% common equity.

The Company considers its capital structure to consist of excess assets over liabilities, long-term debt, and the inter-company demand facility. The Company's capital structure as at December 31, 2008 and December 31, 2007 was as follows:

<i>(Canadian dollars in millions)</i>	2008	2007
Long-term debt payable within one year	132	224
Less: Inter-company demand facility	(44)	(158)
	176	382
Long-term debt	2,160	1,864
Excess of assets over liabilities	1,632	1,523
Total Capital	3,968	3,769

11. EMPLOYEE FUTURE BENEFITS

Pension

Hydro One has a contributory defined benefit pension plan covering all regular employees of Hydro One and its subsidiaries, except Hydro One Brampton Inc. The Hydro One Pension Plan does not segregate assets in a separate account for individual subsidiaries, nor is the cost of the benefit plans allocated to, or funded separately by, entities within the consolidated group. Accordingly, for purposes of these financial statements, the pension plan is accounted for as a defined contribution plan and no deferred pension asset or liability is recorded.

Hydro One's pension plan provides benefits based on highest three-year average pensionable earnings. For new management employees who commenced employment on or after January 1, 2004, and for new Society of Energy Professionals hired after November 17, 2005, benefits are based on highest five-year average pensionable earnings. After retirement, pensions are indexed to inflation. The measurement date used to determine plan assets and the accrued benefit obligation is December 31. Based on the actuarial valuation filed on September 20, 2007, effective for December 31, 2006, Hydro One contributed \$101 million to its pension plan in respect of 2008 (2007 - \$95

HYDRO ONE NETWORKS INC.
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NOTES TO FINANCIAL STATEMENTS (continued)

million), all of which is required to satisfy minimum funding requirements. Contributions are payable one month in arrears. All of the contributions are expected to be in the form of cash. Contributions after 2009 will be based on an actuarial valuation effective December 31, 2009 and will depend on future investment returns, and changes in benefits or actuarial assumptions.

For Hydro One, the actuarial present value at December 31, 2008 of the accrued pension benefits, based on a projection of the valuation at December 31, 2008, was estimated to be \$4,007 million (2007 - \$5,077 million). Pension plan assets available for these benefits were \$3,836 million (2007 - \$5,100 million).

Employee Future Benefits other than Pension

During the year ended December 31, 2008, \$33 million of employee future benefits other than pension costs was charged to the results of operations of the Distribution Business (2007 - \$33 million), and \$23 million was capitalized as part of the cost of fixed assets (2007 - \$22 million). Benefits paid were \$22 million (2007 - \$22 million). The liability associated with employee future benefits other than pension for the Distribution Business at December 31, 2008 was \$524 million (2007 - \$495 million), including the current portion.

A detailed description of employee future benefits is provided in Note 11 of the Consolidated Financial Statements of Hydro One for the year ended December 31, 2008.

12. ENVIRONMENTAL LIABILITIES

<i>December 31 (Canadian dollars in millions)</i>	2008	2007
Environmental liabilities, January 1	41	45
Interest accretion	4	3
Expenditures	(9)	(6)
Revaluation adjustment	88	(1)
Environmental liabilities, December 31	124	41
Less: current portion	(9)	(7)
	115	34

Estimated future environmental expenditures for each of the five years subsequent to December 31, 2008 and in total thereafter are as follows: 2009 - \$9 million; 2010 - \$5 million; 2011 - \$3 million; 2012 - \$3 million; 2013 - \$12 million, and thereafter - \$131 million.

There are uncertainties in estimating future environmental costs due to potential external events such as changing regulations and advances in remediation technologies. The Company continuously reviews factors affecting its cost estimates as well as the environmental condition of the various properties. The actual cost of investigation or remediation may differ from current estimates.

On September 17, 2008, Environment Canada published its final regulations governing the management, storage and disposal of polychlorinated biphenyls (PCBs). These regulations were enacted under the *Canadian Environmental Protection Act, 1999*. The new regulations impose timelines for disposal of PCBs based on different types of equipment, in-use status and PCB contamination thresholds. Under the regulations, all PCBs in concentrations of 500 parts per million (ppm) or more, except for pole-top transformers and their pole-top auxiliary electrical equipment and light ballasts, must be disposed of by the end of 2009. PCBs in concentrations of 50 ppm or more in pole-top transformers and their pole-top auxiliary electrical equipment, light ballasts and other electrical equipment must be disposed of by the end of 2025. In addition, liquids with 2 ppm or more that have been removed from equipment cannot be reused.

