



**Horizon Utilities Corporation
Auditors' Report to the Shareholders
and Financial Statements
Year Ended December 31, 2008 and
December 31, 2007**

AUDITORS' REPORT TO THE SHAREHOLDER

We have audited the balance sheet of Horizon Utilities Corporation as at December 31, 2008 and the statements 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, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants, Licensed Public Accountants

Hamilton, Canada
February 6, 2009



Balance Sheet

(in thousands)

As at December 31, 2008

	2008	2007
ASSETS		
Current assets		
Cash and cash equivalents	\$ 4,301	\$ 14,406
Accounts receivable	88,541	81,402
Inventory [note 3]	5,928	6,378
Other assets [note 4]	1,637	1,798
	100,407	103,984
Fixed assets [note 5]	307,700	290,435
Future payments in lieu of taxes	5,180	4,750
Goodwill	18,923	18,932
Total assets	\$ 432,210	\$ 418,092
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Accounts payable and accruals	\$ 59,676	\$ 53,586
Accounts payable to corporations under common control	11,377	17,120
Credit support for service delivery [note 7]	24,792	23,848
	95,845	94,554
Long-term liabilities		
Long-term borrowings [note 8]	116,000	116,000
Employee future benefits [note 9]	16,294	15,964
Net regulatory liabilities [note 10]	28,629	22,501
	160,923	154,465
Total liabilities	256,768	249,019
Shareholder's equity		
Share capital [note 11]	123,593	123,593
Contributed surplus	15,218	15,218
Retained earnings	36,631	30,262
Total shareholder's equity	175,442	169,073
Total liabilities and shareholder's equity	\$ 432,210	\$ 418,092

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, 2008

	2008	2007
Electricity distribution service charges <i>[note 14]</i>	\$ 88,335	\$ 84,797
Other income from operations <i>[note 15]</i>	9,723	9,792
	98,058	94,589
Expenses:		
Operating expenses <i>[note 17]</i>	43,920	41,650
Depreciation and amortization <i>[note 5]</i>	23,365	21,174
	67,285	62,824
Income from operating activities	30,773	31,765
Net gain on sale of assets	265	384
Interest income	312	642
Interest expense <i>[notes 8]</i>	(9,517)	(9,584)
Income before payments in lieu of taxes	21,833	23,207
Payments in lieu of income and large corporations taxes <i>[note 6]</i>	(6,617)	(8,438)
Net income	15,216	14,769
Retained earnings, beginning of year	30,262	25,944
Dividends paid	(8,847)	(10,451)
Retained earnings, end of year	\$ 36,631	\$ 30,262



Statement of Cash Flows

(in thousands)

For the year ended December 31, 2008

	2008	2007
OPERATING ACTIVITIES		
Net income for the year	\$ 15,216	\$ 14,769
Add (deduct) non-cash items:		
Depreciation and amortization	24,738	22,209
Future payments in lieu of taxes	(265)	(542)
Net change in employee future benefits	(430)	362
Net gain on sale of assets	330	(384)
Net change in other assets and liabilities	(53)	4,277
Cash provided by operating activities	39,536	40,691
INVESTING ACTIVITIES		
Additions to fixed assets	(42,004)	(38,638)
Proceeds received on sale of fixed assets	46	432
Cash used in investing activities	(41,958)	(38,206)
FINANCING ACTIVITIES		
Net change in credit support for service delivery	944	2,756
Loan payable to affiliate	220	-
Dividends paid in the year	(8,847)	(10,451)
Cash used in financing activities	(7,683)	(7,695)
Net decrease in cash and cash equivalents during the year	(10,105)	(5,210)
Cash and cash equivalents, beginning of year	14,406	19,616
Cash and cash equivalents, end of year	\$ 4,301	\$ 14,406
Supplemental disclosure of cash flow information		
Interest received	\$ 372	\$ 654
Interest paid	(9,020)	(8,997)
Taxes paid	(9,628)	(10,163)



Notes to the Financial Statements

December 31, 2008

(\$ 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 232,000 residential and commercial customers in Hamilton and St. Catharines.

On December 31, 2007, all of the common shareholdings of the Corporation, represented by Class 1 and Class A common shares, were transferred to a corporation incorporated in 2006, Horizon Holdings Inc. ("Horizon Holdings"). In consideration for the transfer, the former shareholder of the Class 1 common shares of the Corporation received the same number of Class 1 common shares of Horizon Holdings. Similarly, the former shareholder of the Class A common shares of the Corporation received the same number of Class A common shares of Horizon Holdings. The share transfer and issuance preserved the continuity of interests in the Corporation through Horizon Holdings. Horizon Holdings is 78.9 per cent owned by Hamilton Utilities Corporation ("HUC"), the holder of its Class A common shares, and 21.1 per cent owned by St. Catharines Hydro Inc. ("SCHI"), the holder of its Class 1 common shares.

