

Financial Statements of

NEWMARKET HYDRO LTD.

December 31, 2001



Auditors' Report

To the Shareholder of
Newmarket Hydro Ltd.

We have audited the balance sheet of Newmarket Hydro Ltd. as at December 31, 2001 and the statements of earnings and deficit and of cash flows for the year then ended. These financial statements are the responsibility of the Corporation'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 Corporation as at December 31, 2001 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants

Toronto, Ontario

March 15, 2002 except as to Notes 6 and 14 which are as of April 12, 2002

NEWMARKET HYDRO LTD.

Table of Contents

December 31, 2001

	<u>Page</u>
Balance Sheet	1
Statement of Earnings and Deficit	2
Statement of Cash Flows	3
Notes to the Financial Statements	4-11

NEWMARKET HYDRO LTD.**Balance Sheet**

December 31, 2001

	2001	2000
ASSETS		
CURRENT		
Cash and cash equivalents	\$ 11,864,149	\$ 8,406,522
Accounts receivable	3,450,464	4,738,441
Unbilled revenue	4,605,381	3,771,131
Inventory	725,289	704,096
Prepaid expenses	66,082	50,410
	20,711,365	17,670,600
OTHER ASSETS		
Deferred charges	21,849	11,349
Deferred qualifying transition costs	531,241	310,940
Intangibles	67,422	231,350
Other assets	25,705	29,905
	646,217	583,544
CAPITAL ASSETS (Note 3)	37,526,753	39,030,610
	\$ 58,884,335	\$ 57,284,754
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities (Note 5)	\$ 5,356,641	\$ 4,784,413
Current portion of customers' deposits	173,000	147,822
Current portion of subdividers' lot levies	17,860	35,160
Due to related parties (Note 12)	3,970,550	-
	9,518,051	4,967,395
OTHER		
Customers' deposits	1,626,459	1,396,814
Subdividers' lot levies	-	52,820
Employee future benefits (Note 4)	177,537	82,196
	1,803,996	1,531,830
LONG-TERM DEBT (Note 6)	22,000,000	-
	33,322,047	6,499,225
EQUITY		
Share Capital (Note 7)	25,806,563	51,606,563
Deficit	(244,275)	(821,034)
	25,562,288	50,785,529
	\$ 58,884,335	\$ 57,284,754

APPROVED BY THE BOARD

..... Director

..... Director

NEWMARKET HYDRO LTD.**Statement of Earnings and Deficit**

Year ended December 31, 2001

(with comparative figures for the two-month period ended December 31, 2000)

	December 31, 2001 (12 months)	December 31, 2000 (2 months)
SERVICE REVENUE		
General	\$ 29,401,132	\$ 4,384,897
Residential	18,918,534	2,622,685
Street lighting	150,368	49,897
	48,470,034	7,057,479
Unbilled revenue adjustment	834,250	470,505
	49,304,284	7,527,984
COST OF POWER		
Power purchased from Ontario Power Generation Inc.	42,736,393	7,591,895
GROSS MARGIN	6,567,891	(63,911)
OTHER INCOME		
Interest	393,717	141,112
Occupancy, connection and collection fees	143,085	10,235
Rentals	38,985	23,227
Power Bill Aggregation	528,929	89,874
Miscellaneous	279,664	16,429
Net gain on disposal of capital assets	26,551	3,300
	1,410,931	284,177
OPERATING EXPENSES		
Amortization of capital assets, net of \$207,068 charged to other accounts	2,627,035	447,556
Amortization of contributions for capital construction	(152,498)	(10,751)
System operations and maintenance	1,277,504	210,773
Customer billing and collecting	1,198,985	175,537
Community relations and advertising	45,779	20,614
Administration	1,314,603	188,019
Write-down of intangibles	279,042	-
Interest	446,377	6,921
Property and capital tax	117,896	2,631
	7,154,723	1,041,300
INCOME (LOSS) BEFORE INCOME TAX	824,099	(821,034)
INCOME TAX (Note 8)	24,500	-
NET INCOME (LOSS)	799,599	(821,034)
DEFICIT, BEGINNING OF PERIOD	(821,034)	-
LOT LEVY CONTRIBUTIONS (Note 2(h))	35,160	-
DIVIDENDS (Note 13)	(258,000)	-
DEFICIT, END OF PERIOD	\$ (244,275)	\$ (821,034)

NEWMARKET HYDRO LTD.

