

Aliant Inc.

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Consolidated Financial Statements

(Audited)

December 31, 2005

CANADIAN COMPANIES A.R.

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Responsibility

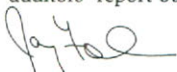
MANAGEMENT'S REPORT

The accompanying financial statements are the responsibility of management. The financial statements have been prepared according to Canadian generally accepted accounting principles and include amounts based on management's best estimates and judgments.

Management has established and maintains accounting and internal control systems that include written policies, procedures and a comprehensive internal audit program. These systems are designed to provide reasonable assurance that our financial records are reliable and form a proper basis for the timely and accurate preparation of financial statements, and that our assets are properly safeguarded.

The board of directors oversees management's responsibilities for financial reporting primarily through the audit committee. The financial statements have been reviewed and approved by the board of directors on recommendation from the audit committee. The audit committee is also responsible for making recommendation with respect to the appointment of the independent auditors and for approving their remuneration and terms of engagement. Other responsibilities of the audit committee include meeting periodically with the independent auditors, management and the internal auditors to review accounting, auditing, internal controls, litigation, financial reporting and other matters. The internal auditors and the shareholders' external auditors have free access to the audit committee both with and without management present.

Our independent auditors, Ernst & Young LLP, have audited our financial statements. The accompanying auditors' report outlines the scope of their examination and their opinion.



Jay Forbes
President and chief executive officer
January 26, 2006



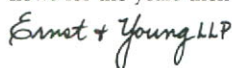
Glen LeBlanc
Senior vice-president and chief financial officer

AUDITORS' REPORT

We have audited the consolidated balance sheets of Aliant Inc. (the "company") as at December 31, 2005 and 2004, and the consolidated statements of income, retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Ernst & Young LLP
Chartered accountants
Halifax, Canada

January 26, 2006, except as to note 23 which is as of April 12, 2006

Statements

CONSOLIDATED BALANCE SHEETS

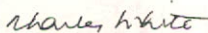
As at December 31

(thousands of dollars)

	Notes	2005	2004
			(as restated, note 1)
Assets			
Current assets			
Cash and cash equivalents		195,009	138,265
Note receivable from related party	20	—	185,000
Accounts receivable	2, 20	296,148	251,054
Inventory		29,279	22,654
Prepayments		21,410	22,642
Future income tax asset	3	5,510	1,624
Income tax receivable		15,010	28,299
		562,366	649,538
Capital investments			
Property, plant and equipment	4	1,783,848	1,796,788
Finite-life intangibles		121,178	123,494
		1,905,026	1,920,282
Other assets			
Deferred charges	5	24,301	56,107
Future income tax asset	3	43,281	41,278
Accrued benefit asset	6	266,878	172,680
Indefinite-life intangibles	7	3,726	2,952
Goodwill	8	61,351	60,783
		399,537	333,800
Total assets		2,866,929	2,903,620
Liabilities and shareholders' equity			
Current liabilities			
Notes payable and bank advances	9	11,208	9,101
Payables and accruals	10, 20	195,691	263,490
Dividends payable	20	37,577	—
Income tax payable		78,537	1,865
Future income tax liability	3	8,746	6,464
Long-term debt due within one year	11	6,623	153,043
		338,382	433,963
Future income tax liability	3	19,821	8,395
Long-term debt	11	897,880	743,342
Accrued benefit liability	6	182,038	170,344
Deferred credits	12, 20	11,324	11,660
		1,449,445	1,367,704
Non-controlling interest		5,588	5,242
Shareholders' equity			
Capital stock	13	1,176,035	1,216,993
Contributed surplus		886	—
Retained earnings		234,975	313,681
		1,411,896	1,530,674
Total liabilities and shareholders' equity		2,866,929	2,903,620

See accompanying notes to the consolidated financial statements

Signed on behalf of the board of directors



Charles White
Chairman



Edward Reevey
Director

CONSOLIDATED STATEMENTS OF INCOME

For the years ended December 31

(thousands of dollars, except per share amounts)

	Notes	2005	2004
Operating revenues	14	2,096,682	(as restated, note 1) 2,033,470
Expenses			
Operating expenses		1,310,569	1,294,282
Depreciation and amortization		391,255	397,337
Restructuring charge	10	—	72,288
		1,701,824	1,763,907
Operating income		394,858	269,563
Other income (expenses)	15	(3,206)	4,342
Interest charges			
Interest on long-term debt		72,738	74,377
Other interest expense		1,027	662
		73,765	75,039
Income before underlisted items		317,887	198,866
Income taxes	3		
Current tax expense		109,409	74,540
Future tax expense (recovery)		6,569	(8,100)
		115,978	66,440
Income before non-controlling interest		201,909	132,426
Non-controlling interest		2,546	1,774
Net income		199,363	130,652
Earnings per common share	16		
Basic and diluted		1.46	0.91

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

For the years ended December 31

(thousands of dollars)

	Notes	2005	2004
Retained earnings, beginning of year, as previously reported		360,351	(as restated, note 1) 415,866
Changes in accounting policies	1	(46,670)	(40,281)
Retained earnings, beginning of year, as restated		313,681	375,585
Net income		199,363	130,652
Dividends declared on preferred shares		(9,537)	(9,537)
Dividends declared on common shares		(153,196)	(146,313)
Excess of repurchase of common shares over stated value	13	(115,336)	(36,706)
Retained earnings, end of year		234,975	313,681

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31

(thousands of dollars)

	Notes	2005	2004
			<i>(as restated, note 1)</i>
Cash from (used in) operating activities			
Net income		199,363	130,652
Adjustments to reconcile net income to cash from operating activities			
Depreciation and amortization		391,255	397,337
Gain on disposal of assets		(2,136)	(1,855)
Future income taxes		6,569	(8,100)
Net benefit plans cost	6	90,133	64,026
Funding of defined benefit pension and other post-employment benefit plans	6	(172,639)	(87,078)
Non-controlling interest		2,546	1,774
Other non-cash items		3,299	2,509
Change in non-cash working capital		5,937	76,530
		524,327	575,795
Cash from (used in) financing activities			
Repurchase of accounts receivable	2	(5,000)	(5,000)
Collection of long-term receivable		4,823	4,874
Net proceeds (repayments) of notes payable and bank advances		2,108	(4,725)
Proceeds of long-term debt	11	149,109	—
Repayments of long-term debt	11	(151,352)	(100,081)
Repayments of capital lease obligations		(2,500)	(244)
Decrease in non-controlling interest		(3,598)	(583)
Issuance of common shares		1,152	1,922
Repurchase of common shares	13	(161,404)	(50,631)
Cash dividends paid on preferred shares		(9,537)	(9,537)
Cash dividends paid on common shares		(111,661)	(140,895)
		(287,860)	(304,900)
Cash from (used in) investing activities			
Purchase of capital investments		(363,241)	(293,354)
Proceeds on sale of capital investments		44	4,056
Purchase of indefinite-life intangibles	7	(774)	(227)
Business acquisitions, net of cash	17	(568)	(23,435)
Other		(184)	—
		(364,723)	(312,960)
Net decrease in cash		(128,256)	(42,065)
Cash, beginning of year		323,265	365,330
Cash, end of year		195,009	323,265
Cash consists of:			
Cash and cash equivalents		195,009	138,265
Note receivable from related party		—	185,000
		195,009	323,265
Supplementary disclosure			
Interest paid		73,219	74,728
Income taxes paid, net		20,560	81,689

See accompanying notes to the consolidated financial statements

Statement notes

1 SIGNIFICANT ACCOUNTING POLICIES

Consolidated financial statements

We have prepared the consolidated financial statements in accordance with Canadian generally accepted accounting principles (Canadian GAAP).

We consolidate the financial statements of all the companies we control and proportionately consolidate our share of the financial statements of our joint venture interest. At December 31, 2005, our principal subsidiaries include Aliant Telecom Inc., Innovatia Inc., DownEast Ltd. and Xwave Solutions Inc. Our joint venture interest is in Aliant ActiMedia. All transactions and balances between these companies have been eliminated on consolidation.

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Our non-controlling interest consists of common equity of our subsidiary companies, Atlantic Mobility Products Ltd. and SalesBridge Canada Corp., held by third parties.

Use of accounting estimates

Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from estimates used in these financial statements.

Revenue recognition

We recognize operating revenues when they are earned, specifically, when services are provided, products are delivered to customers, persuasive evidence of an arrangement exists, amounts are fixed or determinable, and collectability is reasonably assured.

For arrangements where agents perform services for our customers, we recognize revenue based on the amounts billed to the customers when we act as the principal in the arrangement. When we act as the agent, we recognize the net amount as revenue when we perform the service.

We defer payments received in advance until we provide the service or deliver the product to customers.

For fixed-price contracts, we recognize revenue using the percentage of completion method, based on performance as services are provided or contract milestones are met. If it is determined during the performance of the contract that a loss will result, a provision for the estimated loss is immediately recognized.

