

NIAGARA-ON-THE-LAKE HYDRO INC.

Financial Statements

December 31, 2005

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Crawford, Smith and Swallow
Chartered Accountants LLP

4741 Queen Street
Niagara Falls, Ontario
L2E 2M2
Telephone (905) 356-4200
Telecopier (905) 356-3410

*crawford
smith &
swallow*

Offices in:
Niagara Falls, Ontario
St. Catharines, Ontario
Fort Erie, Ontario
Niagara-on-the-Lake, Ontario
Port Colborne, Ontario

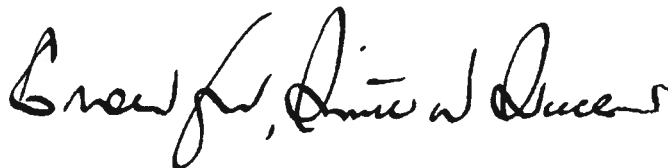
AUDITORS' REPORT

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

We have audited the balance sheet of Niagara-on-the-Lake Hydro Inc. as at December 31, 2005 and the statements of operations, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.



Niagara Falls, Ontario
June 7, 2006

CRAWFORD, SMITH AND SWALLOW
CHARTERED ACCOUNTANTS LLP

NIAGARA-ON-THE-LAKE HYDRO INC.

BALANCE SHEET

December 31, 2005

Assets - notes 8 and 16	2005	2004
	\$	\$
Current Assets		
Cash and cash equivalents	955,069	320,745
Accounts receivable	1,916,762	1,364,759
Unbilled revenue	1,812,641	1,653,730
Due from affiliated companies - note 2	389,139	152,095
Note receivable - note 3	298,750	298,750
Inventories	206,640	154,312
Prepaid expenses	66,624	67,207
	5,645,625	4,011,598
Capital Assets		
Land	308,794	187,798
Buildings	845,924	844,853
Transformer stations	4,816,646	2,707,538
Distribution stations	242,132	242,132
Distribution overhead lines	9,253,890	8,794,357
Distribution underground lines	8,749,155	8,356,808
Distribution transformers	4,673,085	4,671,814
Distribution meters	976,441	930,800
Equipment	2,803,899	2,558,375
Other	25,038	25,038
	32,695,004	29,319,513
Less accumulated amortization	13,760,243	12,700,807
	18,934,761	16,618,706
Other Assets		
Special deposits	316,737	214,335
Long-term investments- note 6	48,877	49,884
Other assets	11,600	
	377,214	264,219
	24,957,600	20,894,523

See accompanying notes

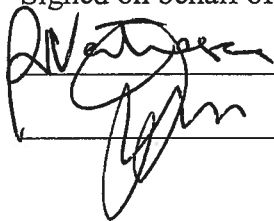
NIAGARA-ON-THE-LAKE HYDRO INC.

BALANCE SHEET

December 31, 2005

Liabilities and Shareholder's Equity	2005 \$	2004 \$
Current Liabilities		
Demand instalment loans - note 8	4,878,362	2,630,760
Accounts payable		
Trade	592,629	619,371
Independent Market Operator payable	1,095,306	998,547
Hydro One payable	184,100	136,724
Due to Town of Niagara-on-the-Lake	187,205	
Payments in lieu of taxes corporate payable	4,905	87,398
Other current liabilities	648,293	448,415
	7,590,800	4,921,215
Other Liabilities		
Regulatory liabilities - note 5	1,730,008	886,784
Employee future benefits - note 7	447,634	431,854
Customer deposits	316,737	214,335
Accumulated vested sick leave credits	19,361	19,361
Other deposits	39,848	39,848
	2,553,588	1,592,182
Long-Term Note Payable - note 9	6,901,333	6,901,333
Contingent Liabilities - notes 14 and 16		
Shareholder's Equity		
Share capital - note 10	2,632,307	2,632,307
Paid-up capital	4,269,026	4,269,026
Retained earnings	1,010,546	578,460
	7,911,879	7,479,793
	24,957,600	20,894,523

