HORIZON UTILITIES CORPORATION

Auditors' Report to the Shareholders
and Financial Statements
Year Ended December 31, 2005 and
December 31, 2004

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheet of Horizon Utilities Corporation as at December 31, 2005 and the statement of income and retained earnings 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 Company as at December 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Hamilton, Canada
February 3, 2006

HORIZON UTILITIES CORPORATION

Balance Sheet

(in thousands)

As at December 31,

	2005	*[note 2]* 2004
ASSETS		
Current assets		
Cash and cash equivalents	**$ 35,629**	$ 54,926
Accounts receivable	**84,309**	57,248
Inventory	**5,454**	3,338
Other assets *[note 4]*	**1,297**	1,903
	126,689	117,415
Fixed assets *[note 5]*	**264,169**	208,398
Future payments in lieu of taxes	**2,397**	-
Goodwill *[note 2]*	**18,923**	-
Total assets	**$ 412,178**	$ 325,813
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Accounts payable and accruals	**$ 91,879**	$ 55,270
Credit support for service delivery *[note 7]*	**19,166**	15,804
	111,045	71,074
Long-term liabilities		
Long-term borrowings *[note 8]*	**116,000**	116,000
Employee future benefits *[note 9]*	**15,258**	12,014
Future payments in lieu of taxes	**-**	464
Net regulatory liabilities *[note 10]*	**13,655**	5,569
	144,913	134,047
Total liabilities	**255,958**	205,121
Shareholder's equity		
Share capital *[note 11]*	**123,593**	91,133
Contributed surplus *[note 2]*	**15,218**	-
Retained earnings	**17,409**	29,559
Total shareholder's equity	**156,220**	120,692
Total liabilities and shareholder's equity	**$ 412,178**	$ 325,813

Commitments and contingencies *[note 13]*

On behalf of the Board:

Director

Director

Statement of Income and Retained Earnings

(in thousands)

For the year ended December 31,

				[note 2]
		2005		**2004**
Electricity distribution service charges *[note 14]*	**$**	**76,815**	$	57,036
Other income from operations *[note 15]*		**7,650**		5,886
		84,465		62,922
Expenses:				
Operating expenses *[note 16]*		**39,508**		26,236
Depreciation and amortization *[note 5]*		**18,599**		15,034
		58,107		41,270
Income from operating activities		**26,358**		21,652
Gain on sale of fixed assets		**104**		309
Interest income		**931**		931
Interest expense *[notes 8 and 16]*		**(8,936)**		(8,416)
Income before payments in lieu of taxes		**18,457**		14,476
Payments in lieu of income and large corporations taxes *[note 6]*		**(5,917)**		(4,873)
Net income		**12,540**		9,603
Retained earnings, beginning of year		**29,559**		22,106
Dividends paid *[note 2]*		**(24,690)**		(2,150)
Retained earnings, end of year	**$**	**17,409**	$	29,559

HORIZON UTILITIES CORPORATION

Statement of Cash Flows

(in thousands)

For the year ended December 31,

		2005		*[note 2]* 2004
OPERATING ACTIVITIES				
Net income for the year	**$**	**12,540**	$	9,603
Add (deduct) non-cash items:				
Depreciation and amortization		**19,562**		15,882
Future payments in lieu of taxes		**(2,061)**		(1,097)
Net change in employee future benefits		**176**		389
Gain on sale of fixed assets		**(104)**		(309)
Net change in other assets and liabilities		**27,490**		11,016
Cash provided by operating activities		**57,603**		35,484
INVESTING ACTIVITIES				
Additions to fixed assets		**(18,848)**		(16,129)
Proceeds received on disposal of fixed assets		**117**		397
Cash used in investing activities		**(18,731)**		(15,732)
FINANCING ACTIVITIES				
Repayment of long-term borrowings		**(29,123)**		(453)
Net change in credit support for service delivery		**338**		3,079
Dividends paid in the year		**(32,064)**		(2,150)
Issuance of Class A common shares for cash		**2,680**		-
Cash (used in) provided by financing activities		**(58,169)**		476
Net (decrease) increase in cash and cash equivalents during the year		**(19,297)**		20,228
Cash and cash equivalents, beginning of year		**54,926**		34,698
Cash and cash equivalents, end of year	**$**	**35,629**	$	54,926
Supplemental disclosure of cash flow information				
Interest received	**$**	**1,026**	$	939
Interest paid	**$**	**(8,546)**	$	(8,179)
Taxes paid	**$**	**(11,998)**	$	(4,748)

Notes to the Financial Statements

December 31, 2005 ($ in thousands)

1) BUSINESS OF CORPORATION

Horizon Utilities Corporation (the "Corporation") was created pursuant to an amalgamation, described in Note 2 below, and provides electricity distribution and related services to its commercial and residential customers.

