



**Horizon Utilities Corporation
Auditors' Report to the Shareholders
and Consolidated Financial Statements
Year Ended December 31, 2010 and
December 31, 2009**



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INDEPENDENT AUDITORS' REPORT

To the Shareholder Horizon Utilities Corporation

We have audited the accompanying consolidated financial statements of Horizon Utilities Corporation, which comprise the consolidated balance sheet, as at December 31, 2010, the consolidated statements of income and retained earnings and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Horizon Utilities Corporation as at December 31, 2010, and the results of its consolidated operations and its consolidated cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants, Licensed Public Accountants

Hamilton, Canada
February 24, 2011



Consolidated Balance Sheet

(in thousands)

As at December 31, 2010

	2010	2009
ASSETS		
Current assets		
Cash and cash equivalents	\$ 9,677	\$ -
Accounts receivable	88,330	89,536
Inventory [note 3]	6,042	6,341
Prepaid expenses	2,244	1,711
	106,293	97,588
Fixed assets [note 4]	332,327	321,041
Future payments in lieu of taxes [note 5]	10,794	9,963
Intangible assets [note 6]	4,444	5,064
Goodwill	18,923	18,923
Total assets	\$ 472,781	\$ 452,579
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Bank indebtedness	\$ -	\$ 24,241
Accounts payable and accruals	56,920	55,001
Accounts payable to corporations under common control	12,789	11,606
Credit support for service delivery [note 7]	20,008	22,451
	89,717	113,299
Long-term liabilities		
Long-term borrowings [note 8]	156,000	116,000
Employee future benefits [note 9]	16,670	16,421
Net regulatory liabilities [note 10]	28,439	29,157
	201,109	161,578
Total liabilities	290,826	274,877
Shareholder's equity		
Share capital [note 11]	123,593	123,593
Contributed surplus	15,218	15,218
Retained earnings	43,144	38,891
Total shareholder's equity	181,955	177,702
Total liabilities and shareholder's equity	\$ 472,781	\$ 452,579

Commitments and contingencies [note 13]

On behalf of the Board:

Director

Director



Consolidated Statement of Income and Retained Earnings

(in thousands)

For the year ended December 31, 2010

	2010	2009
Electricity distribution service charges <i>[note 14]</i>	\$ 91,217	\$ 88,583
Other income from operations <i>[note 15]</i>	9,896	9,756
	101,113	98,339
Expenses:		
Operating expenses <i>[note 17]</i>	46,633	44,732
Depreciation and amortization <i>[note 4]</i>	26,972	24,928
	73,605	69,660
Income from operating activities	27,508	28,679
Net gain on sale of assets	99	92
Interest income	100	57
Interest expense <i>[notes 9 and 17]</i>	(9,683)	(9,209)
Income before payments in lieu of taxes	18,024	19,619
Payments in lieu of income taxes <i>[note 5]</i>	(5,658)	(6,377)
Net income	12,366	13,242
Retained earnings, beginning of year	38,891	34,712
Dividends paid	(8,113)	(9,063)
Retained earnings, end of year	\$ 43,144	\$ 38,891



Consolidated Statement of Cash Flows

(in thousands)

For the year ended December 31, 2010

	2010	2009
OPERATING ACTIVITIES		
Net income	\$ 12,366	\$ 13,242
Add (deduct) non-cash items:		
Depreciation and amortization	28,352	26,258
Future payments in lieu of taxes	(831)	(1,624)
Net change in employee future benefits	249	127
Net loss (gain) on sale of assets	(99)	(92)
Net change in other assets and liabilities	3,356	(10,478)
Cash provided by operating activities	43,393	27,433
INVESTING ACTIVITIES		
Additions to fixed assets	(39,063)	(44,714)
Proceeds received on sale of fixed assets	144	143
Cash used in investing activities	(38,919)	(44,571)
FINANCING ACTIVITIES		
Long-term borrowings	40,000	-
Net change in credit support for service delivery	(2,443)	(2,341)
Dividends paid in the year	(8,113)	(9,063)
Cash provided by (used in) financing activities	29,444	(11,404)
Net increase (decrease) in cash and cash equivalents during the year	33,918	(28,542)
Cash and cash equivalents (bank indebtedness), beginning of year	(24,241)	4,301
Cash and cash equivalents (bank indebtedness), end of year	\$ 9,677	\$ (24,241)
Supplemental disclosure of cash flow information		
Interest received	\$ 92	\$ 71
Interest paid	(8,621)	(9,095)
Taxes paid	(7,137)	(8,401)



Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

1) BUSINESS OF CORPORATION

Horizon Utilities Corporation (the “Corporation”) is one of Ontario’s largest municipally owned electricity distribution companies in Ontario, delivering electricity and related utility services to more than 237,000 residential and commercial customers in Hamilton and St. Catharines.