Directory advertising revenues are billed, in accordance with the contractual terms with advertisers, and recognized on a monthly basis over the estimated life of the print directory or electronic directory advertising, not exceeding 12 months, commencing with the delivery or display date, respectively. Amounts billed up front for the directories are deferred and recognized over the billing period for which the corresponding directories are in circulation, not exceeding 12 months.

For transactions involving multiple products or services, we determine the separate units of accounting and allocate revenue to each based on their relative fair values, being the value it can be sold for on a stand-alone basis or other reliable evidence. Our relevant revenue recognition policies are then applied to the separate units of accounting.

1 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks and investments in money market instruments with a maturity of less than 90 days, all of which are readily convertible to cash and subject to an insignificant risk of change in fair value.

Note receivable from related party

The note receivable is from Bell Canada and represents a revolving loan, as described in note 20.

Transfer of receivables

Under a purchase and sale agreement, we sell certain accounts receivable to a securitization trust. We record the sale when we transfer the accounts receivable and receive proceeds from the trust. The gains or losses that result from these transactions and program administration fees are recognized as other income (expenses). The gain or loss calculated is partly dependent on the carrying amount of the accounts receivable transferred, which is allocated between the accounts receivable sold and the retained interest based on their relative fair value at the date of the transfer. We determine fair value of the accounts receivable transferred based on the present value of future expected cash flows using management's best estimates of key assumptions, such as discount rates, weighted average life of accounts receivable and credit loss ratios.

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Inventory

Inventory represents products or equipment purchased for resale. We value inventory at the lower of cost and net realizable value, with cost being the weighted average laid-down cost using the first-in, first-out method.

Income taxes

We use the asset and liability method to account for income taxes. Under this method, income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets or liabilities for financial reporting purposes compared with tax purposes, as well as the benefit of losses that will more likely than not be realized and carried forward to future years to reduce income taxes. Accordingly, a future income tax asset or liability is determined for each temporary difference based on the tax rates enacted by tax law, or substantively enacted, that are expected to be in effect when the underlying items of income and expense are expected to be realized. The effect of a change in tax rates on future income tax assets and liabilities is included in earnings in the period that the change is substantively enacted. A valuation allowance is recorded to reduce future income tax assets to the amount more likely than not to be realized.

Capital investments

Capital investments are recorded at cost. We calculate depreciation and amortization over the useful lives of the capital investments as noted below:

Capital investments	Method	Rate
Property, plant and equipment		
Buildings and towers	Straight-line	10 – 40 years
Telecommunications facilities and equipment	Straight-line	4 – 40 years
Other equipment	Straight-line	3 – 15 years
Finite-life intangibles		
Software	Straight-line	3 – 5 years
Customer relationships	Straight-line	2 – 9 years
Residual commissions	Declining balance	6 years

1 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Costs capitalized on our self-constructed assets classified as plant under construction, include contracted costs, labour and overhead, but we do not capitalize interest costs. We do not commence depreciating our plant under construction or software under development until it becomes operational.

Gains and losses on the disposal of identifiable capital investments are included in other income (expenses) in the period they occur.

Deferred charges and credits

Deferred charges mainly include long-term receivables, bid pursuit and other up-front customer contract costs. Our retained interest in the transfer of accounts receivable to a securitization trust was included in deferred charges in 2004 but was reclassified to accounts receivable at December 31, 2005, as the trust agreement expires in December 2006. Deferred credits mainly include long-term debt premium income and revenue. Deferred charges and credits are being amortized or recognized as follows:

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	Amortization or recognition period	Income statement impact
Deferred charges:		
Long-term customer contract costs, such as bid pursuit and other up-front costs	Length of the customer contract	Operating expenses
Debt issue costs	Period to maturity of the underlying long-term debt obligation	Interest charges
Deferred credits:		
Long-term debt premium income	Period to maturity of the underlying long-term debt obligation	Reduction of interest charges
Deferred revenue	Length of the customer contract	Operating revenues

Goodwill and indefinite-life intangibles

Goodwill represents the excess, at the date of acquisition, of the cost of an acquired business over the fair value of the net amount assigned to individual assets acquired and liabilities assumed. Indefinite-life intangibles consist of spectrum licenses, which are not being amortized.

We assess goodwill and indefinite-life intangibles for impairment in the second quarter of every year, and when events or changes in circumstances indicate that an asset might be impaired. Any impairment in value is charged to other expense in the period that the review is performed. The annual impairment test was conducted during the second quarters of 2005 and 2004 and no impairment loss was required.

Leases

Leases are classified as capital or operating depending on the terms of the contracts. Capital investments acquired under capital leases are amortized consistent with their nature. Obligations under capital leases are reduced by lease payments net of imputed interest.

Derivative financial instruments

We use derivative financial instruments, periodically, in the management of our foreign currency and interest rate exposures. We do not use derivative financial instruments for trading or speculative purposes.

1 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

We document all relationships between derivatives and the items they hedge, as well as the risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet, specific firm commitments or anticipated transactions. We assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. If a hedge becomes ineffective, we stop using hedge accounting.

We currently use derivative financial instruments as part of a plan to manage the fixed and floating interest rate mix of our total debt portfolio and related overall cost of borrowing. We designate the following interest rate hedge agreements as hedges of the underlying long-term debt:

- Interest rate swap agreements that involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based, and are recorded as an adjustment of interest charges on the hedged long-term debt instrument. The related amount payable to or receivable from counterparties is included as an adjustment to accrued interest.
- Interest rate swaption agreements that, if exercised, will result in us entering into interest rate swaps, to be accounted for as derivative instruments. The long-term debt premium income we received upon entering into the swaption agreements is amortized as an adjustment to interest charges over the period from receipt of the premium income to maturity of the underlying long-term debt obligation.

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Realized and unrealized gains or losses associated with derivative financial instruments, which have been terminated or cease to be effective as a hedge prior to their maturity, are deferred under other current, or non-current, assets or liabilities on the balance sheet and recognized in income in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative financial instrument, any realized or unrealized gain or loss on such derivative financial instrument and any unamortized long-term debt premium income is recognized in income.

Post-employment benefits

We provide pension plans and non-pension post-employment benefits to qualified employees. These include defined benefit (DB) pension plans, defined contribution (DC) pension plans, retirement savings plans and other post-employment benefit (OPEB) plans such as life insurance and health care plans.

We accrue our obligations under these plans. In the case of DB pension plans, we present the liability and any deferred actuarial gains and losses in the plans net of the fair value of plan assets, which are invested to fund that liability.

December 31 is the measurement date of our employee benefit plans. A valuation of each plan is performed at least every three years to determine the actuarial present value of the accrued pension and other non-pension post-employment benefits. The latest valuations are dated December 2005, and were performed as of December 31, 2004. The next required actuarial valuations for funding purposes will be as of December 31, 2005, and will be completed in 2006.

We have adopted the following policies for our DB pension plans and OPEB plans:

- The cost of pensions and other post-employment benefits earned by employees is actuarially determined using:
 - The projected benefit method, prorated on years of service, which takes into account future salary levels;
 - Management's best estimate of expected plan investment performance, salary increases, retirement ages of employees and expected health care costs; and

1 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

- Discount rates for the employee benefit plans are based on current interest rates on the long-term debt of high-quality corporate issuers. The expected long-term rate of return on plan assets is based on long-term forecasts of capital market returns, given our policy asset mix.
- For the purpose of calculating the expected return on plan assets, equity securities are valued at market-related value, where investment returns (gains and losses) in excess of expected returns are recognized in the asset value over a period of three years. Fixed income securities are valued at their fair values.
- We amortize past service costs from plan amendments on a straight-line basis over the average remaining service period of employees who were active at the date of amendment.
- We use the corridor approach to calculate actuarial gains and losses that are reflected in earnings. This involves deducting the greater of 10 per cent of the benefit obligation or 10 per cent of the market-related value of the plan assets from the unamortized net actuarial gains or losses. The excess amount calculated is then amortized over the average remaining service period of active employees, being 13 years at December 31, 2005 (2004 – 13 years).
- When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, we account for the curtailment prior to the settlement.

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Earnings per common share

Earnings per common share is based on the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed in accordance with the treasury stock method and based on the weighted average number of common shares and dilutive common share equivalents.

Stock-based compensation plans

Under our stock option plan, for awards granted after January 1, 2003, we record compensation expense, calculated by using the fair value method as determined by the Black-Scholes options pricing model. Compensation expense recognition commences when stock options are issued to employees, with full recognition equally over the vesting period, being three years.

As permitted under the CICA accounting standard for stock-based compensation and other stock-based payments, we do not record compensation expense upon issuance of stock options to employees under our own stock option plan for awards granted prior to January 1, 2003. However, as required by the standard, we are disclosing the proforma impact on net income and earnings per common share using the fair value method of accounting for stock-based compensation awards. The pro-forma information is presented in note 16.

Compensation expense is also recorded as units vest under our performance share unit plan, and for our contributions to the employees' stock savings plan.

Changes in accounting policies

Effective January 1, 2005, we changed certain accounting policies. These changes have been retroactively applied with comparative financial information restated to conform to the presentation adopted for 2005.