2) AMALGAMATION

On March 1, 2005, Hamilton Hydro Inc. ("HHI") and St. Catharines Hydro Utility Services Inc. ("SCHUSI") merged by amalgamation under the *Business Corporations Act (Ontario)* and continue as the Corporation.

The amalgamation was completed pursuant to a Merger Co-operation Agreement dated November 25, 2004 between the City of Hamilton, as sole shareholder of Hamilton Utilities Corporation ("HUC"), and The Corporation of The City of St. Catharines, as sole shareholder of SCHI, which acknowledged their approval of the merger of HHI and SCHUSI under terms and conditions set out in a Merger Participation Agreement (the "MPA"), dated November 25, 2004, between HUC, HHI, SCHI and SCHUSI.

The MPA provided that the respective shareholders of HHI and SCHUSI, HUC and SCHI, receive common shares in the Corporation with votes and value in proportion to the respective values of HHI and SCHUSI.

A valuation of HHI and SCHUSI was undertaken by a competent third party and was largely based on projections of capital assets, capital expenditures and operating expenses anticipated to be permitted by regulation administered by the Ontario Energy Board ("OEB") governing the distribution charges that each respective corporation charges to its customers. The values agreed to by HUC and SCHI (the "Parties") were as negotiated by the Parties based on such valuation. The results of the negotiation and valuation provide for common share allocations of 78.9% for HUC and 21.1% for SCHI.

In accordance with the MPA, immediately prior to the merger, HHI declared a dividend in specie to HUC consisting of the right to receive any future amounts received by Horizon Utilities that represent the recovery of any regulatory assets in excess of HHI's book value of such assets as at February 28, 2005. SCHUSI also declared a dividend in specie to SCHI consisting of the right to receive any future amounts received by Horizon Utilities that represent the recovery of any regulatory assets in excess of SCHUSI's book value of such assets as at February 28, 2005.

On March 1, 2005 the Corporation issued the following shares in exchange for all of the issued and outstanding shares of HHI and SCHUSI:

	No. Shares
Class 1 Common owned by HUC	7,890
Class A Common owned by SCHI	2,110

December 31, 2005 ($ in thousands)

Notes to the Financial Statements

2) AMALGAMATION (Continued)

This transaction resulted in HUC receiving a controlling interest in the Corporation. Consequently, the Corporation recorded the transaction using the purchase method of accounting. As such, the results of operations and cash flow for 2005 reflect that of Horizon Utilities for the ten months ended December 31, 2005 and HHI for the two months ended February 28, 2005. The comparative financial information for 2004 reflects the financial position, the results of operations and cash flow of HHI.

The purchase consideration was determined by the fair value of the assets and liabilities assumed as at March 1, 2005 and adjusted for the costs related to the merger, including direct costs associated with the transaction as well as human resource and other integration costs.

The total purchase consideration was allocated to identifiable net assets acquired based on their respective fair values as at the date of amalgamation as follows:

Purchase consideration:	
Issuance of 2,110 Class A common shares at fair value	55,052
Transaction and integration costs	3,545
Total purchase consideration	58,597
Fair value of net assets of SCHUSI acquired:	
Current assets	27,449
Fixed assets	56,498
Other assets	2,068
Current liabilities	(14,151)
Long-term liabilities	(32,190)
Net assets acquired	39,674
Excess purchase consideration over fair value of net assets acquired, allocated to goodwill	18,923

The excess of the fair value of the Class A common shares issued to SCHI over the stated capital of SCHUSI immediately prior to the merger has been recorded as contributed surplus on the balance sheet, and that, subsequent to amalgamation, a dividend was paid to SCHI in the amount of $8,931 of which $7,374 was charged to contributed surplus.