The Corporation also has a 99.9% ownership interest in Solar Sunbelt General Partnership (“Solar Sunbelt GP”), which has been established to undertake a solar generation business. The Corporation is also the managing partner of Solar Sunbelt GP.

Horizon Utilities Corporation is owned 100% by Horizon Holdings Inc. (“HHI”).

2) 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) Basis of Consolidation

The consolidated financial statements include the accounts of the Corporation and its 99.9% investment in Solar Sunbelt.

All significant inter-company accounts and transactions have been eliminated.

b) 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 residential 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.

Rate Setting

The electricity distribution rates and other regulated charges of the Corporation are determined in a manner that provides shareholders with a regulated Maximum Allowable Return on Equity (“MARE”) on the amount of shareholder’s equity supporting the business of electricity distribution, which is also determined by regulation.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) Regulation

In December 2009, the OEB concluded a Cost of Capital proceeding with the issuance of its final report thereon. The report principally dealt with the adequacy and determination of the Maximum Allowable Return on Equity ("MARE"). The Board has acknowledged that it needs to refine and reset its current formula for determining MARE to:

- i) acknowledge and incorporate a utility spread off of Canada long-bonds within the Equity Risk Premium ("ERP") to better reflect utility borrowing costs (initially 141.5bps);
- ii) to include a 50bps "transaction cost" component within the ERP to reflect estimated transaction costs related to utility borrowings; and
- iii) reduce MARE volatility from annual changes in the Canada long-bond and by reducing the annual adjustment factor from 0.75 to 0.5; and
- iv) reflect a more realistic and "fair" base risk premium for Local Distribution Companies ("LDCs").

The method of transition to the new MARE is through a cost of service review application, further described below.

Rate Applications

The OEB regulates the electricity distribution rates charged by LDCs, such as Horizon Utilities, using a combination of annual incentive rate mechanism ("IRM") adjustments and periodic cost of service reviews. Both such adjustments and reviews are based on applications made by LDCs to the OEB. The current ratemaking policy of the OEB requires a cost of service review every four years, which is followed by three successive years of IRM adjustments.

IRM adjustments to LDC rates are principally formulaic in nature and based on the annual change in the Gross Domestic Product Inflationary Price Index for Final Domestic Demand ("GDP IPI-FDD") net of a productivity factor and a "Stretch Factor" determined by the relative efficiency of an electricity distributor.

The rate adjustment resulting from a cost of service review is normally based on forecast test year data, including the amount of operating and capital expenses, debt, and shareholder's equity required to support an LDC's business. The aggregate amount of debt and equity upon which an LDC may recover interest charges and MARE is equal to the "rate base" of an LDC, which is determined as the aggregate of its fixed assets in support of regulated electricity distribution activities and a working capital allowance. The proportion of debt and equity upon which an LDC may recover interest and MARE is generally 60% and 40%, respectively.

Rates have historically, and typically, been effective from May 1st to April 30th.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) Regulation

The last cost of service review application (“COS Application”) of the Corporation was approved by the OEB on October 3, 2008, with rates effective May 1, 2008. Such approval effectively provided for 2008 service distribution revenue requirement and rate base of \$93,632 and \$346,420, respectively. Such amounts do not include provision for the investment of the Corporation in the Smart Meter Initiative, further elaborated below.

The Corporation had filed IRM applications to adjust its rates effective May 1, 2009 and May 1, 2010. As a result of such filings, the OEB approved electricity distribution rate adjustments for the Corporation of 1.18% effective May 1, 2009 and 0.18% effective May 1, 2010.