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, 2005

	2005	2004
	\$	\$
Retained Earnings, Beginning of Year	578,460	675,441
Net Income (Loss) for the Year	432,086	(96,981)
Retained Earnings, End of Year	1,010,546	578,460

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.**STATEMENT OF OPERATIONS**

for the year ended December 31, 2005

	2005 \$	2004 \$
Service Revenue		
Residential energy	5,342,110	4,498,726
General <50 energy	2,755,202	2,565,448
General >50 energy	5,388,650	4,206,334
Street lighting energy	85,633	70,453
Sentinel lighting energy	8,614	13,880
Sales for retailers	515,630	675,124
Non-competitive charges	2,897,159	2,545,573
Transformation services	148,193	59,626
	17,141,191	14,635,164
Cost of Power		
Power purchased	13,363,281	11,451,066
Gross Margin	3,777,910	3,184,098
Other Income		
Administration expense recovery	4,836	4,148
Other revenue	102,503	106,208
Interest income	(16,341)	16,635
	90,998	126,991
	3,868,908	3,311,089
Other Expenditure		
Distribution operations	550,613	612,760
Billing and collection	297,737	294,158
General administration	583,612	568,627
Financial expense	699,394	678,861
Amortization - note 15(a)	1,084,878	1,074,164
	3,216,234	3,228,570
Net Income Before Payments in Lieu of Taxes	652,674	82,519
Payments in Lieu of Taxes	220,588	179,500
Net Income (Loss) for the Year	432,086	(96,981)

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.**STATEMENT OF CASH FLOWS**

for the year ended December 31, 2005

	2005 \$	2004 \$
Operating Activities		
Net income (loss) for the year	432,086	(96,981)
Amortization - note 15(a)	1,132,564	1,131,385
Loss (gain) on disposal of capital assets	(14,535)	11,995
Working capital provided by operations	1,550,115	1,046,399
Changes in non-cash working capital components - note 11 (a)	1,669,882	(190,095)
Funds provided by operating activities	3,219,997	856,304
Investing Activities		
Proceeds on disposal of capital assets	20,343	
Additions to capital assets - note 11(b)	(3,454,427)	(1,311,024)
Increase in regulatory liabilities - note 5	843,224	829,582
Increase in special deposits	(102,402)	(84,208)
Decrease (increase) in long-term investment	1,007	(3,653)
Increase in other assets	(11,600)	
Funds used by investing activities	(2,703,855)	(569,303)
Other Activities		
Increase in future employee benefits	15,780	16,509
Increase in customer deposits	102,402	84,208
Funds provided by other activities	118,182	100,717
Increase in Cash and Cash Equivalents	634,324	387,718
Cash and Cash Equivalents, Beginning of Year	320,745	(66,973)
Cash and Cash Equivalents, End of Year	955,069	320,745

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

Incorporation

On July 1, 2000, Niagara-on-the-Lake Hydro Inc. was incorporated under the Business Corporations Act (Ontario) along with its affiliate 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.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the year. Actual results could differ from estimates, including changes as a result of future decisions made by the Ontario Energy Board ("OEB") or the Minister of Energy.

Cash and cash equivalents

Cash equivalents are readily convertible investments with maturities of three months or less. Investments are recorded at the lower of cost and market.

Inventories

Inventory is valued at average cost with allowances for obsolete stock.

Capital assets

Capital assets 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 capital assets 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. See Regulatory Assets, note 5.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

1. Accounting Policies - continued

Investment

The company's investment in a limited liability partnership is accounted for using the equity method. The initial investment is recorded at cost and the carrying value adjusted thereafter to include the pro-rata share of income and losses.

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. The impact of the year end change in this estimated accrual is included in service revenue in the Statement of Operations.

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 rendered 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 7.

Capitalized interest

The company capitalizes an amount of interest on all funds expended and deferred as regulatory assets. See note 15(b).