In addition to transaction and integration costs included as part of the total purchase consideration, the Corporation also incurred $2,689 in additional costs related to the amalgamation, which have been included in operating expenses. These additional costs included severance costs associated with voluntary retirement and separation programs offered to employees, computer programming and other administrative costs related to the integration of operations.

The merger of HHI and SCHUSI results in the third largest municipally owned electricity distribution company in the Province serving approximately 230,000 customers in the municipalities of Hamilton and St. Catharines. The Corporation anticipates that this transaction will create shareholder and customer value through cost efficiencies resulting from the elimination of duplicate processes between the Corporation and SCHUSI.

Notes to the Financial Statements

3) SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared in accordance with generally accepted accounting principles in Canada consistently applied. The more significant accounting policies are summarized below:

a) Regulation

The Ontario Energy Board Act, 1998 (Ontario) (“OEBA”) conferred on the Ontario Energy Board (“OEB”) increased powers and responsibilities to regulate the electricity industry in Ontario. These powers and responsibilities include approving or fixing rates for the transmission and distribution of electricity, providing continued rate protection for rural and remote electricity consumers, and ensuring that distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions of service to electricity distributors which may include, among other things, record keeping, regulatory accounting principles, separation of accounts for distinct businesses, and filing and process requirements for rate setting purposes. In its capacity to approve or set rates, the OEB has the authority to specify regulatory accounting treatments that may differ from Canadian generally accepted accounting principles for enterprises operating in a non-rate regulated environment.

Under the OEBA and the decisions of the OEB, distribution charges for the electricity distribution business were to be increased annually over three years (2001, 2002 and 2003) to achieve an annual rate of return of 9.88% on the amount of common equity deemed to be allocated to this business.

Distribution charges were also to be increased to permit the recovery of costs incurred by the Corporation to prepare for the opening of the competitive electricity market in Ontario (“Market Opening”). The Corporation has capitalized some of these costs as regulatory assets *[note 10]*.

In January 2004, the Corporation filed applications to adjust its distribution charges to provide for the recovery of its regulatory assets over a four year period. The applications were approved by the OEB effective March 1, 2004.

In January 2005, the Corporation filed rate applications to adjust its distribution charges to provide for the full theoretical regulatory rate of return of 9.88% and continued recovery of its regulatory assets. As mandated by the OEB, the rate increase is subject to a financial commitment by the Corporation to invest $7,078 in conservation and demand management activities over the period September 1, 2005 to September 30, 2007. The rate applications and applications for the approval of its conservation and demand management programs have since been approved by the OEB.

On August 26, 2005, the Corporation filed its Electricity Distribution Rate Application for 2006 distribution rates, for rates to be effective May 1, 2006. The 2006 distribution rate, in accordance with the OEB filing requirements, provides for a revised rate of return of 9.0%, as compared to 9.88% in previous years. OEB approval is anticipated later in the first quarter of 2006.

3) SIGNIFICANT ACCOUNTING POLICIES (Continued)

a) Regulation (continued)

The Electricity Restructuring Act (Ontario), 2004 (the "ERA")

On December 9, 2004, the Province enacted the ERA, which provides for a restructuring of Ontario's electricity sector to promote the expansion of electricity supply and capacity, alternative and renewable energy sources, and conservation and demand management. Under the ERA, the commodity cost of electricity for certain customer classes will be determined by the OEB on an annual basis and based on a combination of regulated, contract and competitive market prices for electricity. There are few provisions in the ERA that apply to electricity distributors.

Bill 21 - Energy Conservation Responsibility Act (Ontario), 2005 (the "ECRA")

Bill 21, or the ECRA, not yet enacted, provides a legislative framework to support energy conservation and efficiency in Ontario including support for an initiative of the Government of Ontario to install "Smart Meters" in all homes and businesses throughout Ontario by 2010. Smart Meters permit consumption to be recorded within specific time intervals and specific tariffs to be levied within such intervals.

b) Measurement uncertainty

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and note disclosures related thereto. Due to the inherent uncertainty in making estimates, actual results could differ from estimates recorded in preparing these financial statements, including changes as a result of future regulatory decisions.