1 SIGNIFICANT ACCOUNTING POLICIES *(continued)**Subscriber acquisition costs*

We changed our accounting policy for subscriber acquisition costs from deferring and amortizing over the life of the customer contract to expensing when services are activated. Subscriber acquisition costs include wireless and Internet commissions and cellular hardware subsidies. The following table outlines the impact of these changes.

*(thousands of dollars, except per share amounts)***Year ended December 31, 2004****Consolidated statement of income**

Increase (decrease) to:

Operating expenses	9,184
Income taxes	(3,347)
Net income	(5,837)

Consolidated balance sheet

Decrease to:

Deferred charges	(50,598)
Future income tax liability	(18,838)
Retained earnings	(31,760)

Earnings per common share

Basic and diluted	(0.04)
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Directory revenue and expense recognition

We changed our method for recognizing revenues and expenses in our joint venture directory business, Aliant ActiMedia, from the publication-date method to the defer and amortize method. The publication-date method recognizes revenues and direct expenses when directories are published. Under the defer and amortize method, directory advertising revenues and expenses are generally recognized over the period of circulation, which is usually 12 months. The following table outlines the impact of these changes.

*(thousands of dollars, except per share amounts)***Year ended December 31, 2004****Consolidated statement of income**

Increase (decrease) to:

Operating revenues	55
Operating expenses	927
Income taxes	(320)
Net income	(552)

Consolidated balance sheet

Increase (decrease) to:

Accounts receivable	(22,877)
Prepayments	2,492
Payables and accruals	3,170
Future income tax liability	(8,645)
Retained earnings	(14,910)

Earnings per common share

Basic and diluted	(0.01)
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1 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Comparative figures

The comparative financial information has been reclassified to conform to the presentation adopted for 2005.

Regulation of the telecommunications industry

Aliant Telecom Inc., our primary telecommunications company, is regulated by the Canadian Radio-television and Telecommunications Commission (CRTC) pursuant to the Telecommunications Act. The CRTC ensures that Canadians have access to reliable telephone and other telecommunications services at affordable prices. Our business is affected by CRTC decisions over the prices we charge for specific services, primarily local telephone service, and other operating requirements. Refer to note 22 for further information on the deferral account, a mechanism introduced under the CRTC's price cap decision of 2002.

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2 TRANSFER OF RECEIVABLES

On December 13, 2001, we entered into a five-year revolving purchase and sale agreement to sell up to \$150.0 million of interest in a pool of our subsidiary's, Aliant Telecom Inc., trade accounts receivable to a securitization trust. In March 2004, the program was amended and the available facility was decreased to \$125.0 million. As at December 31, 2005, we had received net cash proceeds of \$120.0 million (2004 – \$125.0 million) on the sale of accounts receivable to the securitization trust.

As part of the agreement, we are required to provide security, currently in the form of additional accounts receivable over and above the cash proceeds received, which is held and owned by the trust. This security, or retained interest, is transferred back to us upon the expiry of the agreement in December 2006. In prior years, the retained interest was recorded in deferred charges, as presented in note 5, but due to its current nature at December 31, 2005, was recorded in accounts receivable. The retained interest amounted to \$39.5 million at December 31, 2005 (2004 – \$43.5 million).

We continue to service these accounts receivable and collect the amounts owing, but the trust's interest in the collection of these accounts receivable, including receivables that make up the retained interest, ranks ahead of our interest. The trust and its investors have no recourse to our other assets for failure of the customer to pay the amounts when due.

Under the agreement the trust reinvests the amounts collected by buying additional interest in our accounts receivable until the agreement expires. During the term of the agreement, we remain subject to certain risks of default which, should they occur, could cause the agreement to end early.

During the year ended December 31, 2005, we recognized a pre-tax loss and administration fees of \$3.5 million, (2004 – \$3.3 million) on the transfer of receivables.

2 TRANSFER OF RECEIVABLES *(continued)*

The following table shows the securitization, certain cash flows received from and paid to the trust during the year, and the assumptions that were used in determining the fair value on the date of transfer. The sensitivity of these assumptions to an immediate 10 to 20 per cent change is not material.

<i>(thousands of dollars, except as otherwise noted)</i>	Range 2005	2005	2004
As at December 31			
Securitized interest in accounts receivable		159,454	168,484
Cash proceeds		120,000	125,000
Retained interest		39,454	43,484
Servicing liability		389	435
Average trade accounts receivable managed		227,664	227,673
For the years ended December 31			
Collections reinvested in revolving sales		1,867,530	1,812,448
Decrease in sales proceeds		5,000	5,000
Assumptions:			
Cost of funds	2.82% – 3.56%	2.98%	2.62%
Average delinquency ratio	19.25% – 22.33%	20.72%	18.20%
Average net credit loss ratio	0.55% – 1.41%	1.04%	0.96%
Weighted average life in days	43 – 50	45	45

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3 INCOME TAXES

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes as well as the benefit of losses that will more likely than not be realized and carried forward to future years to reduce income taxes.

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities are presented in the following table:

<i>(thousands of dollars)</i>	2005	2004
Capital investments	27,773	14,298
Pension and post-employment benefits	(27,589)	(4,006)
Deferred charges	(976)	2,508
Loss carryforwards	7,926	5,503
Long-term debt expense and premium	1,925	2,906
Severance and benefits	5,403	2,039
Other	5,762	4,795
Total future income taxes	20,224	28,043

3 INCOME TAXES *(continued)*

The total future income taxes are comprised of the following:

As at December 31

<i>(thousands of dollars)</i>	2005	2004
Future income tax assets:		
Current portion	5,510	1,624
Long-term portion	43,281	41,278
Future income tax liabilities:		
Current portion	(8,746)	(6,464)
Long-term portion	(19,821)	(8,395)
Total future income taxes	20,224	28,043

Significant components of income tax expense are as follows:

For the years ended December 31

<i>(thousands of dollars)</i>	2005	2004
Current tax expense	109,409	74,540
Future tax expense (recovery):		
Change in temporary differences	7,095	153
Tax rate differential – settlement of prior year's tax issues	—	(9,456)
Change in statutory rate	(526)	1,203
Income tax expense	115,978	66,440

A reconciliation of the statutory income tax rate to the effective income tax rate is as follows:

<i>For the years ended December 31</i>	2005	2004
Statutory income tax rate (including surtax)	35.95%	35.90%
Federal large corporation tax	0.47	1.04
Tax rate differential – settlement of prior year's tax issues	—	(4.53)
Tax rate change – future asset	(0.18)	0.48
Non-taxable loss	—	(0.14)
Non-deductible intangibles	0.14	0.06
Benefit of non-capital losses not recognized	0.48	0.13
Other permanent differences	(0.38)	0.47
Effective income tax rate	36.48%	33.41%

Tax losses

At December 31, 2005, we have \$52.3 million (2004 – \$46.4 million) in non-capital tax losses that are available to reduce taxable income in future years. The tax benefit of \$20.2 million (2004 – \$13.6 million) has been recognized as part of the future tax asset. These losses expire in varying annual amounts from 2011 to 2025. No tax benefit has been recognized for \$32.1 million (2004 – \$32.8 million) of these losses. The losses for which no tax benefit has been recognized expire in varying annual amounts from 2011 to 2025.

We also have capital losses of approximately \$37.4 million at December 31, 2005, (2004 – \$37.2 million) available to be carried forward indefinitely to reduce capital gains in future years. The tax benefit of \$1.5 million of these capital losses has been recognized as part of the future tax asset (2004 – nil). No tax benefit has been recognized on the balance.

4 CAPITAL INVESTMENTS

As at December 31 (thousands of dollars)	2005			2004		
	Cost	Accumulated depreciation and amortization	Net book value	Cost	Accumulated depreciation and amortization	Net book value
Property, plant and equipment						
Land	12,787	—	12,787	12,828	—	12,828
Buildings and towers	372,342	170,279	202,063	367,494	179,652	187,842
Telecommunications facilities and equipment	4,326,671	2,870,861	1,455,810	4,503,111	3,043,789	1,459,322
Other equipment	235,624	149,936	85,688	276,166	197,070	79,096
Plant under construction	22,000	—	22,000	52,200	—	52,200
Materials and supplies	5,500	—	5,500	5,500	—	5,500
	4,974,924	3,191,076	1,783,848	5,217,299	3,420,511	1,796,788
Finite-life intangibles						
Software	256,064	143,027	113,037	257,975	146,002	111,973
Customer relationships	6,319	2,655	3,664	6,357	1,736	4,621
Residual commissions	7,600	3,123	4,477	7,600	700	6,900
	269,983	148,805	121,178	271,932	148,438	123,494
	5,244,907	3,339,881	1,905,026	5,489,231	3,568,949	1,920,282

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Capital investments include assets acquired under capital leases totaling \$19.4 million (2004 – \$7.5 million), net of accumulated amortization of \$2.7 million (2004 – \$1.5 million).

We recorded aggregate amortization expenses on finite-life intangibles for the year ended December 31, 2005, of \$72.0 million (2004 – \$81.7 million).

