

*crawford
smith &
swallow*

NIAGARA-ON-THE-LAKE HYDRO INC.

Financial Statements

December 31, 2010



NIAGARA-ON-THE-LAKE HYDRO INC.

Financial Statements

December 31, 2010

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INDEPENDENT AUDITORS' REPORT

To the Board Members and Shareholder
of Niagara-on-the-Lake Hydro Inc.

We have audited the accompanying financial statements of Niagara-on-the-Lake Hydro Inc., which comprise the balance sheet as at December 31, 2010, and the statements of operations, retained earnings and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

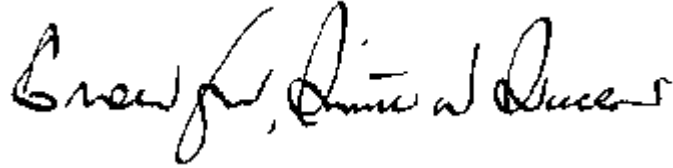
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the 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 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 financial statements present fairly, in all material respects, the financial position of Niagara-on-the-Lake Hydro Inc. as at December 31, 2010, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink, appearing to read "Crawford, Smith and Swallow". The signature is written in a cursive, flowing style.

Niagara Falls, Ontario
April 26, 2011

CRAWFORD, SMITH AND SWALLOW
CHARTERED ACCOUNTANTS LLP
LICENSED PUBLIC ACCOUNTANTS

NIAGARA-ON-THE-LAKE HYDRO INC.

BALANCE SHEET

December 31, 2010

Assets - notes 6, 7 and 17	2010	2009
	\$	\$
Current Assets		
Cash	239,382	336,592
Accounts receivable	2,236,763	1,741,672
Unbilled revenue	1,666,089	1,733,180
Payments in lieu of corporate income taxes receivable	309,480	
Due from affiliated companies - note 2	568,813	810,797
Inventories	218,510	218,184
Prepaid expenses	92,379	78,496
	5,331,416	4,918,921
Property, Plant and Equipment - note 3	19,822,096	20,045,105
Future Payments in Lieu of Corporate Income Tax Assets - note 18	868,570	1,089,824
Other Assets		
Regulatory assets - note 8	1,219,676	
Special deposits	347,483	359,143
Investment - note 4	12,395	9,358
Other assets		1,210
	1,579,554	369,711
	27,601,636	26,423,561

See accompanying notes

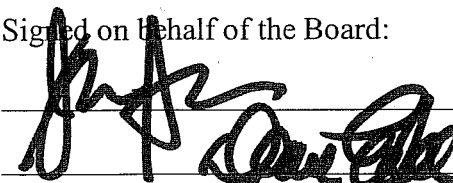
NIAGARA-ON-THE-LAKE HYDRO INC.

BALANCE SHEET

December 31, 2010

Liabilities and Shareholder's Equity	2010	2009
	\$	\$
Current Liabilities		
Demand instalment loans - note 6	3,838,687	3,949,959
Ontario Infrastructure Projects Corporation loan - note 7	1,350,462	
Accounts payable		
Trade	546,159	1,078,016
Independent Electricity System Operator payable	1,243,175	1,047,386
Due to Town of Niagara-on-the-Lake	594,145	500,336
Payments in lieu of corporate income taxes payable		62,828
Other current liabilities	1,124,611	661,505
	8,697,239	7,300,030
Other Liabilities		
Regulatory liabilities - note 8		369,175
Employee future benefits - note 9	454,554	454,765
Customer deposits	347,483	359,143
Accumulated vested sick leave credits	24,509	23,669
Other deposits		24,180
	826,546	1,230,932
Long-Term Note Payable - note 10	5,746,838	6,296,714
Contingent Liabilities - notes 11 and 17		
Shareholder's Equity		
Share capital - note 12	2,632,307	2,632,307
Paid-up capital	4,269,026	4,269,026
Retained earnings	5,429,680	4,694,552
	12,331,013	11,595,885
	27,601,636	26,423,561

Signed on behalf of the Board:

 Director

 Director

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.
STATEMENT OF RETAINED EARNINGS
for the year ended December 31, 2010

	2010	2009
	\$	\$
Retained Earnings, Beginning of Year	4,694,552	3,992,364
Net Income for the Year	735,128	702,188
Retained Earnings, End of Year	5,429,680	4,694,552

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.