Accounts receivable and regulatory assets are stated after evaluation of amounts expected to be collected and an appropriate allowance for doubtful accounts. Inventory is recorded net of provisions for obsolescence. Amounts recorded for depreciation and amortization of equipment are based on estimates of useful service life. Employee future benefits are based on certain assumptions, including interest (discount) rate, salary escalation, the average retirement age of employees, employee turnover and expected health and dental care costs.

c) Cash and cash equivalents

Cash equivalents comprise overnight deposits in an investment account with a Schedule A bank. Investments are carried at cost, which approximates fair value.

d) Inventory

Inventory consists principally of construction and maintenance materials. Inventory is stated at the lower of cost and replacement value, with cost determined on an average cost basis.

3) SIGNIFICANT ACCOUNTING POLICIES (Continued)

e) Fixed assets and depreciation

Fixed assets are recorded at cost, including the cost of work in process, and are removed from the accounts at the end of their estimated service lives, except in those instances where specific identification allows their removal at retirement or disposition. For specifically identifiable assets, gains or losses at retirement or on disposition are credited or charged to other income, otherwise, no gain or loss is recognized unless a sale has occurred.

Depreciation is calculated on a straight-line basis over the estimated service life of fixed assets as follows:

Land rights	50 years
Buildings	25-30 years
Distribution stations	30 years
Distribution lines – overhead and underground	25 years
Distribution transformers	25 years
Distribution meters	25 years
Other fixed assets	3-15 years

Work in process reflects the cost of construction materials and applied labour and overheads consumed in partially completed capital projects and is not depreciated.

f) Goodwill

Goodwill represents the amount by which the purchase price of an acquired business exceeds the fair value of the net identifiable assets purchased.

Goodwill is not amortized and is evaluated for impairment on an annual basis, or more frequently if circumstances require, with any write-down of the carrying value of goodwill being charged against the results of operations. 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.

g) Deferred charges

Deferred charges primarily include professional services costs, including legal and consulting fees, incurred prior to and in respect of the amalgamation between HHI and SCHUSI, which transaction is further described in note 2. These costs were subsequently included as part of goodwill.

h) Credit support for service delivery

Credit support for service delivery represents cash deposits from electricity distribution customers and retailers, as well as construction deposits.

3) **SIGNIFICANT ACCOUNTING POLICIES (Continued)**

h) **Credit support for service delivery (continued)**

Deposits from electricity distribution customers are applied against any unpaid portion of individual customer accounts. Customer deposits in excess of unpaid account balances are refundable to individual customers upon termination of their electricity distribution service.

Customer deposits are also refundable to residential electricity distribution customers demonstrating an acceptable level of credit risk, as determined by the Corporation.

Pursuant to the Ontario Energy Board retail settlement code, the Corporation is entitled to security from retailers to guarantee the payment of the difference between the market price for electricity and the retailer's average contract price.

Construction deposits represent cash prepayments for the estimated cost of capital projects recoverable from customers and developers. Upon completion of the capital project, these deposits are transferred to capital contributions in aid of construction.

i) **Employee future benefits**

The Corporation pays certain health, dental and life insurance benefits, under unfunded defined benefit plans, on behalf of its retired employees.

Employee future benefits are recorded on an accrual basis. The accrued benefit obligations and current service cost are calculated using the projected benefit method pro rated on service and reflect management's best estimate of certain underlying assumptions. The current service cost for a period is equal to the actuarial present value of benefits attributed to that period in which employees rendered their services. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of the amendment. The excess of actuarial gains (losses) over 10% of the accrued benefit obligation are amortized into expense on a straight-line basis over the expected average remaining service life of active employees.

j) **Pension plan**

The Corporation provides a pension plan for its employees though the Ontario Municipal Employees Retirement System ("OMERS"). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund ("the Fund"), and provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards. The fund is a contributory defined benefit pension plan. The Corporation records the required contributions as an expense in the period they accrue.

k) **Related party transactions**

Transactions with related parties represent the culmination of the earnings process and are measured at the exchange amount.

December 31, 2005 ($ in thousands)

3) SIGNIFICANT ACCOUNTING POLICIES (Continued)

l) Payments in Lieu of Taxes ("PILs")

The Corporation is currently exempt from taxes under the Income Tax Act (Canada) ("ITA") and the Ontario Corporations Tax Act ("OCTA").