The Corporation has submitted a COS Application for rates effective January 1, 2011 (“2011 COS Application”). Such application was filed on August 26, 2010. However, a decision of the OEB on the 2011 COS Application is unlikely until April or May of 2011. The 2011 COS Application requests a service distribution revenue requirement and rate base of \$108,708 and \$376,890, respectively.

On June 23, 2009, Horizon Utilities submitted an application to the OEB for the recovery of lost revenue and shared savings related to its Conservation and Demand Management (“CDM”) programs. Such recoveries proceed through prescribed Lost Revenue Adjustment Mechanism (“LRAM”) and Shared Savings Mechanism (“SSM”) and relate to activities for the years 2007 and 2008. On October 23, 2009, an amount of \$840 was approved to be recovered through a rate rider for the period commencing November 1, 2009 through April 30, 2010.

Smart Meter Initiative and Time of Use Electricity Distribution Rates

The Province of Ontario committed to have “Smart Meter” electricity meters installed in all homes and small businesses throughout Ontario by the end of 2010. Smart Meters permit consumption to be recorded within specific time intervals and specific tariffs to be levied within such intervals (Time of Use or “TOU” rates). The OEB requires that TOU rates be implemented for all residential and small commercial electricity distribution customers of the Corporation by June 2011.

In support of this initiative, the Corporation has substantially completed its deployment of Smart Meters to all residential and small commercial with 226,000 Smart Meter installations as at December 31, 2010.

The Corporation’s Smart Meter capital expenditures and related operating expenses are currently being funded through a Utility-Specific Smart Meter Funding Adder in accordance with the Smart Meter Funding and Cost Recovery Guideline of the OEB. The current approved Smart Meter Funding Adder rate is \$1.56 per metered customer per month. On September 24, 2010, the Corporation submitted a new application for a Utility-Specific Smart Meter Funding Adder which provides for a new rate adder of \$2.14 per metered customer per month commencing March 1, 2011. OEB approval of this application is pending.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) Regulation

The Corporation commenced billing TOU rates for 10,000 residential customers, as part of a pilot project, in January 2010. As at December 31, 2010, TOU rates have been implemented for approximately 157,000 customers.

The Corporation anticipates meeting the June 2011 deadline of the OEB for full implementation of TOU rates.

Green Energy Act

In 2009, the government enacted the *Green Energy Act* (“GEA”). This legislation made fundamental changes to the roles and responsibilities of LDCs in the areas of renewable power generation, conservation and demand management delivery, and the development of smart distribution grids.

The GEA provides LDCs with the freedom to own and operate a portfolio of renewable power generation and will permit them to provide district heating services in their communities through co-generation. LDCs will also bear added responsibilities to assist and enable consumers to reduce their peak demand and conserve energy in an effort to meet provincial conservation targets. LDCs will also gain new responsibilities in transforming their local distribution networks into smart grids harnessing advanced technologies to facilitate the connection of small-scale generators and the two-way flow of information.

New LDC License Requirements - Conservation and Demand Management Targets

On November 12, 2010, the OEB amended LDC licenses to include requirements for achieving certain CDM targets over a four year period commencing January 1, 2011. The Corporation’s CDM targets include a demand reduction target of 60.36MW and a consumption reduction target of 281.42GWh. LDCs must also comply with a new CDM Code of the OEB, which provides LDC requirements for the development and delivery of CDM Strategy to the OEB for the achievement of LDC-specific CDM targets, annual accounting and reporting to the OEB, and eligibility criteria for performance incentive payments. The Corporation has filed its CDM Strategy with the OEB.

Other Matters

The continuing restructuring of Ontario’s electricity industry and other regulatory developments, including current and possible future consultations between the OEB and interested stakeholders, may affect future electricity distribution rates and other permitted regulatory recoveries of the Corporation.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) Regulation

Regulatory Accounting

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. The OEB has the general power 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 involves the application of rate regulated accounting, giving rise to the recognition of regulatory assets and liabilities. The Corporation's 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. The Corporation's regulatory liabilities represent costs with respect to non-distribution market related charges and variances in recoveries that are expected to be settled in future periods.

c) Financial Instruments

Under CICA Handbook Section 3855, Financial Instruments – Recognition and Measurement and Section 3861, Financial Instruments - Disclosure and Presentation all financial assets are classified as held-for-trading, held-to-maturity, loans and receivables or available-for-sale and all financial liabilities must be classified as held-for-trading or other financial liabilities.