Statement of Cash Flows

Year ended December 31, 2001

(with comparative figures for the two-month period ended December 31, 2000)

	December 31, 2001 (12 months)	December 31, 2000 (2 months)
NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES		
OPERATING		
Net income (loss)	\$ 799,599	\$ (821,034)
Items not affecting cash		
Amortization of capital assets	2,834,103	482,619
Amortization of contributions for capital construction	(152,498)	(10,751)
Amortization of deferred charges	-	3,484
Employee future benefits	95,341	14,960
Write-down of intangibles	279,042	-
Gain on disposal of capital assets	(26,551)	(3,300)
	3,829,036	(334,022)
Net change in non-cash working capital balances related to operations		
Accounts receivable	1,287,977	(720,974)
Unbilled revenue	(834,250)	(470,505)
Inventory	(21,193)	22,399
Prepaid expenses	(15,672)	(38,650)
Accounts payable and accrued liabilities	572,228	527,508
	4,818,126	(1,014,244)
INVESTING		
Cash received on net asset transfer	-	9,636,158
Additions to capital assets (net of capital contributions)	(1,212,708)	(208,858)
Increase in intangibles	(115,114)	(29,752)
Increase in deferred qualifying transition costs	(220,301)	-
Proceeds from sale of capital assets	26,551	3,300
Decrease in other assets	4,200	3,484
Increase in deferred charges	(10,500)	-
Dividend paid	(258,000)	-
	(1,785,872)	9,404,332
FINANCING		
Increase in customers' deposits	254,823	16,434
Advance from related party	170,550	-
	425,373	16,434
NET CASH INFLOW	3,457,627	8,406,522
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	8,406,522	-
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 11,864,149	\$ 8,406,522
SUPPLEMENTARY CASH FLOW INFORMATION		
Interest paid	\$ 3,784	\$ 6,921
Income taxes paid	\$ 24,500	\$ -

NEWMARKET HYDRO LTD.

Notes to the Financial Statements

December 31, 2001

1. NATURE OF OPERATIONS

Newmarket Hydro Ltd. (the "Corporation") is a "wholly-owned" subsidiary of Newmarket Hydro Holdings Inc. and was incorporated April 10, 2000 under the laws of the Province of Ontario. The Company commenced operations on November 1, 2000. Newmarket Hydro Holdings Inc. is "wholly-owned" by the Town of Newmarket.

The principal activity of the Corporation is to distribute electricity to the residents and businesses in the Town of Newmarket under the license issued by the Ontario Energy Board ("OEB"). The Corporation is regulated by the OEB and adjustments to the Corporation's distribution and power rates require OEB approval.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and policies set forth in the Accounting Procedures Handbook issued by the Ontario Energy Board (OEB) under the authority of the Ontario Energy Board Act, 1998:

(a) *Cash and Cash Equivalents*

Cash equivalents include short-term investments with maturities of three months or less when purchased.

(b) *Inventory*

Inventory consisting of repair parts, supplies and materials for maintenance and capital expansions is valued at the lower of cost (determined on a first-in, and first-out basis) and net realizable value.

(c) *Capital Assets*

Capital assets are capitalized at cost which is comprised of material, labour, charges for truck time plus overheads. Amortization is provided for on the straight-line basis over their estimated service lives as summarized below:

Distribution systems	25 to 30 years
Other equipment	3 to 15 years

(d) *Deferred Qualifying Transition Costs*

Deferred qualifying transition costs consist of qualifying capital costs and related expenditures incurred in the preparation for market opening. Recovery of the deferred costs is regulated by the OEB.

NEWMARKET HYDRO LTD.
Notes to the Financial Statements
December 31, 2001

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Deferred Charges

Deferred charges represent prepaid vehicle lease payments which are amortized over the life of the lease.

(f) Intangibles

Intangibles include corporate restructuring costs that are comprised principally of professional fees. Intangibles are stated at cost and amortized over five years.