Commencing October 1, 2001 and pursuant to the *Energy Competition Act* ("ECA"), the Corporation is required to compute taxes under the ITA and OCTA and remit such amounts thereunder to the Ontario Electricity Financial Corporation ("OEFC"). These amounts, referred to as PILs under the ECA, are applied to reduce certain debt obligations of the former Ontario Hydro continuing in OEFC.

The Corporation provides for PILs using the asset and liability method. Under this method, future tax assets and liabilities are recognized, to the extent such are determined likely to be realized, for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

m) Capital contributions in aid of construction

Capital contributions arise from development charges which are provided and paid by developers and used to finance additions to fixed assets. Capital contributions received are treated as a "credit" contra account and are included in fixed assets. These amounts are subsequently amortized by a charge to accumulated amortization and a credit to amortization expense at an equivalent rate to that used for the depreciation of the related fixed asset.

n) Revenue recognition

Electricity distribution services charges comprise charges to customers for use of the Corporation's electricity distribution system. These charges are recorded when the related services are performed.

4) OTHER ASSETS

Other assets comprise:

	2005	**2004**
Deferred charges	**-**	1,031
Prepaid expenses	**1,229**	804
Other	**68**	68
Total other assets	**1,297**	1,903

Notes to the Financial Statements

December 31, 2005 ($ in thousands)

5) FIXED ASSETS

Fixed assets comprise:

	2005			2004		
	Original Cost	Accumulated Depreciation	Net Book Value	Original Cost	Accumulated Depreciation	Net Book Value
Land	**1,493**	**-**	**1,493**	1,182	-	1,182
Land rights	**129**	**(39)**	**90**	115	(35)	80
Buildings	**22,987**	**(12,661)**	**10,326**	19,518	(11,783)	7,735
Distribution stations	**9,685**	**(6,372)**	**3,313**	8,730	(6,008)	2,722
Distribution lines – overhead and underground	**295,256**	**(116,293)**	**178,963**	247,107	(107,734)	139,373
Distribution transformers	**70,605**	**(29,407)**	**41,198**	61,032	(26,684)	34,348
Distribution meters	**25,367**	**(9,829)**	**15,538**	21,646	(8,678)	12,968
Other fixed assets	**34,312**	**(24,890)**	**9,422**	31,883	(22,993)	8,890
Work in process	**3,826**	**-**	**3,826**	1,100	-	1,100
	463,660	**(199,491)**	**264,169**	392,313	(183,915)	208,398

During the year, the Corporation received $2,161 (2004 - $2,198) of capital contributions in aid of construction.

Total depreciation expense for the year is $19,562 (2004 - $15,882) of which $964 (2004 - $848) has been allocated to operating expenses and capital.

6) PAYMENTS IN LIEU OF TAXES

The provision for PILs varies from amounts which would be computed by applying the Corporation's combined statutory income tax rate as follows:

	2005	2004
Basic rate applied to income before PILs	**36.12%**	36.12%
Increase (decrease) in PILs resulting from:		
Tax basis of depreciable capital assets and goodwill in excess of accounting basis	**(5.34%)**	(5.27%)
Items not deductible for tax purposes and other	**0.45%**	0.69%
Provision for payments in lieu of large corporations taxes	**0.82%**	2.12%
Effective rate applied to income before PILs	**32.06%**	33.66%

At December 31, 2005, based on substantively enacted income tax rates, future income tax assets of $19,869 (2004 - $15,325) have not been recorded. Such future income tax assets relate to tax bases of depreciable capital assets and employee future benefits in excess of amounts recorded for accounting purposes. Such future tax assets have not been recorded in the accounts as there is uncertainty as to whether the Corporation will realize the benefits related to these assets which would be realized as relatively modest reductions of future tax liability over many future years.

Notes to the Financial Statements

December 31, 2005 ($ in thousands)

7) CREDIT SUPPORT FOR SERVICE DELIVERY

Credit support for service delivery comprises:

	2005	2004
Customer deposits	**12,698**	10,884
Retailer deposits	**766**	681
Construction deposits	**5,702**	4,239
Total credit support for service delivery	**19,166**	15,804

8) LONG-TERM BORROWINGS

Long-term borrowings comprise:

	2005	2004
Promissory note payable to HUC	**116,000**	116,000

The promissory note payable to HUC bears interest at 7.0% per annum, payable semi-annually on January 30 and July 30. The promissory note is unsecured and matures on July 30, 2012.