In addition to normal disposal and retirement activity, during the second quarter of 2005 we performed a review of our capital investments, which resulted in removing retired assets with a cost of \$523.8 million and net book value of nil.

5 DEFERRED CHARGES

As at December 31 (thousands of dollars)	2005	2004
Retained interest in transfer of accounts receivable (note 2)	—	43,484
Customer contract costs, net of amortization	4,896	2,375
Debt issue costs, net of amortization	3,610	3,576
Customer instalments	12,011	5,199
Other	3,784	1,473
	24,301	56,107

We recorded aggregate amortization expense on deferred charges for the year ended December 31, 2005, of \$1.5 million (2004 – \$1.8 million).

6 ACCRUED BENEFIT ASSET (LIABILITY)

We provide pension and non-pension post-employment benefits to most of our employees. These include DC pension plans, DB pension plans, retirement savings plans and OPEB plans.

DC pension plans and other retirement savings plans

For most member-employees, our DC pension plans and other retirement savings plans require company contributions and employee contributions of between nil and 6 per cent of pensionable earnings, depending on the plan. For executives, there is a DC pension plan that requires company contributions of up to 15 per cent (2004 – 10 per cent) of the executive's earnings. The total cost of these DC pension plans is equal to our required contributions and was \$7.3 million for the year ended December 31, 2005 (2004 – \$11.7 million).

DC pension plan costs are recognized and funded as employees render services during the year.

DB pension plans

Our DB pension plans provide pensions to employees who retire after meeting certain age/service conditions. Pensions are based on specified pension rates applied to the employees' years of service and best five-year average earnings. Different pension rates apply to management employees, bargaining unit employees (who are required to contribute to the plan) and executives. Pensions are integrated with the Canada Pension Plan and include limited indexing to help protect retired employees' income from inflation.

As of January 1, 2005, certain management and unionized employees had transferred membership and their past service benefits from the DC to the DB pension plans. We have reflected the DC assets of these employees and the corresponding obligation as Transfers from DC pension plans.

During 2004, we made amendments to our DB plan as follows:

- Effective September 20, 2004, certain terms of our DB pension plans were amended to award past service benefits and introduce a contributory feature for certain bargaining unit employees. The past service obligation resulting from these plan amendments was \$31.3 million.
- Effective January 1, 2005, certain terms of our DB pension plans were amended to award past service benefits to eligible management employees. The estimated past service obligation resulting from these plan amendments was \$44.1 million, and was reflected in our accrued benefit obligation as at December 31, 2004.

Also during 2004, we offered a voluntary early retirement incentive program resulting in a workforce reduction of 693 employees, as discussed in note 10. This program resulted in an increase in the actuarial loss of our DB pension obligation of \$47.0 million.

At December 31, 2005, regulatory approval for these plan amendments had not yet been received.

The actuarial valuations performed in 2005 for the year ended December 31, 2004, resulted in an actuarial loss of \$39.2 million. In addition, the valuations prescribed required funding contributions for 2005 of \$120.0 million.

Effective December 31, 2005, we reduced our assumed discount rate used to discount the obligations from 6.25 per cent to 5.25 per cent. This change in assumption increased our DB pension plan obligations by \$281.4 million.

6 ACCRUED BENEFIT ASSET (LIABILITY) *(continued)*

OPEB plans

The OPEB plans we provide to eligible retiring employees include health care coverage, life insurance and certain other benefits. We do not maintain a trust fund to pay for OPEBs, rather we pay the benefits directly to the plan carrier or to the retired employee. The impact on the OPEB plans of reducing the assumed rate used to discount the obligations from 6.25 per cent to 5.25 per cent effective December 31, 2005, was an increase in OPEB plans obligations of \$31.7 million.

During 2005, actuarial valuations were performed on the OPEB plans, which resulted in a \$14.2 million gain for past service costs relating to plan amendments made in 2004.

In January 2006, we made changes to our OPEB plans, which will limit future benefits for retirees. We expect the new plans will reduce our OPEB costs in future years, but the impact has not been determined.

Components of accrued benefit asset (liability)

The following table shows the change in the obligations and assets related to the DB pension plans and the OPEB plans during the years ended December 31.

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<i>(thousands of dollars)</i>	DB pension plans		OPEB plans	
	2005	2004	2005	2004
Plan obligations:				
Accrued benefit obligation, beginning of year	1,794,116	1,496,455	184,644	161,376
Employee current service contributions	4,005	925	—	—
Transfers from DC pension plans	220,863	—	—	—
Current service cost	30,369	24,239	5,159	4,564
Interest on the obligation	110,099	99,596	11,554	10,911
Past service costs relating to plan amendments	—	75,402	(14,191)	—
Actuarial losses	320,551	182,019	42,885	12,080
Benefits paid out of the plan	(105,742)	(84,520)	(5,307)	(4,287)
Accrued benefit obligation, end of year	2,374,261	1,794,116	224,744	184,644
Plan assets:				
Fair value of plan assets, beginning of year	1,355,860	1,262,442	—	—
Actual return on plan assets, excluding impact of foreign currency losses	252,217	137,263	—	—
Foreign currency losses	(30,072)	(18,041)	—	—
Benefits paid out of the plans	(105,742)	(84,520)	(5,307)	(4,287)
Employee current service contributions	4,005	925	—	—
Transfers from DC pension plans	220,863	—	—	—
Employer cash contributions to the plans	167,332	57,791	5,307	4,287
Fair value of plan assets, end of year	1,864,463	1,355,860	—	—
Plan deficit, end of year	(509,798)	(438,256)	(224,744)	(184,644)
Unamortized actuarial losses	707,348	536,107	56,897	14,300
Unamortized past service costs	69,328	74,829	(14,191)	—
Accrued benefit asset (liability), end of year	266,878	172,680	(182,038)	(170,344)

Each of the individual DB pension plans that make up the totals included in the previous table have deficits where the accrued benefit obligation exceeds the fair value of plan assets.

6 ACCRUED BENEFIT ASSET (LIABILITY) *(continued)*

Components of net benefit plans cost

The following table shows the components of the DB pension plans and the OPEB plans cost before and after recognizing their long-term nature. The net benefit plans cost reflects the amount reported in our consolidated statements of income.

<i>(thousands of dollars)</i>	DB pension plans		OPEB plans	
	2005	2004	2005	2004
Current service cost	30,369	24,239	5,159	4,564
Interest on the accrued benefit obligation	110,099	99,596	11,554	10,911
Actual return on plan assets	(222,145)	(119,222)	—	—
Past service costs relating to plan amendments	—	75,402	(14,191)	—
Actuarial loss on accrued benefit obligation	320,551	182,019	42,885	12,080
Elements of employee future benefit plans cost, before recognizing its long-term nature	238,874	262,034	45,407	27,555
Excess of actual return over expected return	119,782	24,518	—	—
Deferral of amounts arising during the year:				
Past service costs relating to plan amendments	—	(75,402)	14,191	—
Actuarial loss on accrued benefit obligation	(320,551)	(182,019)	(42,885)	(12,080)
Amortization of deferred amounts:				
Past service costs	5,501	573	—	—
Net actuarial losses	29,526	18,847	288	—
Adjustments to recognize long-term nature of employee future benefit plans cost	(165,742)	(213,483)	(28,406)	(12,080)
Net benefit plans cost	73,132	48,551	17,001	15,475

Assumptions

The measurement of the accrued benefit obligation and the annual net benefit plans cost for the DB pension plans and OPEB plans requires an actuary to perform the calculations. We make several assumptions, which are used as inputs to the actuarial calculations. The key assumptions are:

	2005	2004
Discount rate	5.25%	6.25%
Expected rate of return on plan assets	7.50	7.50
Rate of compensation increase	3.00	3.50
Growth rate of per capita health care costs, first five years	8.00	8.00
Growth rate of per capita health care costs, thereafter	4.50%	4.50%

Sensitivity to changes in assumptions

The value of the accrued benefit obligation and the amount of net benefit plans cost for the DB pension plans and the OPEB plans that we record are sensitive to the assumptions we make and utilize in our calculations. The following table outlines the estimated impact on the value of the accrued benefit obligation and the annual amount of net benefit plans' cost for a 0.25 percentage point change in the discount rate, the expected rate of return on plan assets and rate of compensation increase. The table also shows the sensitivity of a 1.0 percentage point change in the assumed growth in per capita health care costs.

6 ACCRUED BENEFIT ASSET (LIABILITY) (continued)

(thousands of dollars, rounded to millions,

except as otherwise noted)

	Assumption	Rate change	DB pension plans		OPEB plans	
			Obligation	Cost	Obligation	Cost
Discount rate	5.25%	+/- 0.25%	71,000	1,000	8,000	—
Expected rate of return on plan assets	7.50	+/- 0.25	—	4,000	—	—
Rate of compensation increase	3.00	+/- 0.25	12,000	1,000	—	—
Growth rate of per capita health care costs	4.50 – 8.00%	+ 1.00	—	—	28,000	2,000
		- 1.00%	—	—	(22,000)	(2,000)

The indicated impact of a 0.25 percentage point change in the discount rate on annual net benefit plans' cost includes the impact on the interest and current service cost components of pension cost. In addition to these effects, the amount of amortization of net actuarial losses would also change, but, this change would depend on whether the 0.25 percentage point change was an increase in the discount rate or a decrease in the discount rate and would not extrapolate to other assumed changes in the discount rate. For reference, the amount of amortization of net actuarial losses would increase by approximately \$4.9 million if the discount rate were to be reduced by 0.25 per cent to 5.00 per cent.