Payments in lieu of taxes and capital taxes

Under the Electricity Act, 1998, the company is required to make payments in lieu of taxes to Ontario Electricity Financial Corporation ("OEFC"), commencing October 1, 2001. 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 Corporations Tax Act (Ontario) as modified by the Electricity Act, 1998, and related regulations.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

1. Accounting Policies - continued

Payments in lieu of taxes and capital taxes - continued

The company provides for payments in lieu of taxes using the taxes payable method. Under the taxes payable method, no provisions are made for future payments in lieu of taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future payments in lieu of taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of Niagara-on-the-Lake Hydro Inc.

2. Due From Affiliated Companies

	2005 \$	2004 \$
Niagara-on-the-Lake Energy Inc.	22,516	17,992
Energy Services Niagara Inc.	366,623	134,103
	389,139	152,095

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 less 0.5%. Interest charged for the year amounted to \$ 10,861.

3. Note Receivable

The company has a note receivable due from Energy Services Niagara Inc. The note receivable bears interest at 7.25% with no fixed terms of repayment. Interest charged for the year amounted to \$ 21,659.

4. 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:

	2005 \$	2004 \$
Energy Services Niagara Inc.	185,928	71,685

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.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

5. Regulatory Assets (Liabilities)

The OEB has established in its Electricity Distribution Rate Handbook and its Accounting Procedures Handbook for Electricity Distribution Utilities provisions for recording regulatory assets/liabilities on the company's Balance Sheet.

Regulatory assets/liabilities primarily represent costs that have been deferred in anticipation of future cost recoveries as determined by the OEB. The costs include transition costs to prepare the utility for the competitive electricity market, pre and post market opening settlement variances related to the supply of energy to retailers and standard supply service customers, deferred payments in lieu taxes ("PILS") representing the difference between PILS revenue entitlements and PILS collections and retailer cost variances.

As part of the OEB's 2006 rate application process, the recovery through distribution rates of specific amounts of the company's regulatory asset/liability balances as at December 31, 2004 was approved and is expected to be recovered over a two year period commencing May 1, 2006.

As at December 31, 2005, the company has accumulated \$ (1,730,008) (\$ (886,784) - 2004) in net regulatory liabilities on the balance sheet as other liabilities. It is management's belief that these assets are consistent with the OEB's deferral criteria.

	2005 \$	2004 \$
Qualifying Transition Costs	216,694	288,719
Pre-Market Opening Variances	162,421	153,319
Deferred PILS Variances	(52,867)	(206,668)
RSVA & RCVA Variances	(670,084)	(171,067)
Other Deferred Variances	11,797	11,089
Conservation and Demand Management		39,975
Regulatory Asset Recovery	(315,221)	(111,361)
Deferred Charges - HVDS - note 18	(1,082,748)	(890,790)
	(1,730,008)	(886,784)

6. Long-Term Investments

The company has committed \$ 36,000 to a partnership known as the ENERconnect Limited Partnership as a limited partner. This partnership will carry on the business of procuring power on behalf of, and providing services relating to power procurement to limited partners and other third parties who are not.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

7. Employee Future Benefits

Defined Benefit Plan Information

	2005 \$	2004 \$
Employee benefit plan assets		
Employee benefit plan liabilities	397,324	379,668
Employee benefit plan deficit	397,324	379,668
Unamortized actuarial gain	50,310	52,186
Accrued benefit obligation, end of year	447,634	431,854

	2005 \$	2004 \$
Accrued benefit obligation, beginning of year	431,854	415,345
Expense for the year	43,149	43,174
Amortization of gain	(1,876)	(1,876)
Benefits paid during the year	(25,493)	(24,789)
Accrued benefit obligation, end of year	447,634	431,854

An actuarial valuation was last done for the year ending December 31, 2003.

As at December 31, 2005, the actual benefit obligation was \$ 397,324 with unamortized gain of \$ 50,310. The unamortized balance in excess of the 10% minimum amortization threshold is \$ 18,760. This amount is being amortized over the expected average remaining service life of the employee group, which in this case, is 10 years, or \$ 1,876 per annum.

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 2.2% in 2003 and thereafter.