The Corporation incurred interest expense in respect of the promissory note payable to shareholder of $8,120 (2004 - $8,120).

As at March 1, 2005 and as a result of the transaction described in note 2, the Corporation assumed a promissory note payable to SCHI in the amount of $29,124 on the acquisition of SCHUSI. The promissory note was unsecured and repayable upon 30 days written notice by SCHI. Such notice was received from SCHI. Interest on the promissory note was payable quarterly at a rate of 4.84% per annum. The promissory note was repaid on June 17, 2005. During the year, the Corporation paid interest expense in respect of this promissory note of $417.

9) EMPLOYEE FUTURE BENEFITS

The Corporation pays certain health, dental and life insurance benefits on behalf of its retired employees. The Corporation accrues the cost of these employee future benefits over the periods in which the employees earn the benefits. The cost of employee future benefits earned by employees is actuarially determined applying the projected benefit method pro rated on length of service. Significant assumptions underlying the valuation include management's best estimate of the interest (discount) rate, salary escalation, the average retirement age of employees, employee turnover and expected health and dental care costs.

Notes to the Financial Statements

December 31, 2005 ($ in thousands)

9) EMPLOYEE FUTURE BENEFITS (Continued)

Information about the Corporation's defined benefit plan is as follows:

	2005	2004
Accrued benefit liability, beginning of year	**12,014**	11,625
Fair value of liability assumed on acquisition of SCHUSI	**3,068**	-
Net benefit expense:		
Current service cost	**240**	324
Interest cost	**969**	836
Amortization of net actuarial loss	**-**	34
Net benefit expense for the year	**1,209**	1,194
Benefits paid for the year	**(1,033)**	(805)
Accrued benefit liability, end of year	**15,258**	12,014

An actuarial valuation of the plan obligations was completed as at March 1, 2005 resulting in an unamortized net actuarial loss of $823. The Corporation has adopted the corridor method of accounting for the actuarially determined experience gains (losses). The excess of actuarial gains (losses) over 10% of the accrued benefit obligation is amortized into expense on a straight-line basis over the expected average remaining service life of active employees.

The main actuarial assumptions underlying the valuation are as follows:

a) General inflation

The health care cost trend for prescription drugs is estimated to increase at a declining rate from 9% to 4% over five years. Other medical and dental expenses are assumed to increase at 4% per year.

The approximate effect on the accrued benefit obligation and the estimated net benefit expense if the health care trend rate assumption was increased or decreased by 1% is as follows:

	Accrued Benefit Obligation	Periodic Benefit Cost
1% increase in health care trend rate	1,812	121
1% decrease in health care trend rate	(1,466)	(96)

b) Interest (discount) rate

The obligations at the period end and the present value of future liabilities were determined using a discount rate of 6.25% representing an estimate of the yield on high quality corporate bonds as at the valuation date.

(c) Salary levels

Future general salary and wage levels were assumed to increase at 4% per year.

Notes to the Financial Statements

December 31, 2005 ($ in thousands)

10) NET REGULATORY ASSETS (LIABILITIES)

Net regulatory assets (liabilities) comprise:

	2005	2004
Transition costs (net of reserve $3,501; 2004 - $3,501)	**-**	-
Pre-market opening cost of power variances	**7,202**	3,709
Post-market opening retail settlement variances	**(23,571)**	(11,607)
Deferred payments in lieu of taxes	**2,714**	2,329
Total net regulatory liabilities	**(13,655)**	(5,569)

Net regulatory assets (liabilities) represent costs incurred by the Corporation and settlement variances with other participants in the electricity market, less recoveries, for the purpose of supporting the deregulation of the electricity industry in Ontario. These amounts have been accumulated pursuant to regulation underlying the EA and deferred in anticipation of their future recovery in electricity distribution service charges.

The Corporation ceased recognizing interest income related to transition costs and the retail settlement variance accounts as at December 31, 2002. The Corporation filed for recovery of these interest amounts as part of the August 2005 rate application.