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Investment of DB pension plans assets

We have established a Master Trust to hold and invest the assets of the DB pension plans. The Master Trust follows an investment policy that includes the following asset mix as at December 31.

Asset category	Target weight	Percentage of plan assets		Weighted average expected long-term rate of return
		2005	2004	
Domestic bonds/fixed income securities	40%	40%	41%	4.40%
Canadian equity securities	25	26	26	9.50
Non-Canadian equity securities	35	34	33	9.50
Total	100%	100%	100%	7.50%

The asset mix policy is established through consideration of many factors, including tolerance for fluctuation in market values, portfolio diversification and the targeted long-term rate of return for the assets. Foreign exchange risk is inherent in the asset mix policy and foreign currency fluctuations may significantly effect the Canadian dollar returns on the Master Trust portfolio, especially over short time periods (e.g. 1-5 years). When the Canadian dollar rises in value, the returns on the non-Canadian investments will fall as their market value is translated into Canadian dollars, or conversely, as the Canadian dollar falls in value, the returns on non-Canadian investments will rise as their value is translated into Canadian dollars. We have established an investment policy for the Master Trust that requires approximately 20 per cent of the non-Canadian equity exposure be hedged to the Canadian dollar. The remainder of the Master Trust's non-Canadian investments will be effected by the fluctuating value of the Canadian dollar.

Over the past ten years, our weighted average rate of return for our DB pension plans was 9.0 per cent per annum.

The Master Trust is not permitted to directly own common shares or debt obligations of our company or our subsidiaries. The Master Trust does own units of index funds that may hold shares of Aliant Inc. or debt instruments of our subsidiaries by virtue of the fact that these securities are included in the indices.

6 ACCRUED BENEFIT ASSET (LIABILITY) (continued)

The total value of our securities and those of our related issuers held directly or indirectly in the Master Trust as at December 31 was as follows:

As at December 31 (thousands of dollars, except as otherwise noted)	2005		2004	
	Approximate value	Approximate per cent of total plan assets	Approximate value	Approximate per cent of total plan assets
Plan assets held				
Common shares of BCE Inc.	3,900	0.20%	4,300	0.30%
Debentures of BCE Inc. and Bell Canada	10,600	0.60	6,000	0.50
Securities of Aliant Inc., held indirectly	1,100	—	300	—
	15,600	0.80%	10,600	0.80%

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Pension plan contributions

We are responsible for adequately funding our DB pension plans that are registered under the Income Tax Act and regulated by the Office of the Superintendent of Financial Institutions. The required contributions to the registered plans are made to a trust fund that is used to pay benefits under the plans. These contributions are determined by actuarial valuations and reflect actuarial assumptions about future investment returns, salary projections and future service benefits. We are funding the registered DB pension plans through contributions that meet or exceed the applicable statutory funding rules and regulations governing the particular plans.

The DB and DC pension arrangements for executives and OPEB plans are not registered pension plans. We fund payments under these plans directly when the benefits are paid.

Our required and voluntary contributions to DB pension plans as well as our contributions made to OPEB and DC pension plans are as follows:

For the years ended December 31 (thousands of dollars)	2005	2004
DB pension plans		
Required contributions	124,671	56,936
2003 contributions received by the plans	—	25,000
Additional voluntary funding of DB plans	42,661	855
OPEB plans contributions	5,307	4,287
Funding of DB pension and OPEB plans	172,639	87,078
DC pension plans contributions	7,334	11,678
Total contributions	179,973	98,756

7 INDEFINITE-LIFE INTANGIBLES

As at December 31
(thousands of dollars)

	2005	2004
Spectrum licenses	3,726	2,952

During 2005, we purchased spectrum licenses of \$0.8 million (2004 - \$0.2 million).

8 GOODWILL

As at December 31

(thousands of dollars)

	2005	2004
Goodwill, beginning of year	60,783	31,804
Goodwill acquired (note 17)	568	28,979
Goodwill, end of year	61,351	60,783
Goodwill relates to the following reportable segments:		
Telecommunications – wireline	28,680	28,626
Information Technology	32,671	32,157
	61,351	60,783

9 NOTES PAYABLE AND BANK ADVANCES

As at December 31

(thousands of dollars)

	2005	2004
Committed lines of credit		
Supporting commercial paper program	350,000	350,000
Letters of credit	47,376	6,146
Letters of guarantee	78,500	74,500
	475,876	430,646
Uncommitted operating lines of credit	210,124	205,854
Total	686,000	636,500
Notes payable and bank advances:		
Drawn against the uncommitted lines of credit	10,473	2,157
Other	735	6,944
	11,208	9,101

10 RESTRUCTURING CHARGE

In 2004, we restructured our operations by reducing the workforce in certain areas, which resulted in a pre-tax charge against earnings for the year ended December 31, 2004, of \$5.7 million. As well, in October 2004, we offered a voluntary ERIP to all eligible employees with the retirement date for most employees being January 1, 2005. The ERIP was accepted by 693 employees and resulted in a pre-tax charge against earnings of \$66.6 million in 2004.

The restructuring charge balance in payables and accruals at December 31, 2005, is \$12.5 million (2004 – \$68.6 million). As the majority of employees left the organization in 2005, the cash payments associated with the ERIP were charged against this balance. Some ERIP participants elected to defer a portion of their payment to January following the year of their retirement.

11 LONG-TERM DEBT

As at December 31

(thousands of dollars)

	Interest rate	Maturity	2005	2004
Notes				
Aliant Telecom Inc.				
Series 2	6.65%	2009	100,000	100,000
Series 3	6.70%	2005	—	150,000
Series 4	6.80%	2011	150,000	150,000
Series 5	5.35%	2007	100,000	100,000
Series 6	4.52%	2012	150,000	—
			500,000	500,000
Bonds				
Maritime Tel & Tel				
AD	10.45%	2013	50,000	50,000
Island Telecom				
T	10.60%	2009	3,500	3,500
U	11.15%	2010	6,500	6,500
V	9.77%	2018	5,000	5,000
W	8.76%	2019	5,000	5,000
NewTel Communications				
T	10.75%	2014	75,000	75,000
V	11.40%	2010	40,000	40,000
			185,000	185,000
Debentures				
Maritime Tel & Tel				
Series 2	8.30%	2019	50,000	50,000
Series 4	9.70%	2019	50,000	50,000
Series 5	9.05%	2025	60,000	60,000
NBTEL				
AA	11.13%	2013	40,000	40,000
			200,000	200,000
Total – notes, bonds and debentures			885,000	885,000
Obligations under capital leases				
	2.68%	various dates	13,973	4,502
	to 10.05%	to 2010		
Debt related to business acquisition (note 17)				
	6.70%	2009	5,482	6,650
Other				
		2006	48	233
Total long-term debt			904,503	896,385
Less: portion due within one year			6,623	153,043
			897,880	743,342

During the year ended December 31, 2005:

- We issued \$150.0 million of unsecured medium-term notes, bearing interest at 4.52 per cent per annum, maturing in May 2012, and callable at any time at the greater of par and the Canada Yield Price.
- We repaid a \$150.0 million 6.70 per cent Aliant Telecom Inc. Series 3 note that matured on November 24, 2005.
- We entered into two 36-month capital lease obligations totalling \$12.0 million for the acquisition of telecommunications equipment, bearing implicit interest of 3.75 per cent and 4.42 per cent.

11 LONG-TERM DEBT *(continued)*

All bonds are issued in series and all, except for Series "V" issued by NewTel Communications, are redeemable at our option prior to maturity at the prices, times and conditions specified in each series. The bonds are secured by deeds of trust and mortgage and by supplemental deeds. These instruments contain a first fixed and specific mortgage, a pledge and charge upon all real and tangible property and equipment, which includes inventory and all capital investments except software, and all rights and licenses related to that property of Aliant Telecom Inc. located in either Nova Scotia with respect to the Maritime Tel & Tel issued bonds; in Prince Edward Island with respect to the Island Telecom issued bonds and in Newfoundland and Labrador with respect to the NewTel Communications issued bonds. The bonds also provide, based on province of issue, a floating charge on all future real and tangible property of Aliant Telecom Inc. and all revenues and proceeds derived from that property located in those three provinces.

All debentures and notes are issued in series and certain series are redeemable at our option prior to maturity at the prices, times and conditions specified in each series. The debentures and notes are issued under trust indentures and are unsecured.

