

Minister of Energy

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OCT 17 2006

Ms Rita Burak
Chair of the Board of Directors
Hydro One Inc.
483 Bay Street
15th Floor, North Tower
Toronto, Ontario
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Dear Ms ~~Burak~~: *Rita!*

I am writing you with regard to the government's priorities and directions for furthering structural efficiency and productivity in Ontario's electricity distribution sector.

Over the past two years, the government has undertaken extensive consultations with industry stakeholders on this issue and has heard the industry's views regarding the importance of a consolidation strategy in driving meaningful efficiency and productivity gains in the sector.

We believe that further consolidation, undertaken on a voluntary and commercial basis, can help drive sector efficiencies, reduce costs and create an industry structure conducive to undertaking the size and scope of capital investment required for system upgrades and new investment, improved system reliability, and implementation of the government's smart metering agenda.

The government is undertaking two specific initiatives to facilitate voluntary consolidation in the electricity distribution sector. First, the Minister of Finance has put in place a regulation to provide a two year transfer tax exemption on the sale of publicly owned electricity assets to other Ontario-based, publicly owned electricity distributors.

Second, the government is lifting the moratorium on the purchase and sale of electricity distribution assets by Hydro One, with the understanding that any future asset purchases or dispositions help further overall provincial policy interests for the sector.

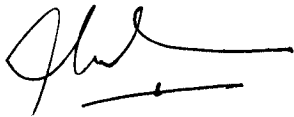
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Key provincial objectives for sector restructuring include achievement of a more efficient system configuration, improved service quality, rate stability and enhanced financial viability for the distribution sector. There is also a public interest in ensuring that Ontario's electricity distributors, including Hydro One, work cooperatively and remain open to opportunities to both buy and sell electricity distribution assets.

We are supportive of your intent to pursue a targeted approach to acquisitions, with a focus on consolidating utilities embedded in the Hydro One rural distribution system. We also believe there may be opportunities to pursue innovative arrangements, such as asset "swaps" and partnerships, that can achieve our goals. In that regard, the Ministries of Energy and Finance look forward to reviewing Hydro One's proposed strategy and critical path for rationalization as part of the lifting of this moratorium. As well, given the impact on the province's overall fiscal position, Hydro One will be expected to provide ongoing updates on the company's progress.

Over the coming months, I look forward to working closely with you in ensuring implementation of the government's policy directions for facilitating greater efficiencies in the electricity distribution sector. We recognize the important leadership role that Hydro One has and will continue to play.

Sincerely,

A handwritten signature in black ink, appearing to read 'Duncan', with a horizontal line underneath.

Dwight Duncan
Minister

c: The Honourable Greg Sorbara, Minister of Finance
Tom Parkinson, President and CEO Hydro One