STATEMENT OF OPERATIONS

for the year ended December 31, 2010

	2010	2009
	\$	\$
Service Revenue		
Residential energy	6,596,290	5,802,264
General <50kW energy	3,377,535	3,078,345
General >50kW energy	5,578,588	4,865,646
Unmetered scattered load energy	16,149	11,909
Street lighting energy	196,171	144,785
Sentinel lighting energy		2,159
Sales for retailers	993,949	971,072
Non-competitive charges	2,267,971	2,296,921
	19,026,653	17,173,101
Cost of Power		
Power purchased	14,509,994	12,653,763
Gross Margin	4,516,659	4,519,338
Other Income		
Administration expense recovery	8,515	19,575
Other revenue	352,800	183,921
Interest income	42,304	31,365
	403,619	234,861
	4,920,278	4,754,199
Other Expenditure		
Distribution operations	749,248	842,614
Billing and collection	333,308	315,290
General administration	718,665	702,545
Financial expense - note 17	677,459	566,253
Amortization - note 16(a)	1,386,007	1,299,342
	3,864,687	3,726,044
Net Income Before Payments in Lieu of Corporate Income Taxes	1,055,591	1,028,155
Payments in Lieu of Corporate Income Taxes		
Current	99,209	376,432
Future - note 18	221,254	(50,465)
	320,463	325,967
Net Income for the Year	735,128	702,188

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.

STATEMENT OF CASH FLOWS

for the year ended December 31, 2010

	2010 \$	2009 \$
Operating Activities		
Net income for the year	735,128	702,188
Amortization - note 16(a)	1,450,087	1,390,518
Increase (decrease) in employee future benefits	(211)	1,855
Increase in accumulated vested sick leave credits	840	
Future payments in lieu of corporate income taxes - note 18	221,254	(50,465)
Working capital provided by operations	2,407,098	2,044,096
Changes in non-cash working capital components - note 13 (a)	887,504	(348,217)
Funds provided by operating activities	3,294,602	1,695,879
Investing Activities		
Additions to property, plant and equipment - note 13(b)	(1,227,078)	(2,035,953)
Increase (decrease) in regulatory liabilities - note 8	(1,588,851)	8,786
Decrease in special deposits	11,660	103,531
Increase in investment	(3,037)	(9,358)
Decrease in other assets	1,210	
Funds used by investing activities	(2,806,096)	(1,932,994)
Financing Activities		
Repayment of long-term note payable	(549,876)	(269,619)
Other Activities		
Decrease in customer deposits	(11,660)	(103,531)
Decrease in other deposits	(24,180)	(19,000)
Funds used by other activities	(35,840)	(122,531)
Decrease in Cash	(97,210)	(629,265)
Cash, Beginning of Year	336,592	965,857
Cash, End of Year	239,382	336,592

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

Incorporation

On July 1, 2000, Niagara-on-the-Lake Hydro Inc. (the "company") was incorporated under the Business Corporations Act (Ontario) along with its affiliated companies, Niagara-on-the-Lake Energy Inc. and Energy Services Niagara Inc. The incorporation was pursuant to the provisions of the Energy Competition Act, 1998.

1. Accounting Policies

These financial statements of Niagara-on-the-Lake Hydro Inc. have been prepared in accordance with Canadian generally accepted accounting principles. The company is a wholly-owned subsidiary of Niagara-on-the-Lake Energy Inc.

Regulation

The Ontario Energy Board Act (Ontario), 1998 ("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 the rate-setting process.

Rate setting

The distribution rates of the company 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.

The OEB regulates the electricity distribution rates charged by an Ontario municipal electric utility ("LDC") using a combination of annual incentive rate mechanisms ("IRM") adjustments and periodic cost of service reviews. Both such adjustments and reviews are based on applications made by LDC's to the OEB. The current ratemaking policy of the OEB requires a cost of service review every four years, followed by three successive years of IRM adjustments.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

1. Accounting Policies - continued

Regulatory accounting

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-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 company'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 company's regulatory liabilities represent costs with respect to non-distribution market related charges and variances that are expected to be settled in future periods. Specific regulatory assets and liabilities are disclosed in note 8.

Inventories

Inventories are measured at the lower of cost, (first in, first out) and net realizable value.