The aggregate amount of payments required in each of the next five years to meet principal repayments and maturities of our long-term debt and the future minimum lease payments under capital leases presently outstanding are as follows:

<i>(thousands of dollars)</i>	2006	2007	2008	2009	2010	Thereafter
Long-term debt	1,258	101,359	1,411	105,002	46,500	635,000
Capital leases	5,365	3,278	2,486	1,523	1,321	—
	6,623	104,637	3,897	106,525	47,821	635,000

12 DEFERRED CREDITS

As at December 31

<i>(thousands of dollars)</i>	2005	2004
Long-term debt premium income	7,408	8,426
Deferred revenue (note 20)	—	1,850
Other	3,916	1,384
	11,324	11,660

13 CAPITAL STOCK

Authorized

Unlimited number of preference shares, cumulative, redeemable at the price of \$25.00 per share and with a fixed annual dividend rate of \$1.3625 per share. These shares are non-voting, except under certain conditions, and are redeemable at our option on June 30, 2006, or on June 30 of each fifth year thereafter. Preference shareholders may convert their Series 2 preference shares to Series 3 shares on a one-to-one basis on June 30, 2006, or on June 30 each fifth year thereafter, provided that we have not delivered a notice of redemption. The fixed dividend on the Series 2 shares is paid quarterly and will be re-set every five years starting on June 30, 2006, to a rate that is not less than 80 per cent of the five-year Government of Canada bond yield. The Series 3 shares have terms that are substantially the same as the Series 2 shares except that, if issued, will pay a floating adjustable dividend rate monthly.

Unlimited number of common shares, without par value.

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CAPITAL STOCK (continued)

Issued and outstanding

As at December 31 (thousands of dollars, except as otherwise noted)	2005		2004	
	Number of shares	Stated capital	Number of shares	Stated capital
Preference shares, Series 2	7,000,000	172,264	7,000,000	172,264
Common shares	127,137,554	1,003,771	132,744,009	1,044,729
		1,176,035		1,216,993

The following table provides the details of the change in the issued and outstanding common shares.

As at December 31 (thousands of dollars, except as otherwise noted)	2005		2004	
	Number of shares	Stated capital	Number of shares	Stated capital
Common shares, beginning of year	132,744,009	1,044,729	133,616,920	1,035,798
Common shares purchased for cancellation	(5,797,715)	(46,068)	(1,732,130)	(13,410)
Shares issued under:				
Business acquisition (note 17)	—	—	582,081	15,000
Dividend reinvestments	163,360	4,571	229,316	6,405
Stock option plan	27,900	539	47,822	936
Common shares, end of year	127,137,554	1,003,771	132,744,009	1,044,729

Common shares purchased for cancellation

We commenced a normal course issuer bid (NCIB) on February 4, 2005, which will allow us to purchase, from time to time, up to 6,637,200 of our outstanding common shares at the market price with cash through the facilities of the Toronto Stock Exchange (TSX), representing approximately 5.0 per cent of our issued and outstanding common shares as of January 31, 2005, being 132,744,009 common shares. Purchases of common shares may be made up to February 3, 2006, and Bell Canada, our majority shareholder, will sell shares into the NCIB on a pro rata basis. In 2004, we acquired common shares under a similar NCIB, which ended on August 5, 2004. For the year ended December 31, 2005, we purchased for cancellation 5,797,715 shares (2004 – 1,732,130 shares) for an aggregate price of \$161.4 million (2004 – \$50.6 million), which reduced capital stock by \$46.1 million (2004 – \$13.4 million), contributed surplus by nil (2004 – \$0.5 million) and retained earnings by \$115.3 million (2004 – \$36.7 million).

Included in the common share purchases for the year ended December 31, 2005, were 2,988,215 shares purchased at market value from Bell Canada (2004 – 827,497 shares) for an aggregate price of \$83.1 million (2004 – \$24.2 million).

Dividend reinvestments

Under the provisions of our common shareholder dividend reinvestment and stock purchase plan, shareholders may elect to purchase additional common shares in lieu of receiving corporate dividends in the form of cash. During 2005, we issued common shares in lieu of paying cash dividends of \$4.6 million (2004 – \$6.4 million).

Under our employees' stock savings plans, dividends are automatically reinvested in additional common shares. In relation to this plan, we issued common shares in lieu of paying cash dividends during the year ended December 31, 2005, of \$3.3 million (2004 – \$3.8 million). Common shares are purchased on the open market for participants in our employees' stock savings plan.

13 CAPITAL STOCK (continued)

Stock option plan

We have a stock option plan for executives and certain senior managers. Under this stock option plan, we may grant stock options to plan members for up to 6,852,714 shares of common stock, of which 2,892,493 options for the same number of common shares were outstanding as at December 31, 2005 (2004 - 2,496,777). The exercise price of each option equals the opening market price of our common shares on the date of grant. An exception to this occurred in 2004, when our common share price rose significantly but temporarily on market speculation. As a result of the price increase, we requested, and were granted, by the TSX the right to use a five-day average trading value for purposes of determining the exercise price of the January 2004 stock option grant only. The right to exercise the options vests evenly over three years from the date they are granted under the plan and can be exercised for a period of up to 10 years from the date of grant.

A summary of the status of our stock option plan as at December 31 and changes during the years ended on those dates is as follows:

	2005		2004	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
<i>As at December 31</i>				
Options outstanding, beginning of year	2,496,777	30.37	2,338,367	30.06
Granted	481,520	29.24	432,621	32.39
Forfeited	(57,904)	31.82	(226,389)	33.31
Exercised	(27,900)	19.30	(47,822)	19.58
Options outstanding, end of year	2,892,493	30.26	2,496,777	30.37
Options exercisable, end of year	2,084,481	30.35	1,703,581	30.38

The following table summarizes information about stock options outstanding at December 31, 2005:

Range of exercise prices	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual life in years	Weighted average exercise price	Number exercisable	Weighted average exercise price
11.746 to 15.718	53,867	1.0	14.49	53,867	14.49
19.125 to 20.079	76,995	2.1	19.96	76,995	19.96
21.768 to 25.552	135,443	3.1	23.00	135,443	23.00
26.790 to 34.900	2,236,329	6.8	30.53	1,428,317	30.82
35.250 to 38.100	389,859	5.1	35.43	389,859	35.43
	2,892,493		30.26	2,084,481	30.35

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CAPITAL STOCK *(continued)*

The following table shows the assumptions used to determine compensation expense for stock options issued using the Black-Scholes option pricing model.

<i>December 31</i>	2005	2004
Weighted average fair value per option granted <i>(dollars)</i>	4.83	6.67
Assumptions		
Dividend yield	4.03%	3.38%
Expected volatility	21.30%	22.40%
Risk-free interest rate	3.98%	4.20%
Expected lives	7.78 years	7.78 years

For the year ended December 31, 2005, compensation expense in the amount of \$2.0 million (2004 – \$1.1 million) related to stock options granted was recorded.

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Performance share unit plan

We have a performance share unit (PSU) plan for certain executive and senior management to further align their long-term incentive compensation with total shareholder returns. Participants in the plan are required, over a period of five years, to hold a specific dollar value of shares reflecting their position and responsibilities. Share units granted are subject to both time-based, over three years, and performance-based vesting. Upon vesting, each share unit is convertible into one common share acquired on the open market or a cash payment equal to the fair market value of those shares, subject to adjustment depending on the achievement of performance criteria. The performance criteria are relative to our total shareholder return (share price appreciation plus dividends) compared to the total shareholder return for comparative groups of companies. Grantees are also entitled to receive additional share units based on dividends paid on our common shares.

During the second quarter of 2005, the PSU was amended to include a supplementary personal performance share unit plan (PPSU) component, which was approved by the board of directors. The PPSU plan was established for certain executives and senior management. The PPSUs and PSUs are similar except that the PPSUs have performance-based criteria for vesting of share unit grants, which are based on the achievement of personal objectives supporting specific key corporate objectives rather than overall corporate performance. The 2004 PSU grant was restructured as a PPSU grant in the second quarter of 2005.

A summary of the status of our PSU plan as at December 31 and changes during the years ended on those dates is as follows:

<i>As at December 31</i>	2005	2004
	Number	Number
	of units	of units
Units outstanding, beginning of year	109,322	61,121
Granted	144,889	50,193
Forfeited	(16,463)	—
Exercised	(63,998)	(1,992)
Units outstanding, end of year	173,750	109,322

For the year ended December 31, 2005, compensation expense in the amount of \$2.1 million (2004 – \$0.9 million) related to the PSUs and PPSUs granted was recorded.

13 CAPITAL STOCK *(continued)*

Employees' stock savings plan

We have an employees' stock savings plan for our eligible full-time employees, over 80 per cent of whom participate in the plan. To satisfy the employees' purchases of shares under this plan, we may issue up to 2,079,527 additional common shares out of treasury or shares may be purchased on the open market.

Under the terms of the plan, employees can choose each year to have up to 10 per cent of their annual base earnings withheld to purchase our common shares. We will also contribute to the plan on behalf of participants based upon the employees' contributions using a prescribed formula. The purchase price of the common shares is the arithmetic average of the closing price of the common shares traded on the TSX on the last five days up to, and including, the dividend payment date. Participants in the plan purchase additional common shares in lieu of receiving corporate dividends in the form of cash.