Interest (Discount) Rate - The present value of future liabilities and the expense were determined using discount rates of 6.0% and 5.5% respectively. This corresponds to the assumed CPI rate plus an assumed real rate of return of 3.8% and 3.3%, respectively.

Salary Levels - Future general salary and wage levels were assumed to increase at 3.5% per annum.

Medical Costs - Medical costs were assumed to increase at the CPI rate plus a further increase of 12.8% in 2003 graded down to 2.8% in 2013 and thereafter.

Dental Costs - Dental costs were assumed to increase at the CPI rate plus a further increase of 2.8% in 2003 and thereafter.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

8. Demand Instalment Loans

	2005 \$	2004 \$
Demand instalment loan, bearing interest at prime plus 0.75 %, repayable in monthly instalments of \$ 15,558 due August, 2008	2,495,796	2,630,760
Demand instalment loan, prime less 0.5 %, repayable in monthly instalments of \$ 13,333, due August 2010	2,382,566	
	4,878,362	2,630,760

The security for the demand instalment loans, bank advances, and letters of credit is a general security agreement, including an assignment of accounts receivable and finished goods and a floating charge over all tangible properties. Under the terms of the credit facility, the company must maintain certain financial covenants and ratios.

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

	\$
2006	346,692
2007	346,692
2008	2,282,400
2009	159,996
2010	1,742,582

9. Long-Term Note Payable

On November 1, 2000, Niagara-on-the-Lake Hydro Inc. incurred a long-term note payable to the Town of Niagara-on-the-Lake in the amount of \$ 6,901,333. Pursuant to the transfer by-law, the long-term note payable was issued as a non-interest bearing instrument pending the establishment of permanent terms. There is no immediate intent to redeem the long-term note payable.

Effective March 1, 2001, interest is payable at 7.25% and amounts paid and accrued for the year amounted to \$ 500,347 (\$ 500,347 - 2004).

10. Share Capital

Authorized

Unlimited number of common shares

	2005 \$	2004 \$
Issued		
1,001 common shares	2,632,307	2,632,307

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

11. Statement of Cash Flows

(a) Changes in working capital components include:

	2005 \$	2004 \$
Accounts receivable	(552,003)	(133,805)
Unbilled revenue	(158,911)	(407,504)
Due from affiliated companies	(237,044)	(132,309)
Note receivable		(168,750)
Inventories	(52,328)	3,699
Prepaid expenses	583	1,843
Demand instalment loans	2,247,602	(128,004)
Accounts payable	304,598	563,460
Payments in lieu of taxes payable	(82,493)	177,000
Other current liabilities	199,878	34,275
	1,669,882	(190,095)

(b) Acquisition of capital assets

During the period, capital assets were acquired in the amount of \$ 3,934,016. Capital contributions received from third parties amounted to \$ 479,589. Cash payments of \$ 3,454,427 were made to purchase capital assets.

(c) Interest and payments in lieu of taxes

	2005 \$	2004 \$
Interest received	11,523	7,955
Interest paid	699,275	601,055
Payments in lieu of taxes paid	303,596	40,630

12. Pension Agreement

The company makes contributions to the Ontario Municipal Employees Retirement Systems ("OMERS"), which is a multi-employer plan, on behalf of approximately 20 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 2005 was \$ 55,933 (\$ 54,431 - 2004) for current service.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

13. 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, 2007.

To December 31, 2005, the company has not been made aware of any additional assessments.

14. Contingent Liability

Class Action

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

The claim is that late payment penalties result in the 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 the preliminary stage. Pleadings have closed but examinations for discovery have not been conducted and classes have not been certified. The Electricity Distributors Association is undertaking the defence of this class action on behalf of the Defendant Class.

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 company. 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.

15. Other Information

(a) Amortization

	2005	2004
	\$	\$
Amortization of capital assets charged to operations	1,084,878	1,074,164
Amortization of capital assets charged to operating assets	47,686	57,221
	1,132,564	1,131,385

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

15. Other Information - continued

(b) Capitalized Interest

	2005	2004
	\$	\$
Capitalized interest	(55,367)	(16,415)

16. Financial Instruments

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 \$ 316,737 (\$ 214,335 - 2004) 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.