All financial instruments are carried on the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other liabilities, which are measured at amortized cost.

The Corporation has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Bank indebtedness	Held-for-trading
Accounts receivable	Loans and receivables
Accounts payable and accruals	Other liabilities
Accounts payable and accruals to corporations under common control	Other liabilities
Credit support for service delivery	Other liabilities
Long-term borrowings	Other liabilities

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

c) Financial Instruments

Effective for the 2009 annual reporting period, the Corporation adopted the amended CICA Handbook Sections 3862, Financial Instruments Disclosures, which provide new financial instrument fair value measurement and liquidity risk management disclosures. The amendments require an entity to classify fair value measurements using a fair value hierarchy, which includes three levels of inputs that may be used to measure fair value:

- Level 1 – Unadjusted quoted market prices in active markets for identical assets or liabilities;
- Level 2 – Observable or corroborated inputs, other than level 1, such as quoted prices for similar assets or liabilities in inactive markets or market data for substantially the full term of the assets or liabilities; and
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities.

The amendments also provide required liquidity risk disclosures.

d) 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.

e) 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.

f) Inventory

Inventory, which consists of parts and supplies acquired for internal construction, consumption or recoverable work, is valued at the lower of cost and replacement cost. Cost is determined on a weighted average basis. Net realizable value is determined by replacement cost.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

g) 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 is not depreciated and comprises the cost of construction materials, applied labour, and overheads consumed in capital projects that are not available for productive use at the end of the fiscal year.

h) Intangible assets

Intangible assets include intangible software costs, which are stated at cost less accumulated amortization. The amortization of intangible software costs is recorded on a straight-line basis over an estimated service life of 3 years.

i) 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.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

j) Credit support for service delivery

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

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.

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.

k) 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 is amortized into expense on a straight-line basis over the expected average remaining service life of active employees.

l) Pension plan

The Corporation provides a pension plan for its employees through 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.

m) Related party transactions

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

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

n) 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 the period that includes the date of enactment or substantive enactment.

o) Capital contributions in support of construction

Capital contributions arise from new connection charges which are provided and paid by developers and/or customers 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.

p) 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.

3) INVENTORY

The amount of inventories consumed by the Corporation and recognized as an expense during 2010 was \$1,182 (2009 - \$783).

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

4) FIXED ASSETS

Fixed assets comprise:

	2010			2009		
	Original Cost	Accumulated Depreciation	Net Book Value	Original Cost	Accumulated Depreciation	Net Book Value
Land	1,483	-	1,483	1,483	-	1,483
Land rights	147	(56)	91	147	(53)	94
Buildings	28,230	(18,537)	9,693	27,612	(17,250)	10,362
Distribution stations	10,999	(7,666)	3,333	10,030	(7,371)	2,659
Distribution lines – overhead and underground	360,618	(164,531)	196,087	348,293	(157,308)	190,985
Distribution transformers	93,014	(40,580)	52,434	89,462	(39,382)	50,080
Distribution meters	62,619	(19,474)	43,145	59,750	(16,565)	43,185
Other fixed assets	46,594	(29,870)	16,724	43,332	(27,455)	15,877
Work in process	9,337	-	9,337	6,316	-	6,316
	613,041	(280,714)	332,327	586,425	(265,384)	321,041

During the year, the Corporation received \$8,512 (2009 - \$7,962) of capital contributions from developers or customers to support new customer connections.

Total depreciation expense for the year is \$28,352 (2009 - \$26,258) of which \$1,380 (2009 - \$1,330) has been allocated to operating expenses and capital.