(g) Contributions for Capital Construction

Contributions for capital construction consist of third party contributions toward the cost of constructing distribution assets and a portion will be refunded by the Corporation based on future economic evaluations, in accordance with the OEB Distribution System Code. They are accounted for as reductions to the cost of related capital assets and are amortized at rates corresponding with the useful lives of the related capital assets.

(h) Subdivider Lot Levies

Subdivider lot levies received by the former commission prior to January 1, 2000 are recorded by the Corporation as liabilities until the funds are expended, at which time they are transferred to equity of the Corporation. Lot levies received on or after January 1, 2000 are transferred to contributions for capital construction upon being expended.

(i) Revenue Recognition and Cost of Power

Service revenue is recorded on the basis of regular meter readings and estimated customer usage since the last meter reading date to the end of the period. The related cost of power is recorded on the basis of power consumed.

(j) Payments in Lieu of Income Taxes

Under the Electricity Act, 1998, the Corporation is required to make payments-in-lieu of corporate taxes to the Ontario Electricity Financial Corporation (OEFC), commencing October 1, 2001. These payments are calculated in accordance with the rules for computing taxable 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. Prior to October 1, 2001, the Corporation was not subject to income or capital taxes.

The Corporation uses the taxes payable method of accounting for income taxes. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. Rate-regulated enterprises need not recognize future income taxes to the extent that future income taxes are expected to be included in the rates charged to and recovered from future customers.

Payments-in-lieu of income taxes are henceforth referred to as income taxes.

NEWMARKET HYDRO LTD.
Notes to the Financial Statements
December 31, 2001

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Due to the inherent uncertainty in making estimates, actual results could differ from those estimates.

(l) Comparative Figures

The Corporation commenced operations November 1, 2000. The comparative figures therefore comprise only two months. Certain comparative figures have been reclassified to conform to 2001 presentation.

3. CAPITAL ASSETS

	2001			2000
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Land	\$ 44,815	\$ -	\$ 44,815	\$ 44,815
Transmission and distribution systems	64,682,248	(24,614,636)	40,067,612	39,243,224
Plant and equipment	2,882,362	(2,085,299)	797,063	1,057,341
Office equipment	527,250	(342,005)	185,245	53,826
Leasehold improvements	17,358	(3,471)	13,887	-
	68,154,033	27,045,411	41,108,622	40,399,206
Contributions for capital construction	(3,798,874)	217,005	(3,581,869)	(1,368,596)
	\$ 64,355,159	\$ 26,828,406	\$ 37,526,753	\$ 39,030,610

4. EMPLOYEE FUTURE BENEFITS

Newmarket Hydro Ltd. pays certain health, dental and life insurance benefits on behalf of its retired employees. The Corporation recognizes these post-retirement costs in the period in which the employees rendered the services.

The accrued benefits obligation assumed from the former Commission was determined by actuarial valuation to be \$419,969 at January 1, 2000. The accrued benefits obligation is being recorded in the accounts on a prospective basis. Accordingly, the obligation is being amortized over the average remaining service period of employees (11 years).

The accrued benefit obligation at January 1, 2001 and the net periodic expense for the year ended December 31, 2001 were determined by actuarial valuation. The actuarial valuation at January 1, 2001 determined the accrued benefit obligation to be \$507,148.

NEWMARKET HYDRO LTD.
Notes to the Financial Statements
December 31, 2001

4. EMPLOYEE FUTURE BENEFITS (continued)

Information about the employee future benefits is as follows:

	<u>2001</u>	<u>2000</u>
Accrued benefit obligation, beginning of year	\$ 507,148	\$ 419,969
Unamortized transitional obligation, end of year	\$ 414,939	\$ 381,790

	<u>2001</u> (12 months)	<u>2000</u> (2 months)
Estimated accrued benefit liability, beginning of period	\$ 82,196	\$ 68,498
Expense for the period	53,185	8,597
Amortization of transitional obligation	54,029	6,363
Benefits paid during the period	(11,873)	(1,262)
Estimated accrued benefit liability, end of period	\$ 177,537	\$ 82,196

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

General inflation

Future general inflation levels, as measured by changes in the Consumer Price Index ("CPI"), were assumed to be 3.5% in 2000 and thereafter.