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) 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.

Rate Setting

The distribution rates of the Corporation are based on a revenue requirement that provides 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.

On April 12, 2006, the OEB approved distribution rates for the Corporation, effective May 1, 2006 to April 30, 2007. Such distribution rates provided for a revised MARE of 9.0% on the amount of shareholder's equity supporting the business of electricity distribution as at December 31, 2004. In prior years, such MARE was 9.88%.



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

a) Regulation (Continued)

On April 12, 2007, the OEB approved distribution rates for the Corporation, effective May 1, 2007. Such distribution rates were effectively adjusted upwards from 2006 levels by 1.92%, representing the Gross Domestic Product Inflationary Price Index for Final Domestic Demand ("GDP IPI-FDD") net of an industry productivity expectation of 1%; for a net increase of 0.92%.

On October 22, 2007, the Corporation filed an application for electricity distribution rates to be effective May 1, 2008 ("2008EDR Application"). Such application based distribution rates on a 2008 forecast of the amount of operating and capital expenses, debt, and shareholder's equity required to support the business of electricity distribution. The distribution rates applied for further included provision for the cost of debt capital, payments in lieu of corporate taxes, and the MARE.

On March 7, 2008, and in accordance with its report on Cost of Capital and 2nd Generation Incentive Regulation for Electricity Distributors, the OEB revised the MARE from 9.00% to 8.57% and deemed short-term debt rate from 4.77% to 4.47%. This change was effective May 1, 2008.

On October 3, 2008, the OEB issued its decision regarding the 2008EDR Application. Such decision provided for 2008 base distribution revenue requirement and rate base of \$86,662 and \$346,420, respectively. Such amounts do not include provision for the investment by the Corporation in the Smart Meter Initiative, further elaborated below. This decision did, however, provide for the Corporation to file a separate application for a rate adder to recover its ongoing investment in Smart Meters and related expenses including financing charges and MARE, which are recorded in a deferral account and will be subject to a future prudency review of the OEB. This decision also provided for the recovery of \$868 of lost revenue and shared provincial savings related to certain conservation and demand management ("CDM") programs of the Corporation delivered in 2005 and 2006.

On November 17, 2008, the Corporation submitted its 2009 electricity distribution rate application ("2009EDR Application") to adjust its electricity distribution rates based on the 3rd Generation Incentive Rate Mechanism ("3G-IRM") of the OEB, applicable to all Ontario electricity distributors. Such adjustments are to be effective May 1, 2009. The 3G-IRM provides for a formulaic adjustment to electricity distribution rates. Such adjustment includes, among other components, an increase in distribution rates for the annual change in the GDP IPI-FDD net of a productivity factor of 1% and a "Stretch Factor" determined by the relative efficiency of an electricity distributor. The Stretch Factor applicable to the Corporation as of the effective date of the 2009EDR Application was 0.4%

Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

a) Regulation (Continued)

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.

Specific regulatory assets and liabilities are disclosed in Note 10.

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.

Smart Meter Initiative

The Province of Ontario has committed to have "Smart Meter" electricity meters installed in 800,000 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.

The Corporation has installed approximately 140,000 Smart Meters as of the end of 2008 and anticipates having installed a total of 236,000 Smart Meters upon completion of its mass deployment.

b) 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.



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) Financial instruments (continued)

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
Accounts receivable	Loans and receivables
Accounts payable and accruals	Other liabilities
Credit support for service delivery	Other liabilities
Long-term borrowings	Other liabilities

Effective January 1, 2008, the Corporation adopted CICA Handbook Sections 3862 Financial Instruments Disclosures; 3863 Financial Instruments Presentation. The adoption of the new standard requires the disclosure of qualitative and quantitative information about the Corporation's risks associated with recognized and unrecognized financial instruments. The adoption of the new standard on presentation carried forward unchanged the presentation requirements from Section 3861, Financial Instruments Disclosure and Presentation, and therefore did not have any impact on the Financial Statements.

c) 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.

d) 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.

Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

e) Inventory

Effective January 1, 2008, the Corporation adopted Canadian Institute of Chartered Accountant's (CICA) Handbook Section 3031, Inventories. Under the new standard, inventories are required to be measured at the lower of cost and net realizable value and any items considered to be major future components of property, plant and equipment are to be transferred to fixed assets. This new standard also provides updated guidance on the appropriate methods of determining cost and the impact of any write-downs to net realizable value. The implementation of this standard did not have any impact on the Corporations' results of operations.

f) 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.

g) 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 Financial Statements

December 31, 2008

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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 is 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 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.



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

2) SIGNIFICANT ACCOUNTING POLICIES (Continued)

k) Related party transactions

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

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.



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

3) 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.

The amount of inventories consumed by the Corporation and recognized as an expense during 2008 was \$840 (2007 - \$838).

4) OTHER ASSETS

Other assets comprise:

	2008	2007
Prepaid expenses	1,637	1,612
Other	-	186
Total other assets	1,637	1,798

5) FIXED ASSETS

Fixed assets comprise:

	2008			2007		
	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	146	(49)	97	142	(45)	97
Buildings	26,988	(15,980)	11,008	26,426	(14,725)	11,701
Distribution stations	9,724	(7,102)	2,622	9,706	(6784)	2,922
Distribution lines – overhead and underground	332,416	(148,412)	184,004	319,813	(136,963)	182,850
Distribution transformers	81,772	(37,565)	44,207	79,002	(35,618)	43,384
Distribution meters	52,992	(14,527)	38,465	37,170	(12,498)	24,672
Other fixed assets	51,953	(31,511)	20,442	42,998	(28,297)	14,701
Work in process	5,372	-	5,372	8,625	-	8,625
	562,846	(255,145)	307,700	525,365	(234,930)	290,435

During the year, the Corporation received \$6,198 (2007 - \$3,402) of capital contributions in aid of construction.

Total depreciation expense for the year is \$24,738 (2007- \$22,209) of which \$1,373 (2007- \$1,035) has been allocated to operating expenses and capital.



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

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:

	2008	2007
Basic rate applied to income before PILs	33.50%	36.12%
Increase (decrease) in PILs resulting from:		
Tax basis of depreciable capital assets and goodwill in excess of accounting basis	(3.97%)	(2.64%)
Revaluation of Future Tax Liability at 2012 statutory rate of 29.0%	0.31%	3.00%
Items not deductible for tax purposes and other	0.47%	(0.12%)
Effective rate applied to income before PILs	30.31%	36.36%

At December 31, 2008, based on substantively enacted income tax rates, future income tax assets of \$14,255 (2007 - \$14,782) 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.

7) CREDIT SUPPORT FOR SERVICE DELIVERY

Credit support for service delivery comprises:

	2008	2007
Customer deposits	15,303	15,112
Construction deposits	9,489	8,736
Total credit support for service delivery	24,792	23,848



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

8) LONG-TERM BORROWINGS

Long-term borrowings comprise:

	2008	2007
Promissory Note Payable to Horizon Holdings	116,000	116,000
Total long-term borrowings	116,000	116,000

Long-term borrowings comprise a \$116,000 Promissory Note Payable to Horizon Holdings (2007 - \$116,000) bearing interest at 7.0% per annum (2007 - 7.0%), and payable semi-annually on January 30 and July 30. Such promissory note is unsecured and matures on July 30, 2012.

The Corporation incurred interest expense in respect of the promissory note payable to Horizon Holdings of \$8,120 (2007 - \$8,120).

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.

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

	2008	2007
Accrued benefit liability, beginning of year	15,964	15,602
Net benefit expense:		
Current service cost	335	374
Interest cost	1,010	969
Amortization of net actuarial loss	99	138
Net benefit expense for the year	1,444	1,481
Benefits paid for the year	(1,114)	(1,119)
Accrued benefit liability, end of year	16,294	15,964

An actuarial valuation of the plan obligations was completed as at December 31, 2008 resulting in an unamortized net actuarial loss of \$1,467. 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.

Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

9) EMPLOYEE FUTURE BENEFITS (Continued)

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 8% to 4% over four 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	1,364	163
1% decrease in health care trend rate	(1,114)	(156)

b) Interest (discount) rate

The obligations at the period end and the present value of future liabilities were determined using a discount rate of 7.3% 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.

10) NET REGULATORY LIABILITIES

Net regulatory liabilities comprise:

	2008	2007
Settlement variances	19,457	18,803
Smart Meter deferral account	1,998	1,699
Regulatory assets recovery account	6,901	1,024
Other	273	975
Total net regulatory liabilities	28,629	22,501

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



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

10) NET REGULATORY LIABILITIES (Continued)

Settlement variances - represent amounts that have accumulated since January 1, 2007 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.