5) 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:

	2010	2009
Basic rate applied to income before PILs	31.00%	33.00%
Increase (decrease) in PILs resulting from:		
Tax basis of depreciable capital assets and goodwill in excess of accounting basis	(4.38%)	(4.29%)
Revaluation of Future Tax Liability at 2014 statutory rate of 25.0%	3.88%	3.13%
Items not deductible for tax purposes and other	0.91%	0.69%
Effective rate applied to income before PILs	31.41%	32.53%

At December 31, 2010, based on substantively enacted income tax rates, future income tax assets of \$10,563 (2009 - \$11,867) have not been recorded. Such future income tax assets relate to tax bases of depreciable capital assets in excess of amounts recorded for accounting purposes at October 1, 2001. 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 Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

6) INTANGIBLE ASSETS

Intangible assets comprise:

	2010	2009
Intangible software costs	12,783	11,740
Less: accumulated amortization	(8,339)	(6,676)
	4,444	5,064

7) CREDIT SUPPORT FOR SERVICE DELIVERY

Credit support for service delivery comprises:

	2010	2009
Customer deposits	14,851	15,381
Construction deposits	5,157	7,070
	20,008	22,451

8) LONG-TERM BORROWINGS

Long-term borrowings comprise:

	2010	2009
\$116,000 Promissory note payable to HHI bearing interest at 7.0% and due July 30, 2012	116,000	116,000
\$40,000 Promissory note payable to HHI bearing interest at 4.89% and due July 21, 2020	40,000	-
	156,000	116,000

Interest on the \$116,000 promissory note is payable semi-annually on January 30 and July 30. Interest expense of \$8,120 (2009 - \$8,120) was paid to HHI.

Interest on the \$40,000 promissory note is payable semi-annually on January 21 and July 21. During the year, the Corporation accrued interest in respect of the promissory note in the amount of \$879. There were no amounts paid in 2010.

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 prorated 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 Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

9) EMPLOYEE FUTURE BENEFITS (Continued)

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

	2010	2009
Accrued benefit liability, beginning of year	16,421	16,294
Net benefit expense:		
Current service cost	288	222
Interest cost	1,048	1,059
Amortization of net actuarial loss	-	-
Net benefit expense for the year	1,336	1,281
Benefits paid for the year	(1,087)	(1,154)
Accrued benefit liability, end of year	16,670	16,421

An actuarial valuation of the plan obligations was completed as at December 31, 2010 resulting in an unamortized net actuarial loss of \$3,068. 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 6% to 4% over two 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	2,203	173
1% decrease in health care trend rate	(1,762)	(105)

b) Interest (discount) rate

The obligations at the period end and the present value of future liabilities were determined using a discount rate of 5.3% (2009 – 6.4%) 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 3% (2009 – 3%) per year.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

10) NET REGULATORY LIABILITIES

Net regulatory liabilities (assets) comprise:

	2010	2009
Regulatory variances disposition account	15,054	4,444
Future payments in lieu of taxes	8,792	7,686
Settlement variances	5,044	16,315
Regulatory deferral account	397	624
Smart Meter deferral account	33	649
IFRS transition costs	(881)	(561)
	28,439	29,157

Net regulatory 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 *Electricity Act, 1998 (Ontario)* and deferred in anticipation of their future recovery or repayment in electricity distribution service charges.

Regulatory variances disposition account – represents approved regulatory asset and liability balances as at December 31, 2008, consisting of settlement variances and associated interest, less amounts paid to customers up to December 31, 2010. The recent OEB decision on the 2010 IRM Application provided for the disposition of \$19,467 of the Corporation’s net regulatory liabilities over a twenty-four month period commencing May 1, 2010.

Future payments in lieu of taxes – represents the amount of future income taxes expected to be included in future rates and recovered from or paid to customers through the rate setting process.

Settlement variances - represent amounts that have accumulated since January 1, 2009 and have not yet been approved in rates by the OEB 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.

Regulatory deferral account – represents the deferral of various operating expenditures related to the GEA, retailer expenses, and the implementation of HST, which will be subject to future disposition in accordance with the directions set out by the OEB.

Smart Meter deferral account – represents the deferral of operating expenditures, capital expenditures, and revenues related to Smart Meters.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

10) NET REGULATORY LIABILITIES (Continued)

IFRS transition costs – represents the incremental costs incurred by the Corporation in relation to the transition from Canadian Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS). The Corporation is required to adopt IFRS no later than January 1, 2012. In its decision of July 28, 2009, the OEB provided that these costs be recorded by LDCs in a deferral account for a review of their recovery at their next respective COS Application. The Corporation anticipates full recovery of these costs.