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NOTES TO FINANCIAL STATEMENTS (continued)

Management judges that the Company has very limited PCB-contaminated assets in excess of 500 ppm. Priority will be given to targeting inspection and testing work toward identifying and removing PCBs in assets as quickly as operationally feasible. Assets to be disposed of primarily consist of pole and pad mount distribution transformers and light ballasts which require disposal by 2025. Contaminated distribution station equipment will generally be decontaminated by removing PCB-contaminated insulating oil and refilling with less than 2 ppm oil as the liquids are removed.

Consistent with its accounting policy for environmental costs, since 2001 the Company has recorded a liability for the estimated future expenditures associated with the phase-out and destruction of PCB-contaminated insulating oil from electrical equipment. The Company's liability has been based on management's best estimate of the net present value of the future expenditures expected to be required to comply with existing PCB regulations.

Management's best estimate of the Distribution Business' additional estimated future expenditures to comply with the final regulations is about \$116 million. The increase in estimated future expenditures primarily relates to the inspection and testing of pole top distribution transformers, the removal and disposal or decontamination and refilling of certain distribution station equipment found to be in excess of regulatory thresholds. These expenditures will be incurred over the period from 2009 to 2025 with the majority of the spending occurring in the 2013 to 2025 period. As a result of the final regulations and the resulting increase in future expenditures, the Company has increased its liability in the third quarter by approximately \$88 million.

As the Company anticipates that the related expenditures will continue to be recoverable in future rates, an \$88 million increase to the Distribution Business' environmental regulatory asset has been recorded to reflect the probability of future recovery of these PCB expenditures from customers.

In determining the amounts to be recorded as environmental liabilities, the Company has estimated the current cost of completing mitigation work and has made assumptions as to when the future expenditures will actually be incurred to generate future cash flow information. A long-term inflation assumption of approximately 2% has been used to express current cost estimates as estimated future expenditures. These future expenditures are discounted using factors ranging from 5.14% to 6.25% depending on the year the obligations were first recorded. All factors used in estimating our environmental liabilities represent management's best estimates. However, it is reasonably possible that numbers or volumes of contaminated assets, current cost estimates, inflation assumptions and assumed pattern of annual cash flows may differ significantly from our assumptions. In addition, the availability of critical resources such as skilled labour and replacement assets and the ability to take maintenance outages in critical facilities may influence the timing of expenditures.

Estimated environmental liabilities are reviewed annually or more frequently if significant changes in regulation or other relevant factors occur. Estimate changes are accounted for prospectively.

13. HYDRO ONE NETWORKS' SHARE CAPITAL

Hydro One Networks is authorized to issue an unlimited number of preferred shares and common shares.

14. RELATED PARTY TRANSACTIONS

The Province and Successor Corporations of Ontario Hydro

The Province, OEFC, IESO, Ontario Power Authority (OPA) and Ontario Power Generation Inc. (OPG) are related parties of Hydro One Networks' Distribution Business. In addition, the OEB is related to the Company by virtue of its status as a Provincial Crown Corporation, although as a self-financing and self-sufficient regulatory organization, it carries out independent regulation for Ontario's energy sector, including Hydro One's regulated Distribution Business. Transactions between these parties and the Distribution Business were as follows:

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NOTES TO FINANCIAL STATEMENTS (continued)

The Distribution Business received amounts for rural rate protection from the IESO. Revenues for 2008 include \$125 million (2007 - \$125 million) related to this program.

In 2008, the Distribution Business purchased power in the amount of \$1,870 million (2007 - \$1,937 million) from the IESO-administered electricity market and \$35 million (2007 - \$27 million) from OPG.

Under the Ontario Energy Board Act, 1998, the OEB is required to recover all of its annual operating costs from gas and electricity distributors and electricity transmitters. In 2008, the Distribution Business incurred \$5 million (2007 - \$5 million) in OEB fees.

The Company has service level agreements with Ontario Hydro's successor corporations, primarily OPG. These services include field and engineering, logistics, corporate, telecommunications and information technology services. Operation, maintenance and administration costs related to the purchase of services from these successor corporations were less than \$1 million in each of 2008 and 2007.