Interest (discount) rate

The present value as at December 31, 2001 of the future benefits, and the expense for the twelve months ended December 31, 2001, were determined using a discount rate of 6.0%. This corresponds to the assumed CPI rate plus an assumed rate of return of 2.5%.

Salary levels

Future general salary and wage levels were assumed to increase at 2% per annum.

Health costs

Health costs were assumed to increase at the CPI rate plus a further increase of 4% annually, graded down to 1% in 2004 and thereafter.

Dental costs

Dental costs were assumed to increase at the CPI rate plus a further increase of 1.0% in 2000 and thereafter.

NEWMARKET HYDRO LTD.

Notes to the Financial Statements

December 31, 2001

5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2001	2000
Accounts payable - Ontario Power Generation Inc.	\$ 4,559,459	\$ 3,921,826
Other accounts payable and accrued liabilities	499,612	595,471
Deferred revenues	289,765	267,116
Upper Canada Energy Alliance	7,805	-
	<u>\$ 5,356,641</u>	<u>\$ 4,784,413</u>

6. LONG-TERM DEBT

In recognition of the requirements of Bill 35 (the Energy Corporations Act, 1998), the Town of Newmarket on October 16, 2000 passed a transfer bylaw that provided for the issuance of both debt and equity by Newmarket Hydro Ltd. to the Town of Newmarket in consideration for the net assets transferred to Newmarket Hydro Ltd. Owing to Newmarket Hydro Ltd. being party to other agreements including, the "Amalgamation Participation Agreement of the York Utilities", the final determination with respect to the amount of the debt was not determined until 2001.

The Corporation has issued an unsecured promissory note in the amount of \$22,000,000, effective October 1, 2001, to the Town of Newmarket. The note bears interest at a simple annual rate equal to the rate of interest that the Corporation is, from time to time, permitted by the OEB to recover in its rates (currently 7.25% per annum). Interest is due on the last day of each fiscal year and on terms and at such time as may be further determined by the Director of Finance/Town Treasurer in consultation with senior corporate officers of the Corporation. Determination of, and changes to, maturity and repayment terms require 13 months notice. The Promissory Note has been subordinated to the IMO Letter of Credit referred to in Note 14.

Recognition of the promissory note during the current year resulted in an adjustment to share capital of \$22,000,000.

7. SHARE CAPITAL

	2001	2000
Authorized		
Unlimited number of common shares		
Issued		
1,001 (2000 - 1,001) Common shares	\$ 25,806,563	\$ 51,606,563

The final determination relating to the various terms of the transfer bylaw was approved and became effective October 1, 2001. This resulted in a \$22,000,000 adjustment to equity as a result of promissory notes issued (see Note 6) and a \$3,800,000 adjustment related to the payment of excess working capital to Newmarket Hydro Holdings Inc. (see Note 13).

NEWMARKET HYDRO LTD.
Notes to the Financial Statements
December 31, 2001

8. INCOME TAXES

The Corporation became obligated to make payments-in-lieu of taxes on October 1, 2001. There were no income or capital taxes in the periods prior to October 1, 2001.

The provision for income taxes under the taxes payable method for the year is \$24,500 representing large corporations tax.

Future income taxes have not been recorded in the accounts as they are expected to be reflected through future distribution revenues. As at December 31, 2001 future income tax assets of \$3,034,000 have not been recorded on the balance sheet. Future income tax benefits of \$83,400 have not been reflected in the income tax provision for the year ended December 31, 2001.

The Corporation has income tax losses carried forward of \$148,000 which expire in 2008. Had the Corporation accounted for income taxes under the liability method, the benefit of these losses would have been reflected as a reduction to income tax expense of \$44,600.