Property, plant and equipment

Property, plant and equipment are stated at cost and removed from the accounts when disposed or retired. Costs of assets which are pooled are removed from the accounts at the end of their estimated average service lives. Gains or losses at retirement or disposition of such assets are credited or charged to other income.

Amortization is provided for property, plant and equipment using the straight-line method based on the following estimated service lives:

Buildings	25 to 50 years
Transformer stations	40 years
Distribution stations	30 years
Distribution lines	25 years
Distribution transformers and meters	25 years
Other capital assets	3 to 15 years
Intangible assets	20 years

Other assets

Expenditures made which may benefit future periods are recorded as other assets.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

1. Accounting Policies - continued

Investment

The company's investment is accounted for using the cost method.

Customer deposits

Customer deposits are cash collections from customers to guarantee the payment of electricity bills. Deposits expected to be refunded to customers within the next fiscal period are classified as a current liability.

Employee future benefits

The company pays certain medical, dental and life insurance benefits on behalf of its retired employees. The company recognizes these post-retirement costs in the period in which the employees render the services. The excess of net actuarial gains (losses) over 10% of the actual benefit obligation are amortized over the expected average remaining service life of the active employees. See note 9.

Paid-up capital

Paid-up capital reflects the balance of capital contributions received by the former Niagara-on-the-Lake Hydro-Electric Commission prior to January 1, 2000.

Revenue recognition

Service revenue is recorded as revenue in the period to which it relates. Service revenue from the sale of electrical energy includes an estimated accrual for power supplied but not billed to customers from the last meter reading date to the year end.

Capitalized interest

The company capitalizes an amount of interest on all funds expended and deferred as regulatory assets/liabilities. See note 16(b).

Payments in lieu of corporate income taxes and capital taxes

The company is currently exempt from corporate income taxes under the Income Tax Act (Canada) and Ontario Taxation Act.

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

Future income taxes reflect the tax consequences of "temporary differences" between the balance sheet carrying amounts and the tax bases of assets and liabilities. These temporary differences are determined in accordance with Handbook Section 3465.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

1. Accounting Policies - continued

Financial instruments

The company has classified its financial instruments as follows:

Cash is classified as "assets held for trading".

Accounts and other receivables and regulatory assets are classified as "loans and receivables".

Demand instalment loans, Ontario Infrastructure Projects Corporation loan, accounts payable and other accrued liabilities, regulatory liabilities, customer deposits, accumulated sick leave credits and long-term note payable are classified as "other financial liabilities".

The company is required 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 - Quoted prices in active markets for identical assets or liabilities;

Level 2 - Quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets or quoted prices that are derived principally from or corroborated by observable market data or other means;

Level 3 - Unobservable inputs that are supported by little or no market activity.

Measurement uncertainty

The preparation of financial statements in conformity with Canadian 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 inherent uncertainty in making estimates, actual results could differ from these estimates recorded in preparing these financial statements including changes as a result of future regulatory decisions.

Accounts receivable, unbilled revenue and regulatory assets/liabilities 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.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

2. Due From Affiliated Companies

	2010 \$	2009 \$
Niagara-on-the-Lake Energy Inc.	4,655	4,622
Energy Services Niagara Inc.	564,158	806,175
	568,813	810,797

The balance due from Niagara-on-the-Lake Energy Inc. is non-interest bearing with no fixed terms of repayment. The balance due from Energy Services Niagara Inc. bears interest at a variable rate and at year end was prime plus 0.15%. Interest charged for the year amounted to \$ 22,641 (\$ 18,126 - 2009).

3. Property, Plant and Equipment

	Cost \$	Accumulated Depreciation \$	2010 \$	2009 \$
Land	307,134		307,134	307,134
Buildings	994,976	334,383	660,593	653,170
Transformer stations	5,399,696	846,513	4,553,183	4,668,127
Distribution stations	160,630	106,566	54,064	57,133
Distribution overhead lines	10,976,898	6,438,512	4,538,386	4,487,411
Distribution underground lines	11,284,628	5,510,832	5,773,796	5,681,307
Distribution transformers	5,483,213	2,995,153	2,488,060	2,611,796
Distribution meters	1,064,727	668,505	396,222	401,240
Equipment and trucks	4,011,047	2,982,515	1,028,532	933,335
Other	25,038	12,727	12,311	13,563
Work in progress	9,815		9,815	230,889
	39,717,802	19,895,706	19,822,096	20,045,105

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

4. Investment

	2010	2009
	\$	\$
100 common shares of Utility Collaborative Services Inc. ("UCS") - at cost	100	100
Payments and costs incurred on behalf of UCS	12,295	9,258
	12,395	9,358

In 2009, the company acquired a 12.5% interest in UCS. The purpose of this company is to provide billing system support services for the company. Payments and costs incurred on behalf of UCS are not specifically refundable.