Transition costs - represent specific and incremental costs to the Corporation for systems and process changes to support the opening of the competitive electricity market in Ontario on May 1, 2002 (“Market Opening”). These costs have been deferred pursuant to regulation underlying the EA and are subject to review and approval for recovery by the Ontario Energy Board (“OEB”).

Pre-market opening cost of power variances - represent the excess of the cost of the commodity electricity to the Corporation over the amount billed to its customers prior to Market Opening.

Post-market opening retail settlement variances - represent amounts that have accumulated since Market Opening and comprise:

i) variances between amounts charged by the Independent Electricity System Operator (“IESO”) for the operation of the wholesale electricity market and grid, various wholesale market settlement charges and transmission charges, and the amounts billed to customers by the Corporation based on the OEB approved wholesale market service rate; and,

ii) variances between the amounts charged by the IESO to allow for purchases of imported electricity and the amounts billed to customers by the Corporation based on OEB approved rates.

Deferred payments in lieu of taxes – represent variances that result from the difference between OEB approved PILs recoverable in electricity distribution services charges and the actual amount of these charges to customers that relates to the recovery of PILs.

In the absence of rate regulated accounting, generally accepted accounting principles would require the Corporation to reverse the carrying charges recorded, related to the regulatory assets (liabilities) described above, in the operating results for the year in which they are incurred. Since the Corporation ceased recognizing the carrying charges related to these regulatory assets (liabilities) in 2002, there is no impact on operating results in the current year or prior year.

Notes to the Financial Statements

December 31, 2005 ($ in thousands)

11) SHARE CAPITAL

Authorized:	
Unlimited Class 1 Common shares	
Unlimited Class A Common shares	
Issued:	
7,890 Class 1 Common shares	**91,133**
2,110 Class A Common shares	**32,460**
	123,593

12) PENSION PLAN

The Corporation participates in the Ontario Municipal Employees Retirement Fund (OMERS), a multi-employer plan, on behalf of its employees. The plan is a contributory defined benefit pension plan. Contributions are 6.0% for employee earnings below the year's maximum pensionable earnings and 8.8% thereafter, and are anticipated to rise to 6.5% and 9.6% in 2006. During 2005, the Corporation expensed contributions totaling $1,416 (2004 - $1,149) made to OMERS in respect of the employer's required contributions to the plan.

13) COMMITMENTS AND CONTINGENCIES

Commitments

Minimum Lease Payments

The Corporation has entered into operating leases for certain computer equipment. Minimum annual lease payments required in 2006 are $293 and nil thereafter.

Contingencies

A class action claiming $500,000 in restitutionary payments plus interest was served on the former Toronto Hydro-Electric Commission, continuing as Toronto Hydro Corporation, on November 18, 1998. The action was initiated against the former Toronto Hydro-Electric Commission as the representative of the Defendant Class consisting of all municipal electric utilities in Ontario which have charged Late Payment charges on overdue utility bills at any time after April 1, 1981.

The claim is that late payment penalties result in municipal electric utilities receiving interest at effective rates in excess of 60% per year, which is illegal under Section 347(1)(b) of the Criminal Code. This action is at a preliminary stage. Pleadings have closed but examinations for discovery have not been conducted and the classes have not been certified. The Electricity Distributors Association is undertaking the defense of this class action on behalf of the Defendant Class.

December 31, 2005 ($ in thousands)

13) COMMITMENTS AND CONTINGENCIES (Continued)

Contingencies (continued)

On April 22, 2004, in a decision in a class action commenced against The Consumers' Gas Company Limited (now Enbridge Gas Distribution Inc.), the Supreme Court of Canada ruled that Consumers' Gas was required to repay that portion of certain late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the Criminal Code. Although the claim related to charges collected by Consumers' Gas after the enactment of section 347 of the Criminal Code in 1981, the Supreme Court limited recovery to charges collected after the action was initiated in 1994.

The Corporation is not a party to the Consumers' Gas class action, however, it is anticipated that the above noted class action will now proceed for determination in light of the reasons of the Supreme Court in the Consumers' Gas class action.