A reconciliation between income recorded on the financial statements and the loss for income tax purposes is provided as follows:

Income before provision for income taxes	\$ 824,099
Less: Income prior to October 1, 2001 not subject to tax	(1,099,999)
Amortization in excess of capital cost allowance	168,300
Other net amounts deducted for tax over book amounts	(40,400)
Loss for tax purposes	\$ (148,000)

Significant components of the Corporation's future tax assets as at December 31 are as follows:

Loss carry forwards	\$ 44,600
Capital assets	2,935,800
Employee future benefits	53,600
Net future income tax asset	\$ 3,034,000

9. PENSION AGREEMENT

The Corporation makes contributions to the Ontario Municipal Employees' Retirement Fund (OMERS), which is a multi-employer plan, on behalf of its employees. The plan is a defined benefit plan which specifies the amount of the retirement benefits to be received by the employees based on the length of service and rates of pay.

Currently, due to a surplus of investment earnings in the fund, the Corporation and its employees are in a "contribution holiday". Therefore, in the twelve months ended December 31, 2001, there were no current service pension costs charged to income.

NEWMARKET HYDRO LTD.

Notes to the Financial Statements

December 31, 2001

10. LEGAL PROCEEDINGS

A class action claiming \$500 million in restitutionary payments plus interest was served on Toronto Hydro Electric Commission on November 18, 1998. The action was initiated against Toronto Hydro as the representative of the Defendant Class consisting of all municipal electric utilities in Ontario that 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 are illegal under Section 347(1)(b) of the Criminal Code.

The Electricity Distributors Association is undertaking the defense of this class action. At this time it is not possible to quantify the effect, if any, on the financial statements of the Corporation, and as such no accrual of any potential liability has been recognized.

11. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of the financial instruments included in the financial statements approximate their carrying amounts due to the short-term maturity of those instruments. The fair value of the long-term debt has not been calculated on the basis that the future terms of the promissory notes (Note 6) are indefinite.

12. COMMITMENTS

On October 1, 2001 the Corporation entered into a lease agreement with the Town of Newmarket for rental of the 590 Steven Court building for five years. Annual payments of \$180,500 are due on December 31 of each year subsequent to commencement date.

In accordance with the OEB Distribution System Code, the Corporation will be required to make payments to developers relating to third party contributions for capital construction. The obligation to make payments will result in a reduction to "Contributions for Capital Construction" once the amount is determinable.

NEWMARKET HYDRO LTD.

Notes to the Financial Statements

December 31, 2001

13. RELATED PARTY TRANSACTIONS

The following summarizes the Corporation's related party transactions with the Town of Newmarket for the twelve months ended December 31, 2001 and the balances at December 31, 2001:

<u>Transactions</u>	
Revenues	
Energy sales (at commercial rates)	\$ 1,366,071
Services	
Street light capital	\$ 155,615
Street lamp maintenance	\$ 347,514
Costs	
Interest	\$ 398,750
Rent	\$ 45,000
Water bill	\$ 1,203
Municipal taxes	\$ 82,795
<u>Balances</u>	
Accounts receivable	\$ 127,758
Long term debt	\$ 22,000,000
Accrued interest payable	\$ 414,395

The following summarizes the Corporation's related party transactions with its parent company for the year ended December 31, 2001 and the balances at December 31, 2001:

<u>Transactions</u>	
Dividends paid	\$ 258,000
<u>Balances</u>	
Amounts due to Newmarket Hydro Holdings Inc	\$ 3,970,550

The transfer bylaw (see Note 6) transferred substantially all the distribution assets and liabilities of the Newmarket Hydro Electric Commission, effective November 1, 2000 to two newly created corporations. Of the assets transferred to Newmarket Hydro Ltd., the bylaw allowed for the future transfer of excess working funds to Newmarket Hydro Holdings Inc. During the current period this amount was determined as being \$3,800,000 and is included in the amounts due to Newmarket Hydro Holdings Inc. Recognition of the excess working funds resulted in an adjustment to share capital of \$3,800,000.

14. SUBSEQUENT EVENT

On February 21, 2002 the Independent Market Operator notified the Corporation of its obligation under Part 5.4 of the Independent Market Operator (IMO) Settlements Manual to secure prudential support in the amount of \$5,406,833 before electricity market opening (May 1, 2002). On April 12, 2002 the Corporation secured the necessary prudential support by means of Letter of Credit. The Letter of Credit includes restrictive clauses with respect to debt repayment.