5. Related Party Transactions

During the period, Niagara-on-the-Lake Hydro Inc. provided operation and administration services to its affiliates in the normal course of business in the following amounts:

	2010	2009
	\$	\$
Energy Services Niagara Inc.	233,692	174,303

In the ordinary course of business, the company enters into transactions with the Town of Niagara-on-the-Lake (the "Town") including its boards and agencies. The company derives revenues from the sale of electricity and recovers costs of supplying electrical equipment and distribution system from these related parties. Purchases from related parties take place at fair market value. Account balances resulting from these transactions which are included in the balance sheet are settled in accordance with normal trade terms.

Interest paid on the long-term note payable is disclosed in note 10.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

6. Demand Instalment Loans

	2010 \$	2009 \$
Demand instalment loan, bearing interest at prime plus 0.75 %, repayable in monthly instalments of \$ 15,556, due August 2013	1,890,776	1,934,867
Demand instalment loan, bearing interest at prime plus 0.75 %, repayable in monthly instalments of \$ 13,333, due August 2015	1,947,911	2,015,092
	3,838,687	3,949,959

The security for the demand instalment loans, operating line, and letters of credit is a general security agreement in the first position, including an assignment of accounts receivable and finished goods and a floating charge over all tangible properties subject to a third party agreement with Ontario Infrastructure Projects Corporation limiting this interest to \$ 7,500,000 in specific borrowings. There are unlimited guarantees provided by Niagara-on-the-Lake Energy Inc. and Energy Services Niagara Inc. Finally, an assignment and postponement of claim provided by the Corporation of the Town of Niagara-on-the-Lake in an amount that is unlimited.

Repayment terms for the demand instalment loans have been negotiated for an amortization period of fifteen years. The principal payments due over the next five years are as follows:

	\$
2011	326,317
2012	344,118
2013	362,890
2014	382,686
2015	403,562

7. Ontario Infrastructure Projects Corporation ("OIPC") Loan

This is a construction loan bearing interest between 0.95% and 1.75% for the period, interest only repayable monthly and due December, 2014 or until such time as it is converted into a debenture loan. The security for the loan is a general security agreement in the second position, including an assignment of accounts receivable, inventory, equipment, chattel paper, instruments and securities, intangibles, books and accounts, real property and proceeds. In addition, guarantees have been provided by Niagara-on-the-Lake Energy Inc. and Energy Services Niagara Inc.

Subsequent to year-end, the company completed the drawings on this construction loan which resulted in a final outstanding balance of \$ 1,500,000. The Board of Directors then approved the conversion to a debenture loan which is to bear interest at 4.27%, repayable in monthly principle instalments of \$ 8,333 plus interest and due February, 2026.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

8. Regulatory Liabilities (Assets)

The OEB has established in its Electricity Distribution Rate Handbook and its Accounting Procedures Handbook for Electricity Distribution Utilities provisions for recording deferral and variance account regulatory assets or liabilities on the company's balance sheet. Deferral and variance account regulatory assets/liabilities primarily represent costs that have been deferred in anticipation of future cost recoveries as determined by the OEB.

Settlement variances represent amounts that have accumulated since January 1, 2007 and are comprised of:

-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 company based on OEB approved wholesale market service rates

-variances between the amounts charged by the IESO for energy community costs and the amounts billed to customers by the company based on OEB approved rates

Smart meter deferral accounts are comprised of the deferral of operating expenditures, capital expenditures and revenues related to Smart meters in accordance with direction set out by the OEB. Smart meters permit consumption to be recorded within specific time intervals and specific tariffs to be levied within such intervals.

As part of the OEB's 2009 rate application process, the recovery through distribution rates of specific amounts of the company's deferral and variance account regulatory asset balances as at December 31, 2007 was approved and is to be recovered over a four year period commencing May 1, 2009.