Smart Meter deferral account – represents the deferral of operating expenditures, capital expenditures and revenues related to Smart Meters in accordance with the direction set out by the OEB.

Regulatory asset recovery account – represents approved regulatory asset balances as at January 1, 2005, consisting of settlement variances and associated interest, less amounts recovered up to December 31, 2006. The recent OEB decision on the 2008EDR Application provided for the disposition of \$7,373 of the Corporation’s net regulatory liabilities over a twenty-nine month period ending April 30, 2011.

11) SHARE CAPITAL

	2008	2007
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 6.5% for employee earnings below the year’s maximum pensionable earnings and 9.6% thereafter. Contributions are expected to remain the same in 2008. During 2008, the Corporation expensed contributions totaling \$1,802 (2007 - \$1,809) made to OMERS in respect of the employer’s required contributions to the plan.



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

13) COMMITMENTS AND CONTINGENCIES

Commitments

Contractual Obligations

Pursuant to the terms of a Connection and Cost Recovery Agreement dated December 10, 2008, the Corporation has committed to upgrade the capacity of one of its transformer stations. The total commitment over a three year period is approximately \$7,278 and the remaining commitment at year-end is approximately \$4,876.

Leases

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

2009	206
Total	206

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.

Class Action

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 ("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 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. It is anticipated that the action will now proceed for determination in light of the reasons of the Supreme Court in the Enbridge class action.



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

13) COMMITMENTS AND CONTINGENCIES (Continued)

Contingencies (continued)

Class Action (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 Supreme Court remitted the matter back to the Ontario Superior Court of Justice for determination of the damages. The parties have reached a settlement of this class action and the settlement has been approved by the Ontario Superior Court of Justice.

On February 4, 2008, the OEB, in response to an application filed by Enbridge, ruled that all of Enbridge's costs related to settlements of the class action lawsuits, including legal costs, settlement cost and interest, are recoverable from ratepayers. The OEB's decision allows Enbridge to recover all amounts over a five year period commencing in 2008.

In May 2008, the representative plaintiff in the class action made a petition to the Lieutenant Governor in Council of Ontario (LGiC) in which he asked the LGiC to require the OEB to reconsider its decision of February 4, 2008 and potentially re-hear the matter. Interested parties have made their submission to the LGiC. It is not clear when the LGiC will make its decision regarding the petition.

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.



Notes to the Financial Statements

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(\$ in thousands)

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:

	2008	2007
Gross customer billings	508,963	523,360
Less: Pass through charges billed by the Corporation		
Electricity charges paid through to generators	(295,462)	(307,041)
Transmission and miscellaneous charges	(57,066)	(59,849)
Market service charges	(32,895)	(34,408)
Debt retirement charges	(35,205)	(37,265)
Total electricity distribution service charges	88,335	84,797

15) OTHER INCOME FROM OPERATIONS

Other income from operations comprises:

	2008	2007
Water and waste water billing and customer care charges	3,262	3,076
Collection and other service charges	1,917	2,382
Pole and other rental income	1,325	1,358
Late payment charges	1,134	1,023
Management and other support services	604	859
Scrap sales	569	571
Miscellaneous	912	523
Total other income from operations	9,723	9,792

16) CAPITAL DISCLOSURES

The main objectives of the Corporation when managing capital are to ensure ongoing access to funding to maintain and improve the electricity distribution system, compliance with covenants related to its credit facilities, prudent management of its capital structure with regard for recoveries of financing charges permitted by the OEB on its regulated electricity distribution business, and to deliver the appropriate financial returns.



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

16) CAPITAL DISCLOSURES (Continued)

The Corporation's definition of capital includes shareholder's equity and long-term debt. As at December 31, 2008, shareholder's equity amounts to \$36,449 (2007 - \$30,262) and long-term debt amounts to \$116,000 (2007 - \$116,000).

The OEB regulates the amount of interest on debt and MARE that may be recovered by the Corporation, through its electricity distribution rates, in respect of its regulated electricity distribution business. The OEB permits such recoveries on the basis of a deemed capital structure represented by 60% debt and 40% equity. The actual capital structure for the Corporation may differ from the OEB deemed structure.

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

Shareholder loans

Pursuant to an Amended Credit Agreement dated January 20, 2006, HUC has made available 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, 2010. 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 ultimate parent company, the City of Hamilton. Other income includes \$3,262 (2007 - \$3,076) earned with respect to this agreement. As at the end of the year, accounts payable and accruals include \$9,443 (2007 - \$10,214) owing to the City of Hamilton for amounts collected on behalf of the City of Hamilton pursuant to this agreement.