The total number of common shares bought on the open market for employees during the year ended December 31, 2005, was 1,310,700, (2004 - 1,049,000). Compensation expense related to the employees' stock savings plan of \$7.5 million for the year ended December 31, 2005 (2004 - \$6.0 million) was recorded.

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14 SEGMENTED INFORMATION

We operate through the following reportable segments:

Telecommunications - operating segment provides a full range of telecommunications services in New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland and Labrador. Included in this line of business are Aliant Telecom Inc., Innovatia Inc., DownEast Ltd. and Aliant ActiMedia. In 2004, the telecommunications operating segment was a reportable segment. In 2005, this operating segment was changed to include two reportable segments:

- *Wireline* - provides local telephone, long distance, Internet, directory advertising, and other products and services.
- *Wireless* - provides cellular, paging and other wirefree services.

The prior year's reportable segments have been restated to be comparable with the current year's presentation. Within the telecommunications operating segment, we use operating income as one of the key measures to evaluate operating performance.

Information Technology - provides systems integration, application development, local area network installation, wide area network management, data centre operations, computer hardware, package software and information technology planning services. Xwave Solutions Inc. operates in this line of business.

Corporate and others - mainly includes the operations of Aliant Inc. as a corporate entity. This line of business does not carry on any significant operations and has no major sources of income or assets of its own, other than the interest it holds in its subsidiaries and joint venture. These are accounted for using the equity method and eliminated upon consolidation.

Our operations, including most of our revenue, assets and goodwill, are located in Canada. Our segments are organized by products and services, and reflect how we manage our operations. The accounting policies of the segments are the same as those described in note 1, except as noted above. We evaluate performance based on a number of financial and non-financial indicators including net income, return on equity and revenue growth.

We account for intersegment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices.

14 SEGMENTED INFORMATION (continued)

For the year ended December 31, 2005

(thousands of dollars)

	Telecommunications			Information Technology	Corporate and others	Eliminations	Consolidated
	Wireline	Wireless	Total				
Revenue from							
external customers	1,414,204	430,131	1,844,335	250,622	1,725	—	2,096,682
Intersegment revenue	(4,818)	13,109	8,291	105,015	—	(113,306)	—
Operating revenues	1,409,386	443,240	1,852,626	355,637	1,725	(113,306)	2,096,682
Operating expenses	821,907	237,987	1,059,894	325,871	35,163	(110,359)	1,310,569
Depreciation and amortization							
	339,485	47,000	386,485	5,935	1,210	(2,375)	391,255
Operating income	247,994	158,253	406,247	23,831	(34,648)	(572)	394,858
Other income (expenses)			(3,264)	171	208,416	(208,529)	(3,206)
Interest charges			72,779	328	6,943	(6,285)	73,765
Income taxes (recovery)			121,190	9,296	(14,369)	(139)	115,978
Non-controlling interest			2,546	—	—	—	2,546
Net income			206,468	14,378	181,194	(202,677)	199,363
Purchase of capital investments							
	307,888	52,612	360,500	5,055	9	(2,323)	363,241
Goodwill acquired	54	—	54	514	—	—	568
Total assets			2,717,566	190,678	1,643,662	(1,684,977)	2,866,929

For the year ended December 31, 2004

(thousands of dollars)

	Telecommunications			Information Technology	Corporate and others	Eliminations	Consolidated
	Wireline	Wireless	Total				
Revenue from							
external customers	1,414,521	380,410	1,794,931	237,126	1,413	—	2,033,470
Intersegment revenue	(3,110)	10,253	7,143	106,339	—	(113,482)	—
Operating revenues	1,411,411	390,663	1,802,074	343,465	1,413	(113,482)	2,033,470
Operating expenses	845,529	209,700	1,055,229	321,887	29,270	(112,104)	1,294,282
Depreciation and amortization							
	344,827	46,208	391,035	8,482	1,217	(3,397)	397,337
Restructuring charge	64,580	463	65,043	5,798	1,447	—	72,288
Operating income	156,475	134,292	290,767	7,298	(30,521)	2,019	269,563
Other income (expenses)			(1,549)	1,419	148,160	(143,688)	4,342
Interest charges			74,459	727	5,272	(5,419)	75,039
Income taxes (recovery)			68,551	1,270	(4,014)	633	66,440
Non-controlling interest			1,773	1	—	—	1,774
Net income			144,435	6,719	116,381	(136,883)	130,652
Purchase of capital investments							
	228,030	61,004	289,034	5,459	240	(1,379)	293,354
Goodwill acquired	28,626	—	28,626	353	—	—	28,979
Total assets			2,656,370	169,651	1,825,068	(1,747,469)	2,903,620

14 SEGMENTED INFORMATION *(continued)*

Revenue from external customers by product and service

For the years ended December 31

<i>(thousands of dollars)</i>	2005	2004
Telecommunications		
Local	728,289	750,251
Long distance	310,668	341,366
Wireless	439,620	386,361
Internet	131,882	119,089
Product	124,351	109,738
Directory	53,337	49,597
Innovatia	39,742	27,478
Other telecommunications	16,446	11,051
	1,844,335	1,794,931
Information Technology		
Fulfillment	136,921	125,614
IT services	113,701	111,512
	250,622	237,126
Other	1,725	1,413
	2,096,682	2,033,470

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15 OTHER INCOME (EXPENSES)

For the years ended December 31

<i>(thousands of dollars)</i>	2005	2004
Interest income	8,437	13,139
Accounts receivable securitization (note 2)	(3,539)	(3,316)
Provincial large corporation tax	(4,480)	(4,705)
Gain on disposal of business units (note 17)	—	1,262
Foreign exchange	(3,278)	(581)
Other	(346)	(1,457)
	(3,206)	4,342

16 EARNINGS PER COMMON SHARE

For the years ended December 31

(thousands of dollars, except per share amounts)

	2005	2004
Net income applicable to common shares:		
Net income	199,363	130,652
Preferred share dividends	(9,537)	(9,537)
Net income applicable to common shares	189,826	121,115
Basic:		
Weighted average number of common shares outstanding	130,048	132,740
Basic earnings per common share	1.46	0.91
Diluted:		
Weighted average number of common shares outstanding	130,048	132,740
Impact of outstanding stock options	—	—
	130,048	132,740
Diluted earnings per common share	1.46	0.91

The impact of outstanding stock options represents common shares issuable under the terms of our stock option plan that have an exercise price that is lower than the average market value during the period. There was no impact on diluted earnings per common share in 2005 or 2004. Refer to note 13 for details of our stock option plan.

Compensation expense was recorded on awards granted under our stock option plan subsequent to 2002, as described in note 1.

Proforma adjustments to net income and earnings per common share

The fair value of the 2002 stock options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used:

December 31	2002
Dividend yield	3.10%
Expected volatility	24.60%
Risk-free interest rate	5.08%
Expected lives	7.78 years

For the year ended December 31, 2004, the proforma adjustment to net income for compensation expense related to the 2002 stock options was \$1.2 million, which reduced basic and diluted earnings per common share by \$0.01.

There is no proforma adjustment in 2005 related to compensation expense on the 2002 stock options granted as it was fully recognized over the vesting period, being three years.

17 BUSINESS ACQUISITIONS AND DISPOSITIONS

Business acquisitions

Our consolidated financial statements include the results of acquired businesses from the date they were purchased.

On October 1, 2004, our Telecommunications segment purchased 100 per cent of the outstanding common shares of DownEast Ltd., a communication solutions retailer. The finite-life intangibles recognized relate to residual commissions between Aliant Telecom Inc. and DownEast Ltd. and are subject to amortization. The goodwill recognized is not deductible for tax purposes. The number of Aliant Inc. common shares issued as consideration given was determined using the volume weighted average price of the common shares traded on the TSX on the last five trading days up to, and including, the closing date. The long-term debt incurred is non-interest bearing, but for financial statement purposes has been discounted by 6.70 per cent.

On December 1, 2004, our Information Technology segment acquired the net assets of the Atlantic Canada operations of Fujitsu Consulting (Canada) Inc. (Fujitsu Atlantic operations). On March 16, 2005, the Innervations Partnership Assets, which were previously owned by the Fujitsu Atlantic operations but were subject to a right of first refusal, were also purchased. These operations offer consulting skills and client knowledge, complementing our existing experience and strengthening our presence in Atlantic Canada. The finite-life intangibles recognized relate to active and potential customer contracts related to the Fujitsu Atlantic operations that were in place at the time of acquisition and are subject to amortization. The goodwill recognized is deductible for tax purposes.