As part of the OEB's 2010 rate application process, the recovery through distribution rates of specific amounts of the company's deferral and variance account regulatory asset balances as at December 31, 2008 was approved and is to be recovered over a one year period commencing May 1, 2010.

As at December 31, 2010, the company has accumulated \$ (1,219,676) (\$ 369,175 - 2009) in net regulatory (assets)/liabilities on the balance sheet as other assets/liabilities. It is management's belief that these assets/liabilities are consistent with the OEB's deferral criteria.

	2010	2009
	\$	\$
Deferred PILS variances	110,085	109,387
Settlement variances	349,980	753,614
Renewable generation connection and Smart grid development deferral accounts	(287,804)	(18,126)
Other deferral accounts	20,537	35,349
Smart meter deferral accounts	(1,412,474)	(511,049)
	(1,219,676)	369,175

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

9. Employee Future Benefits

Defined Benefit Plan Information	2010 \$	2009 \$
Employee benefit plan assets		
Employee benefit plan liabilities	369,722	366,223
Employee benefit plan deficit	369,722	366,223
Unamortized actuarial gain	84,832	88,542
Accrued benefit obligation, end of year	454,554	454,765
	2010 \$	2009 \$
Accrued benefit obligation, beginning of year	454,765	452,910
Expense for the year	30,428	28,934
Amortization of gain	(3,709)	(6,316)
Benefits paid during the year	(26,930)	(20,763)
Accrued benefit obligation, end of year	454,554	454,765

An actuarial valuation was done for the year ending December 31, 2009.

As at December 31, 2010 the actual benefit obligation was \$ 369,722 with unamortized gain of \$ 84,832 which is being amortized over an expected average remaining service life of 15 years.

The main actuarial assumptions employed for the valuation are as follows:

General Inflation - Future general inflation levels, as measured by changes in the Consumer Price Index (CPI), were assumed at 2.0% in 2009 and thereafter.

Interest (Discount) Rate - The present value of future liabilities and the expense were determined using discount rates of 6.0%.

Salary Levels - Future general salary and wage levels were assumed to increase at 3.3% per annum.

Medical Costs - Medical costs were assumed to be 9% for 2009, decreasing by approximately 0.65% annually until 2015 where it has been graded down to 5% and 5% thereafter.

Dental Costs - Dental costs were assumed to be 5% in 2009 and thereafter.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

10. Long-Term Note Payable

Long-term note payable to the Town of Niagara-on-the-Lake, interest is payable at 7.25% and amounts paid and accrued for the year amounted to \$ 450,470 (\$ 473,475 - 2009). During the year, there were repayments of \$ 549,876 (\$ 269,619 - 2009) to the Town. The long-term note payable is unsecured and there are no fixed terms of repayment.

11. Contingent Liability

Class Action

Pursuant to its order dated July 22, 2010 (the "Order"), the Ontario Superior Court Justice approved the settlement of a class action lawsuit. This action was brought under *Class Proceedings Act*, 1992. The plaintiff class sought \$ 500 million in restitution for amounts paid to Toronto Hydro and to other LDC's who received late payment penalties which constitute interest at an effective rate in excess of 60% per year, contrary to section 347 of the *Criminal Code*.

The Order formalized a settlement pursuant to which all defendant LDC's will pay the amount of \$ 17 million plus costs and taxes in settlement of all claims. The amount allocated for each LDC is based on its percentage of electricity distribution service revenue, relative to that of the entire class, over the period for which it had exposure for repayment of late payment penalties exceeding the interest rate limit set out in the *Criminal Code*. The company's share of the settlement is \$ 24,801.

Under the terms of the settlement, all LDC's, including the company, 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 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.

Subsequent to this decision, the Board of Directors proceeded on its own motion with management's agreement to remove the rate rider and the company will pay \$ 24,801 by June 30, 2011.

12. Share Capital

Authorized

Unlimited number of common shares

Issued

1,001 common shares

	2010	2009
	\$	\$
	2,632,307	2,632,307

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

13. Statement of Cash Flows

(a) Changes in working capital components include:

	2010	2009
	\$	\$
Accounts receivable	(495,091)	(56,306)
Unbilled revenue	67,091	52,616
Payments in lieu of taxes receivable	(372,308)	35,125
Due from affiliated companies	241,984	129,279
Inventories	(326)	(104)
Prepaid expenses	(13,883)	(34,672)
Demand instalment loans	(111,272)	(429,543)
Ontario Infrastructure Projects Corporation loan	1,350,462	
Accounts payable	(242,259)	(19,422)
Other current liabilities	463,106	(25,190)
	887,504	(348,217)

(b) Acquisition of capital assets

During the period, capital assets were acquired in the amount of \$ 1,527,248. Capital contributions received from third parties amounted to \$ 300,170. Cash payments of \$ 1,227,078 were made to purchase capital assets.