11) SHARE CAPITAL

	2010	2009
Authorized:		
Unlimited Class 1 Common shares		
Unlimited Class A Common shares		
Issued:		
7,890 Class 1 Common shares	91,133	91,133
2,110 Class A Common shares	32,460	32,460
	123,593	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 during the year were 6.4% for employee earnings up to the year’s maximum pensionable earnings (“YMPE”), as prescribed by federal tax legislation, and 9.7% above the YMPE. During 2010, the Corporation expensed contributions totaling \$2,084 (2009 - \$1,987). Contributions are expected to increase by approximately 1% per year over the next three years reflecting plan amendments recently announced by OMERS.

13) COMMITMENTS AND CONTINGENCIES

Commitments

Contractual Obligations

a) Connection and Cost Recovery Agreement

Pursuant to the terms of a Connection and Cost Recovery Agreement dated December 10, 2008, the Corporation had committed to upgrade the capacity of one of its transformer stations. The total commitment over a three year period was approximately \$7,278 and the remaining commitment as at year-end is \$nil. (2009 - \$2,426).



Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

13) COMMITMENTS AND CONTINGENCIES (Continued)

Commitments

Contractual Obligations

b) Master CDM Agreement

On February 1, 2011, the Corporation entered into a Master CDM Agreement (“CDM Agreement”) with the Ontario Power Authority (“OPA”) for the period January 1, 2011 to December 31, 2014. The CDM Agreement provides terms under which the Corporation may engage the OPA to design and pay for Province-wide CDM programs in support of meeting its CDM Targets (Note 2).

Subject to the terms of the CDM Agreement, all OPA CDM program costs are paid by the OPA. The Corporation effectively acts as a delivery agent for those programs that it participates in under the CDM Agreement. The Corporation estimates that, for those programs that it will participate in under the CDM Agreement, the total OPA CDM program costs over the four year period will be approximately \$57,000, of which approximately \$11,700 represent administration costs of the Corporation. The Corporation will be entitled to receive, in advance and in semi-annual installments each January and July, all of its estimated administration costs associated with each program. Any administration costs incurred by the Corporation in excess of the pre-approved estimate would not be recoverable. All other program costs incurred by the Corporation, (such as customer incentives and goods and services delivered under the programs) are recoverable from the OPA on an invoiced basis in accordance with the CDM Agreement.

Leases

The Corporation has entered into operating leases for certain computer equipment. Minimum annual lease payments required are as follows:

2011	305
2012	255
<hr/>	
	560

Contingencies

General

From time to time, the Corporation is involved in various litigation matters arising in the ordinary course of its business. The Corporation has no reason to believe that the disposition of any such current matter could reasonably be expected to have a materially adverse impact on the Company's financial position, results of operations or its ability to carry on any of its business activities.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

13) COMMITMENTS AND CONTINGENCIES (Continued)

Contingencies

Class Action

Pursuant to its order dated July 22, 2010 (the “Order”), the Ontario Superior Court of Justice approved the settlement of a class action lawsuit, which was served on the former Toronto Hydro-Electric Commission, continuing as Toronto Hydro Corporation, on November 18, 1998. The original class action was for the amount of \$500,000 and was initiated against the former Toronto Hydro-Electric Commission as the representative of the Defendant Class consisting of all municipal electric utilities (“MEU”) in Ontario, of which the Corporation is a successor MEU, which have charged Late Payment charges on overdue utility bills at any time after April 1, 1981.

The Order formalized a settlement pursuant to which the defendant MEUs will pay the amount of \$17,000 plus costs and taxes in settlement of all claims. The amount allocated for payment by each MEU is based on its percentage of electricity distribution service revenue, relative to that of the entire Defendant Class, over the period for which it had exposure for repayment of late payment penalties exceeding the interest rate limit set out in the federal Criminal Code. The Corporation’s share of the settlement is \$1,100, payable on June 30, 2011.

Under the terms of the settlement, all of the MEUs, including the Corporation, requested an order from the OEB allowing for future recovery from customers of all costs related thereto. On October 29, 2010, the OEB issued a notice of proceeding involving the entire Defendant Class to determine whether the costs and damages incurred by such are recoverable from electricity rate payers, and, if so, the form and timing of such recovery. On February 22, 2011, the OEB issued its decision on this matter and approved the recovery of all costs and damages arising from the settlement of the class action over a 12 month period commencing May 1, 2011, through a fixed rate rider.