The Defendant Class may have defences available to it in this action that were not disposed of by the Supreme Court in the Consumers' Gas class action. Also, the determination of whether the late payment charges collected by the Corporation from its customers were in excess of the interest limit stipulated in section 347 of the Criminal Code is fact specific in each circumstance.

At this time, given the preliminary status of this action, it is not possible to quantify the effect, if any, on the financial statements of the Corporation. Consequently, no provision has been made in these financial statements with respect to any possible losses that may arise as a result of this matter.

14) BILLINGS TO ELECTRICITY DISTRIBUTION CUSTOMERS

The Corporation is licensed by the OEB to distribute electricity. As a licensed distributor, the Corporation is responsible for billing customers for electricity generated by third parties and the related costs of providing electricity service, such as transmission services and other services provided by third parties. The Corporation is required, pursuant to regulation, to remit such amounts to these third parties, irrespective of whether the Corporation ultimately collects these amounts from customers. The Corporation may file to recover uncollected debt retirement charges from OEFC once each year. Otherwise, the Corporation is unable to recover uncollected amounts formerly remitted to these third parties. The Corporation retains only its electricity distribution services charge that is regulated by the OEB.

Electricity distribution services charges comprise:

	2005	**2004**
Gross customer billings	**548,951**	380,100
Less: Pass through charges billed by the Corporation		
Electricity charges paid through to generators	**(333,823)**	(213,737)
Transmission and miscellaneous charges	**(66,786)**	(54,238)
Market service charges	**(34,710)**	(26,788)
Debt retirement charges	**(36,817)**	(28,301)
Total electricity distribution service charges	**76,815**	57,036

December 31, 2005 ($ in thousands)

Notes to the Financial Statements

15) OTHER INCOME FROM OPERATIONS

Other income from operations comprises:

	2005	2004
Water and waste water billing and customer care charges	**2,790**	2,572
Miscellaneous	**1,403**	785
Collection and other service charges	**1,192**	752
Pole rental income	**1,079**	743
Late payment charges	**937**	721
Scrap sales	**249**	313
Total other income from operations	**7,650**	5,886

16) RELATED PARTY TRANSACTIONS

Shareholder loans

Pursuant to a Credit Agreement dated February 28, 2005, HUC has made available a revolving line of credit in the amount of $35,000 and bearing interest at 0.5% below the prime rate as determined and posted, from time to time, by the Canadian Imperial Bank of Commerce.

On January 20, 2006, the Credit Agreement was subsequently amended ("Amended Credit Agreement") and provides the Corporation with a revolving line of credit up to $55,000 to finance general corporate requirements, working capital requirements and prudential obligations. The Amended Credit Agreement matures on January 19, 2009. Interest rates payable on the Amended Credit Agreement are based on a margin above HUC's borrowing rate, as determined by reference to HUC's debt rating.

Revenue

The Corporation provides certain water and wastewater billing and customer care services to the sole shareholder of its parent company, the City of Hamilton. Other income includes $2,790 (2004 - $2,572) earned with respect to this agreement. As at the end of the year, accounts payable and accruals include $8,540 (2004 - $9,206) owing to the City of Hamilton for amounts collected on behalf of the City of Hamilton pursuant to this agreement.

Operating expenses

Operating expenses include $1,032 (2004 - $880) paid to Hamilton Utilities Corporation for certain management and administrative services and $573 (2004 - $509) paid to Hamilton Hydro Services Inc., a corporation under common control, for the provision of certain computer maintenance, network and internet services.

Notes to the Financial Statements

December 31, 2005 ($ in thousands)

17) FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, accounts receivable, credit support for service delivery and accounts payable and accruals approximate fair values because of the short maturity of these instruments.

Financial assets held by the Corporation, such as accounts receivable, expose it to credit risk.

The Corporation earns its revenue from a broad base of customers located in the City of Hamilton and the City of St. Catharines. One customer, the City of Hamilton, accounts for 3% (2004 – 4%) of revenue. No other single customer in either year would account for revenue in excess of 1% of the respective reported balances.

One customer, the City of Hamilton, accounts for 2% of accounts receivable at year-end. No other single customer accounts for more than 1% of accounts receivable at year-end.

18) COMPARATIVE FIGURES

Certain comparative data have been reclassified to conform with the presentation of the current year.