The Corporation provides certain management and administrative services to Hamilton Hydro Services Inc. and Horizon Energy Solutions Inc., corporations under common control. Other income includes \$432 (2007 - \$353) earned with respect to these agreements.

On December 31, 2007, pursuant to an intercompany loan agreement, Horizon Energy Solutions Inc., a corporation under common control, borrowed an amount of \$650 from the Corporation. The loan, included in accounts receivable, is payable on demand and bears interest at the rate of 0.5% above the prime rate as determined and posted, from time to time, by the Canadian Imperial Bank of Commerce.

On July 31, 2008, pursuant to an "Asset Purchase Agreement", the Corporation sold assets relating to the meter service provider business to Horizon Energy Solutions Inc. in exchange for a Promissory Note Payable ("Promissory Note") to the Corporation in the amount of \$220. The Promissory Note bears interest at 6.1% per annum on the principal sum, payable semi-annually on the last day of January and July. Such promissory note is unsecured and due on demand by the Corporation.



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

17) RELATED PARTY TRANSACTIONS (Continued)

Revenue (continued)

Interest income includes \$35 (2007 - \$nil) earned with respect to the loan agreement and the promissory note.

Operating expenses

Operating expenses include \$ nil (2007 - \$329) paid to Hamilton Utilities Corporation for certain management and administrative services and \$nil (2007 - \$753) paid to Hamilton Hydro Services Inc. for the provision of certain computer maintenance, telephone services, network and internet services.

Accounts payable

As at the end of the year, accounts payable and accruals include \$ nil (2007 - \$5,749) due to Hamilton Utilities Corporation and \$ nil (2007 - \$1,366) due to St. Catharines Hydro Inc.

18) 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.

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 and 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. One customer, the City of Hamilton, accounts for 3% (2007 - 3%) of revenue. No other single customer in either year would account for revenue in excess of 1% of the respective reported balances.

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, 2008 is \$1,000. No single customer accounts for more than 1% of accounts receivable at year-end.



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

18) FINANCIAL INSTRUMENTS (Continued)

Risk factors (continued)

i) Credit risk (continued)

The Corporation's credit risk associated with accounts receivable is primarily related to payments from distribution customers. At December 31, 2008, approximately \$709 is considered 60 days past due. Horizon Utilities has approximately 290,000 customers, the majority of which are residential. Credit risk is managed through collection of security deposits from customers in accordance with directions provided by the OEB. As at December 31, 2008, Horizon Utilities holds security deposits in the amount of \$24,793 (2007 - \$23,848).

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. Horizon Utilities is exposed to fluctuations in interest rates as the regulated rate of return for the Corporation's distribution business is 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 to ensure access to sufficient funds to meet operational and investing requirements. The Corporation's objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing interest expense. The Corporation has access to a line of credit and monitors cash balances to ensure that sufficient levels of liquidity are on hand to meet financial commitments as they come due.

19) EMERGING ACCOUNTING CHANGES

Rate Regulated Entities

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



Notes to the Financial Statements

December 31, 2008

(\$ in thousands)

19) EMERGING ACCOUNTING CHANGES (Continued)

Goodwill and Intangible Assets and Other Standards

In January 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets, and amended Handbook Section 1000, Financial Statement Concepts, and Accounting Guideline 11 Enterprises in the Development Stage and withdrew Handbook Section 3450, Research and Development Costs. Handbook Section 3064 clarifies that costs may only be deferred when they relate to an item that meets the definition of an asset. The concept of matching revenues and expenses remains appropriate for allocating the cost of an asset that is consumed in general revenue over multiple reporting periods. Handbook Sections 3064 replaces Handbook Section 3062 and provides extensive guidance on when expenditures qualify for recognition as intangible assets. These changes are effective for fiscal years beginning on or after October 1, 2008. The Corporation is currently in the process of evaluating the potential impact of these standards on its financial statements.

International Financial Reporting Standards [“IFRS”]

On February 13, 2008, the AcSB announced that publicly accountable enterprises will be required to change over to IFRS effective January 1, 2011. Some of the converged standards will be implemented in Canada during the transition period with the remaining standards adopted at the change over date. The Corporation has launched an internal initiative to govern the conversion process and is currently in the process of evaluating the potential impact of the conversion to IFRS on its financial statements.

20) COMPARATIVE FIGURES

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