(c) Interest and payments in lieu of taxes

	2010	2009
	\$	\$
Interest received	5,065	8,359
Interest paid	633,066	647,213
Payments in lieu of taxes paid	471,517	352,795

14. Pension Agreement

The company makes contributions to the Ontario Municipal Employees Retirement Systems ("OMERS"), which is a multi-employer plan, on behalf of approximately 19 members of its staff. The plan is a defined benefit plan which specifies the amount of the retirement benefit to be received by the employees based on the length of service and rates of pay.

The amount contributed to OMERS for 2010 was \$ 90,135 (\$ 82,558 - 2009) for current service.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

15. General Liability Insurance

The company is a member of the Municipal Electric Association Reciprocal Insurance Exchange ("MEARIE") which is a pooling of general liability insurance risks. Members of MEARIE would be assessed, on a pro-rata basis, based on the total of their respective deposit premiums should losses be experienced by MEARIE, in excess of reserves and supplementary insurance, for the years in which the company or the former Niagara-on-the-Lake Hydro-Electric Commission was a member.

Participation in MEARIE covers a three year underwriting period which expires January 1, 2011. To December 31, 2010, the company has not been made aware of any additional assessments.

16. Other Information

(a) Amortization

	2010	2009
	\$	\$
Amortization of capital assets charged to operations	1,386,007	1,299,342
Amortization of capital assets charged to operating assets	64,080	91,176
	1,450,087	1,390,518

(b) Capitalized Interest

	2010	2009
	\$	\$
Capitalized interest	(64,977)	6,956

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

17. Financial Instruments

Recognition and Measurement

Level 1 - The fair value of cash and bank advances, accounts receivable, accounts payable and accrued liabilities, demand instalment loans and customer deposits and accumulated sick leave credits correspond to their carrying values due to their short term maturity.

Level 3 - It is not practicable to determine the fair value of the long-term note payable to the Town of Niagara-on-the-Lake or the Ontario Infrastructure Projects Corporation loan due to the limited amount of comparable market information available.

Credit Risk

The company in the normal course of business monitors the financial condition of its customers and reviews the credit history of new customers. The company is currently holding customer deposits on hand in the amount of \$ 347,483 (\$ 359,143 - 2009) and is reflected on the balance sheet. Allowances are also maintained for potential credit losses. Management believes that it has adequately provided for any exposure to normal customer credit risk.

Liquidity Risk

Liquidity risk is the risk that the company will not be able to meet its financial obligations as they fall due. The company's approach to managing liquidity risk is to ensure that it always has sufficient cash and credit facilities to meet its obligations when due.

The company manages this risk by developing cash forecasts as well as the annual preparation of a 12 month operating plan and the annual preparation of a 60 month capital plan.

Interest Rate Risk

The demand instalment loans bear interest at floating rates and thus, the carrying values approximates fair values.

However, the company has entered into two fair value swap transactions, with the intent of fixing the interest rate on the first \$ 1,890,776 demand instalment loan at 6.03% and the second \$ 1,947,911 demand instalment loan at 5.38% to the final maturity dates of August, 2018 and October, 2020 respectively.

The fair value of the interest rate swap agreements are based on amounts quoted by CIBC to realize favourable contracts or settle unfavourable contracts, taking into account interest rates as at December 31, 2010. At December 31, 2010 the interest rate swap was in a net unfavourable position of \$ 355,511 (\$ 157,346 - 2009). This unfavourable amount has been included in the demand instalment loan balance. During the year, the company monetized the "optionality" component of the swap and received \$ 200,800 in lieu of giving up the right to paydown the swaps before their maturity date. This amount was charged to the fair value component of the swap. Therefore, the net current year impact of the change in fair value of the interest rate swap included in the statement of operations is an increase (decrease) in financial expense of \$ 2,635 ((\$ 136,112) - 2009).