Cash Flow Risk

The company has entered into two swap transactions, the effect of which is to fix the interest rate on the first \$ 2,495,796 demand instalment loan at 6.03% and the second \$ 2,382,566 demand instalment loan at 5.38% to the maturity date. The company is exposed to interest rate risk on the bank advances which have floating interest rates.

Operating Line of Credit

As at December 31, 2005, 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 minus 0.5% and are secured by all assets of the company. There are unlimited guarantees provided by Niagara-on-the-Lake Energy Inc. and Energy Services Niagara Inc.

Letters of Credit/Guarantees

The company had arranged for a total letter of credit or guarantee in the amount of \$ 1,000,000. As at December 31, 2005, \$ 857,908 is available to the Independent Electricity System Operator ("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.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

16. Financial Instruments - continued

Fair Values

The carrying values of cash and bank advances, accounts receivable, accounts payable and accrued liabilities, and client deposits and advances approximate their fair values due to the relatively short periods to maturity of the instruments.

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

The potential replacement cost to Niagara-on-the-Lake Hydro Inc. of the interest rate swap was \$ 86,303.

The investment and long-term note payable are stated at face value. It is not practicable within the constraints of timeliness or cost to determine the fair value with sufficient reliability.

17. Payments in Lieu of Taxes

Future payments in lieu of income taxes relating to this regulated business have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 2005, future payments in lieu of income tax assets of \$ 1,334,166 (\$ 1,431,327 - 2004), based on substantively enacted income tax rates, have not been recorded. The company was not subject to payments in lieu of taxes prior to October 1, 2001.

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

	2005 \$	2004 \$
Future payments in lieu of tax assets		
Capital assets	1,175,485	1,276,788
Employee future benefits	161,685	155,986
Regulatory assets	(3,004)	(1,447)
	1,334,166	1,431,327

An independent valuation was completed effective October 1, 2001 in order to determine the fair market value of the company for the purpose of calculating payments in lieu of taxes under s. 93 of the Electricity Act. The valuation resulted in a fair market value of approximately \$ 17,219,000 of tangible capital assets, an increase of approximately \$ 4,116,022 over net book value as at October 1, 2001. This valuation was performed for the purposes of calculating payments in lieu of taxes only and has not been reflected as an adjustment to net book value for accounting purposes.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2005

17. Payments in Lieu of Taxes - continued

The reconciliation of the company's effective income tax rate for payments in lieu of taxes is as follows:

	2005 %	2004 %
Federal income tax rate	29.12	29.12
Provincial income taxes, net of federal abatement	14.00	14.00
Applicable tax rate	43.12	43.12
Amortization recorded in excess of capital cost allowance claimed for income tax purposes	(9.73)	(96.31)
Effect of other items that are deductible for income tax purposes	0.39	15.89
Addition for changes in regulatory assets not deductible for tax purposes	(0.28)	379.52
Losses of prior years recognized in the year		(67.26)
General rate reduction	(5.44)	(44.64)
Addition (reduction) relating to CMT		(12.79)
2004 reassessment	5.74	
	33.80	217.53

18. Deferred Charges - HVDS

The amount reflected as deferred charges - HVDS represent transformation tariffs related to a distribution station previously owned by Hydro One and purchased by the company on October 27, 2005. Hydro One's collection of these charges were deferred by Bill 210. Charges were accrued from May 1, 2002 until the time of this purchase and are recorded as part of RSVA variances on the balance sheet. The OEB approved a rate order on January 10, 2005 which authorizes Hydro One to recover specific approved amounts related to Hydro One regulatory asset balances as of December 31, 2003. The OEB also approved a further rate order on April 27, 2006 which authorizes Hydro One to recover specific approved amounts related to regulatory assets over the period January 1, 2004 to April 30, 2006, from each embedded distributor on a monthly basis over a four year period beginning May 1, 2006.

19. Comparative Figures

Certain comparative figures have been restated to conform with the current years presentation.