As a result, the Corporation has recorded the settlement amount as an operating expense, with the corresponding regulatory recovery recorded through electricity distribution revenue.

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.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

14) BILLINGS TO ELECTRICITY DISTRIBUTION CUSTOMERS (Continued)

Electricity distribution services charges comprise:

	2010	2009
Gross customer billings	545,153	485,814
Less: Pass through charges billed by the Corporation		
Electricity charges paid through to generators	(332,094)	(286,387)
Transmission and miscellaneous charges	(55,509)	(48,351)
Market service charges	(32,778)	(30,564)
Debt retirement charges	(33,555)	(31,929)
	91,217	88,583

15) OTHER INCOME FROM OPERATIONS

Other income from operations comprises:

	2010	2009
Water and waste water billing and customer care charges	3,628	3,429
Collection and other service charges	1,629	1,618
Pole and other rental income	1,344	1,415
Late payment charges	1,201	1,168
Conservation and demand management programs	1,028	1,185
Management and other support services	422	360
Scrap sales	327	434
Miscellaneous	317	147
	9,896	9,756

16) CAPITAL DISCLOSURES

The main objectives of the Corporation when managing financial capital are to:

- ensure ongoing cost effective access to such to provide adequate investment in support of its regulated electricity distribution business and its other businesses;
- compliance with covenants within its financial instruments;
- the prudent management of its capital structure, with regard for recoveries of financing charges permitted by the OEB on its regulated electricity distribution business; and
- deliver reasonable returns on the investments of its shareholders.

The Corporation's definition of capital includes shareholder's equity and long-term debt. This definition has remained unchanged from December 31, 2009.

The OEB regulates the amount of interest on debt and MARE that may be recovered by the regulated electricity distribution business of the Corporation through its electricity distribution rates. The actual capital structure for the Corporation may differ from the OEB deemed structure.



Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

16) CAPITAL DISCLOSURES (Continued)

The Corporation has customary covenants typically associated with long-term debt. The Corporation is in compliance with all credit agreement covenants and limitations associated with its long-term debt.

17) RELATED PARTY TRANSACTIONS

Credit Facility

Pursuant to a Credit Agreement dated June 30, 2010, Horizon Holdings Inc. (“HHI”), the parent company, has made available a revolving line of credit up to \$95,000 to finance general corporate requirements, capital investments, working capital requirements, and prudential obligations. The Credit Agreement matures on June 30, 2013. Interest rates payable on the Credit Agreement are based on HHI’s borrowing rate, as determined by reference to HHI’s debt rating.

As at December 31, 2010, there was no amount outstanding on the Credit Agreement.

Credit Agreement

Pursuant to a Credit Agreement dated June 30, 2010, the Corporation has made available a revolving line of credit of up to \$5,000 to Solar Sunbelt to finance general corporate requirements, capital investments and working capital requirements. The Credit Agreement matures on June 30, 2013. Interest rates receivable on the Credit Agreement are based on Horizon Utilities’ borrowing rate, and interest is payable monthly by the 15th day of the following month.

Revenue

The Corporation provides certain water and wastewater billing and customer care services to the sole shareholder of Hamilton Utilities Corporation, the City of Hamilton. Other income includes \$3,628 (2009 - \$3,429) earned with respect to these services. Accounts payable and accruals included \$10,205 (2009 - \$9,790) owing to the City of Hamilton for amounts collected on its behalf with respect to these services.

The Corporation provides certain management, billing, and administrative services to Hamilton Utilities Corporation and its subsidiary, Hamilton Hydro Services Inc. Other income includes \$270 (2009- \$270) earned with respect to these agreements.

The Corporation provides certain management, billing, and administrative services to Horizon Energy Solutions Inc. Other income includes \$80 (2009 - \$80) earned with respect to these agreements.

Operating Expenses

Operating expenses include \$821 (2009 - \$813) paid to HHI for strategic management and business development services.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

17) RELATED PARTY TRANSACTIONS (Continued)

Promissory Notes Receivable

The following promissory notes are included in accounts receivable:

	2010	2009
\$650 Promissory note receivable from Horizon Energy Solutions Inc. bearing interest at prime plus 0.5%, and due on demand	650	650
\$220 Promissory note receivable from Horizon Energy Solutions Inc. bearing interest at 6.1%, and due on demand	220	220
	870	870

Interest income includes \$33 (2009 - \$32) earned with respect to the promissory notes receivable from Horizon Energy Solutions Inc.