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

17. Financial Instruments - continued

Operating Line of Credit

As at December 31, 2010, the company had a line of credit of \$ 2,000,000 of which NIL had been drawn down. The line of credit consists of revolving operating and term facilities that bear interest at prime rate plus 0.15% and are covered under the security issued for the demand instalment loans as described in note 6.

Letters of Credit/Guarantees

The company had arranged for a total letter of credit or guarantee in the amount of \$ 1,200,000. As at December 31, 2010, \$ 1,181,408 is available to the IESO of which NIL had been drawn upon. This is to provide a prudential letter of credit in support of the purchase of electrical power from the IESO. Any draw under this facility will be converted into a capital loan facility with a monthly repayment program to be negotiated. This facility is covered under the security issued for the demand instalment loans as described in note 6.

18. Payments in Lieu of Corporate Income Taxes

Temporary differences and carryforwards which give rise to future payments in lieu of corporate income tax assets and liabilities are as follows:

	2010 \$	2009 \$
Future payments in lieu of corporate income tax assets:		
Property, plant and equipment	1,179,104	739,646
Employee future benefits	113,639	113,691
Regulatory liabilities (assets)	(424,173)	236,487
	868,570	1,089,824
Distributed as such:		
Future payments in lieu of corporate income income tax assets - non-current	868,570	1,089,824
	868,570	1,089,824

19. Asset Retirement Obligations

The company has identified asset retirement obligations relating to future site remediation costs for three different distribution station sites in the Niagara-on-the-Lake area. Once a site has been decommissioned, it will require remediation prior to sale. At this time, some of the sites have been decommissioned and therefore require remediation. However, since the remediation will not be done until the site is put up for sale, sufficient information is not available at this time to determine the fair value of the remediation costs. The liability will be recognized in the period that sufficient information exists to make a reasonably accurate estimate of the amount.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

20. Capital Management

The company's main objectives when managing capital are to:

- ensure ongoing access to funding to maintain and improve the electricity distribution system, and to meet any capital needs of its other related companies should the need arise
- ensure compliance with covenants related to its credit facilities, demand loan payable and the Town note

The company's definition of capital includes shareholder's equity and long term debt which includes demand instalment loans, OIPC loan and the long-term note payable. As at December 31, 2010 shareholder's equity amounts to \$ 12,331,013 (2009 - \$ 11,595,885) and long-term debt amounts to \$ 10,935,987 (2009 - \$ 10,246,673). The company's capital structure as at December 31, 2010 is 47% debt and 53% equity (2009 - 47% debt and 53% equity). There have been no changes in the company's approach to capital management during the year.

As at December 31, 2010 the company is subject to a debt agreement that contains the following covenants:

- the company is to maintain a debt to capitalization ratio that at any time does not exceed 0.65 to 1
- the company is to maintain a interest coverage ratio of not less than 2.25 to 1 at any time, calculated as EBITDA divided by interest expense
- the operating line facility must have no outstanding debt or liability for at least one day per annum.
- there are several negative covenants to meet such as adequate insurance is to be maintained, there is to be no lien of any of the present or future assets of the company, the company must not assign any right to income, without prior consent.

In addition, as at December 31, 2010 the company is subject to a second debt agreement that contains the following covenants:

- the company is to maintain a debt service coverage ratio of 1 to 1 or higher for the term of the agreement
- the company is to maintain a debt to capital ratio at 60% or lower for the term of this agreement
- the company is to maintain its current ratio at 1.1 to 1 or higher for the term of this agreement
- there are several negative covenants to be maintained.

As at December 31, 2010 and as at December 31, 2009, the company was in compliance with all covenants included in its OIPC loan, long-term note payable, demand instalment loans, operating line and letter of credit.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2010

21. Emerging Accounting Changes

International Financial Reporting Standards

On February 13, 2008 the AcSB confirmed that publicly accountable enterprises will be required to adopt International Financial Reporting Standards ("IFRS") in place of Canadian GAAP for reporting purposes for fiscal years beginning on or after January 1, 2011. A limited number of converged standards will be incorporated into Canadian GAAP prior to 2011, with the remaining standards to be adopted at the change over date. Management has begun the process of determining the impact of the new standards on the financial position of the company. At this time, the impact on the company's future financial position and results of operations is not fully determinable or estimable.