The Ontario Power Authority funds some of our Conservation Demand Management (CDM) programs. The funding includes program costs, incentives and management fees and bonuses. In 2008, the Company received \$7 million (2007 - \$3 million) from the OPA in respect of the CDM programs and had a net accounts receivable of \$8 million (2007 - net accounts receivable of \$3 million).

The provision for payments in lieu of corporate income taxes was paid or payable by the Company to the OEFC.

Hydro One and Subsidiaries

The Company provides services to, and receives services from, Hydro One and its other subsidiaries. Amounts due to and from Hydro One and its subsidiaries are settled through the inter-company demand facility.

The Company has entered into various agreements with Hydro One and its subsidiaries related to the provision of corporate functions and services, supply management, computer support and operational services such as environmental, forestry and line services. Revenues include \$1 million (2007 - \$1 million) related to the provision of services to Hydro One and its subsidiaries and operation, maintenance and administration costs include \$5 million (2007 - \$3 million) related to the purchase of services from Hydro One and its subsidiaries.

The Company's debt, including the portion allocated to the Distribution Business, is due to Hydro One. Financing charges include interest expense on this debt in the amount of \$123 million (2007 - \$122 million). In addition, balances payable or receivable under the inter-company demand facility are due to or from Hydro One. Financing charges of the Distribution Business include interest expense on this facility in the amount of \$3 million (2007 - \$4 million).

The amounts due to and from related parties as a result of the transactions referred to above are as follows:

<i>December 31 (Canadian dollars in millions)</i>	2008	2007
Accounts receivable	8	3
Accounts payable and accrued charges	(203)	(181)

Included in accounts payable and accrued charges are amounts owing to the IESO in respect of power purchases of \$201 million (2007 - \$179 million).

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NOTES TO FINANCIAL STATEMENTS (continued)

15. STATEMENTS OF CASH FLOWS

For the purposes of the Statements of Cash Flows, “cash and cash equivalents” refers to the Balance Sheet item “inter-company demand facility.”

The changes in non-cash balances related to operations consist of the following:

<i>Year ended December 31 (Canadian dollars in millions)</i>	2008	2007
Accounts receivable (increase) decrease	(3)	14
Materials and supplies decrease (increase)	4	(8)
Accounts payable and accrued charges increase	52	37
Accrued interest increase	3	-
Long-term accounts payable and accrued charges decrease	-	(1)
Employee future benefits other than pension increase	29	31
Other	1	(7)
	86	66
Supplementary information:		
Interest paid	119	119
Payments in lieu of corporate income taxes	45	68

16. CONTINGENCIES

The Company is a wholly owned subsidiary of Hydro One. As such, the assets of the Company’s Distribution Business are available for the satisfaction of the debts, contingent liabilities and commitments of the Company and Hydro One.

17. COMMITMENTS

The Company and Hydro One have numerous commitments. These commitments have not been specifically allocated to the Distribution Business. However, the net assets of the Distribution Business are available to satisfy these commitments.

18. SUBSEQUENT EVENTS

On January 13, 2009 Hydro One issued \$100 million in notes under the Company’s MTN Program. The issue was an additional offering of 3.89% notes maturing on November 19, 2010, originally issued on November 19, 2008. On the same date, Hydro One Networks issued notes payable to Hydro One Inc. in the same amount and with the same maturity date. The Distribution Business’ share of the additional offering was \$35 million. The total amount outstanding for this issue is now \$200 million of which the Distribution Business’ share is \$75 million.

On January 14, 2009 Hydro One issued \$200 million in notes under the Company’s MTN Program. The issue was an additional offering of 5.0% notes maturing on November 12, 2013, originally issued on November 10, 2008. On the same date, Hydro One Networks issued notes payable to Hydro One Inc. in the same amount and with the same maturity date. The Distribution Business’ share of the additional offering was \$70 million. The total amount outstanding for this issue is now \$600 million of which the Distribution Business’ share is \$230 million.

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On March 3, 2009, Hydro One issued \$300 million in notes under the Company's MTN program. The issue was an offering of 6.03% notes maturing on November 3, 2039. On the same date, Hydro One Networks issued notes payable to Hydro One Inc. in the same amount and with the same maturity date. The Distribution Business' share was \$105 million.

19. COMPARATIVE FIGURES

The comparative Financial Statements have been reclassified from statements previously presented to conform to the presentation of the December 31, 2008 Financial Statements.