18) FINANCIAL INSTRUMENTS

Recognition and Measurement

The Corporation's fair value measurements are as follows:

Level 1

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.

Level 3

It is not practicable to determine the fair value of the long-term borrowings from Horizon Holdings due to the limited amount of comparable market information available.

Risk Factors

The Corporation's activities provide for a variety of financial risks, particularly credit risk, market risk and liquidity risk.

i) Credit risk

Financial Assets carry credit risk that a counter-party will fail to discharge an obligation which would result in a financial loss. 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. There is one large commercial customer that accounts for 3% (2009 - 3%) of revenue. No other single customer in either year would account for revenue in excess of 1% of the respective reported balances.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

18) FINANCIAL INSTRUMENTS (Continued)

Risk Factors

i) Credit risk (Continued)

The carrying amount of accounts receivable is reduced through the use of an allowance for doubtful accounts and the amount of the related impairment loss is recognized in the income statement. Subsequent recoveries of receivables previously provisioned are credited to the income statement. The balance of the allowance for doubtful accounts at December 31, 2010 is \$1,550 (2009 - \$1,150). No single customer accounts for more than 1% of accounts receivable at year-end.

The Corporation's credit risk associated with accounts receivable is primarily related to payments due from its electricity distribution customers. At December 31, 2010, approximately \$1,081 of such amounts are considered 60 days past due. The Corporation has approximately 237,000 electricity distribution customers, the majority of which are residential customers. Credit risk is managed by the Corporation through its credit policies, including the collection of security deposits from customers under conditions prescribed by the OEB.

At year end, the Corporation held security deposits in the amount of \$20,008 (2008 - \$22,451).

ii) Market Risk

Market risks primarily refer to the risk of loss that results from changes in commodity prices, foreign exchange rates, and interest rates. The Corporation currently does not have commodity or foreign exchange risk. The Corporation is exposed to fluctuations in interest rates as the rate of return applicable to the Corporation's distribution business (the MARE) is regulated and derived using a complex formulaic approach which is, in part, based on the forecast for long-term Government of Canada bond yields. This rate of return is approved by the OEB as part of the approval of distribution rates.

iii) Liquidity risk

The Corporation monitors its liquidity risk with respect to its operational and investment requirements for financial capital. The Corporation seeks to ensure that it has sufficient financial liquidity to meet its obligations as such become due while minimizing interest expense. The Corporation has access to a revolving credit.

Accounts payable, as reported on the financial statements, are generally due within 60 days of the receipt of an invoice.

Notes to the Consolidated Financial Statements

December 31, 2010

(\$ in thousands)

19) EMERGING ACCOUNTING CHANGES

a) International Financial Reporting Standards (“IFRS”)

The Canadian Accounting Standards Board (“AcSB”) has adopted a strategic plan that will require publicly accountable enterprises to adopt IFRS in place of Canadian GAAP, for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011.

In October 2010, the AcSB approved the incorporation of IFRS 1 into Part 1 of the Canadian Institute of Chartered Accountants (“CICA”) Handbook for qualifying entities with activities subject to rate regulation. Part 1 of the CICA Handbook specifies that first-time adoption is mandatory for interim and annual financial statements relating to annual periods beginning on or after January 1, 2012.

The amendment also requires entities that do not prepare its interim and annual financial statements in accordance with Part 1 of the Handbook during the annual period beginning on or after January 1, 2011 to disclose that fact.

The Corporation has decided to defer its implementation of IFRS to January 1, 2012.

b) Consolidated Financial Statements and Non-controlling Interests

In January 2009, the CICA issued Handbook Section 1601, Consolidated Financial Statements. This section, along with the new Handbook Section 1602 Non-controlling Interests, replace Handbook Section 1600, Consolidated Financial Statements and establish standards for the preparation of consolidated financial statements. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted as of the beginning of a fiscal year. The Corporation has determined that these standards will impact on the classification of its non-controlling interest and will have no impact on valuation of its consolidated financial statements.

20) COMPARATIVE FIGURES

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