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The following table shows the final purchase price allocation for business acquisitions in 2004:

<i>(thousands of dollars)</i>	Fujitsu Atlantic operations	DownEast Ltd.	Total
Accounts receivable	1,346	4,965	6,311
Inventory	—	2,135	2,135
Prepayments	13	671	684
Capital investments	99	1,926	2,025
Finite-life intangibles	2,248	7,600	9,848
Payables and accruals	(359)	(1,745)	(2,104)
Future income tax liability	—	(2,046)	(2,046)
Goodwill	867	28,680	29,547
	4,214	42,186	46,400
Cash position at acquisition	—	(747)	(747)
Net assets acquired	4,214	41,439	45,653
Consideration			
Cash	4,214	19,789	24,003
Long-term debt	—	6,650	6,650
Issuance of 582,081 Aliant Inc. common shares	—	15,000	15,000
	4,214	41,439	45,653

During 2005, costs were incurred in relation to the acquisition of DownEast Ltd. and the Innervations Partnership Assets, which increased goodwill by \$54,000 and \$514,000, respectively.

Business dispositions

Our Information Technology segment sold its Internet help desk operation on June 1, 2004, and its information technology service business in Western Canada on July 31, 2004. Proceeds received on these dispositions amounted to \$2.6 million. The carrying value of net assets sold was \$1.1 million and the gain, net of transaction costs, of \$1.3 million was recorded in other income (expenses).

18 FINANCIAL INSTRUMENTS

Risk management

Periodically, we use interest rate swaps and swaptions, forward contracts and forward rate agreements to manage our exposure to interest rate risk and foreign currency risk associated with our long-term debt or firm commitments. The terms of these derivative contracts match the terms associated with the underlying long-term debt or other hedged obligation. These contracts are generally used to reduce risks in financing costs and to diversify our access to capital markets.

Credit risk

We are exposed to credit risk with respect to accounts receivable from customers, but the concentration of this risk is minimized because we have a large and diverse customer base. We have credit evaluation, approval and monitoring processes intended to mitigate potential credit risks, and maintain provisions for potential credit losses that are assessed on an ongoing basis. Refer to notes 1 and 2 for details on the transfer of receivables.

Currency exposures

In order to reduce our exposure to foreign currency risk on material contracts denominated in foreign currency, we use forward rate contracts or similar arrangements, which are not accounted for as hedges.

At December 31, 2005, we had contracts outstanding to sell 0.5 million Euro (2004 – 1.4 million Euro) at a rate of \$1.3666 per one Euro (2004 – \$1.6415 per one Euro). The forward rates for the contracts at December 31, 2005, was \$1.3805 per one Euro (2004 – \$1.6326 per one Euro).

Interest rate exposures

Our long-term debt consists primarily of fixed interest rate financing. In order to diversify our sources of interest rate risk and manage the overall cost of borrowing we entered into interest rate derivative transactions and are therefore subject to risks associated with fluctuating interest rates. We had the following derivative instruments outstanding at December 31, 2005:

- Interest rate swap – For hedging purposes, we have entered into an interest rate swap transaction with a notional amount at December 31, 2005, of \$100.0 million (2004 – \$100.0 million) expiring on May 11, 2011. The swap transaction involves us exchanging our underlying fixed interest rate of 6.80 per cent per annum for a three-month Bankers' Acceptance floating interest rate plus 2.06 per cent.
- Interest rate swaption – We have also entered into swaption transactions related to our Maritime Tel & Tel series AD bonds and our NBTel series AA debentures with a total notional amount at December 31, 2005, of \$90.0 million (2004 – \$90.0 million). These long-term debt issues are callable at our option on March 2, 2006, and July 19, 2006, respectively. The swaptions grant an option to the counterparty in the transaction to enter into an interest rate swap transaction with us on the call dates of the two underlying debt instruments. If exercised, these swaptions will involve us entering into fixed-floating interest rate swaps whereby we pay fixed interest rates of 10.45 per cent and 11.125 per cent, respectively, in exchange for receiving the three-month Bankers' Acceptance floating interest rate from the effective dates, which correspond with the call dates of the underlying debt in March and July of 2006, until maturity in 2013. In exchange for providing the counterparty with these options, we received premium income payments from the counterparty of \$7.6 million in 2001 and \$5.4 million in 1997. This premium income is being amortized against interest charges over the period to maturity of the underlying debt issues. The remaining unamortized premium income as at December 31, 2005, of \$7.4 million (2004 – \$8.4 million) is recorded as a deferred credit.

18 FINANCIAL INSTRUMENTS *(continued)*

Fair value

Fair values approximate amounts at which financial instruments could be exchanged between willing parties, based on current markets for instruments of the same risk, principal and remaining maturities. We base fair values on estimates using present value and other valuation techniques, which are significantly affected by the assumptions used concerning the amount and timing of estimated future cash flows and discount rates, which reflect varying degrees of risk. Potential income taxes and other expenses that would be incurred on disposition of these financial instruments have not been reflected in the fair values. As a result, due to the use of subjective judgment and uncertainties, the fair values are not necessarily the net amounts that would be realized if these instruments were actually settled.

The carrying value of all financial instruments approximates fair value with the exception of the following:

As at December 31 (thousands of dollars)	2005		2004	
	Carrying value	Fair value	Carrying value	Fair value
Long-term debt	904,503	1,096,478	896,385	1,104,637
Interest rate derivative financial instruments, net liability position	(7,408)	(31,800)	(8,426)	(27,500)

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19 COMMITMENTS

The estimated future minimum lease payments under operating leases and purchase commitments are as follows:

(thousands of dollars)	2006	2007	2008	2009	2010	Thereafter
Operating leases	43,190	38,513	36,254	34,560	28,465	120,409
Purchase commitments	39,237	9,426	3,957	1,854	—	—
	82,427	47,939	40,211	36,414	28,465	120,409

Purchase commitments primarily relate to various information systems and technology agreements, obligations under service contracts and a billing system for our wireless services.

20 RELATED PARTY TRANSACTIONS

Bell Canada, which is owned 100 per cent by BCE Inc., beneficially owns and controls 53.21 per cent (2004 - 53.22 per cent) of our outstanding common shares as at December 31, 2005.

In 1999, we entered into a Memorandum of Agreement (MOA) with BCE Inc. and Bell Canada. This long-term strategic alliance agreement describes the understanding between us, BCE Inc. and Bell Canada with respect to the provision and delivery of telecommunications services. Through this MOA, we gained access to Bell Canada's technology, the exclusive right to use specified Bell Canada trademarks in our territory, and a license to use Bell Canada's promotional materials. Bell Canada agreed to promote the use and sale of technology and intellectual property developed by us. We agreed to provide each other with support services, including operational, technical, marketing, training and other support services. The MOA will continue in effect for as long as BCE holds an interest in Aliant Inc. of at least 10 per cent, subject to termination rights on the occurrence of certain specified events. BCE Inc. agreed not to proactively increase its ownership interest in Aliant Inc. beyond 55 per cent, except by making an offer for all remaining common shares.

20 RELATED PARTY TRANSACTIONS *(continued)*

We also have an agreement with Bell Canada that provides access to certain of each other's intellectual property, in addition to providing us with access to Bell Canada's engineering and network intellectual property.

In the normal course of business, we enter into agreements with Bell Canada and its controlled investees to provide and purchase telecommunications and other support services, and purchase capital investments. All related party transactions are at the exchange amounts as follows:

For the years ended December 31

<i>(thousands of dollars)</i>	2005	2004
Operating revenues	138,671	139,625
Operating expenses	140,854	122,177
Other income	5,325	2,414
Capital investments	9,841	5,389

Common shares of Aliant Inc. purchased at market value from Bell Canada under a normal course issuer bid, as described in note 13, were as follows:

As at December 31

<i>(thousands of dollars, except as otherwise noted)</i>	2005	2004
Number of common shares purchased	2,988,215	827,497
Value	83,084	24,152

Balances with Bell Canada and its controlled investees are as follows:

As at December 31

<i>(thousands of dollars)</i>	2005	2004
Note receivable from related party	—	185,000
Accounts receivable	31,224	30,961
Payables and accruals	14,303	6,350
Dividends payable	19,711	—
Deferred credits	—	1,850

As at December 31, 2004, our notes receivable from related party was with Bell Canada and was in the form of a revolving loan that matured on the first day of each month and could be recalled at any time, bearing interest of 2.56 per cent per annum at December 31, 2004. The note was repaid in full on December 30, 2005.

The accounts receivable from, payables and accruals to and deferred credits to controlled investees of Bell Canada are non-interest bearing and under normal credit terms and have arisen from the sales of products and provision of services referred to above.

Estimated future minimum payments under our contractual obligations with Bell Canada, which are included in commitments in note 19, are \$9.5 million in 2006 and nil thereafter.

21 JOINT VENTURE

We hold an 87.14 per cent partnership interest in the joint venture Aliant ActiMedia.

The effect of proportionate consolidation of the joint venture on our consolidated financial statements is summarized as follows:

As at or for the years ended December 31

<i>(thousands of dollars)</i>	2005	2004
Consolidated statements of income		
Operating revenues	53,337	49,598
Expenses	22,470	20,044
Net income	30,867	29,554
Consolidated balance sheets		
Current assets	20,396	17,384
Long-term assets	216	278
Current liabilities	7,536	7,798
Net investment	13,076	9,864
Consolidated statements of cash flows		
Operating activities	1,181	2,260
Investing activities	(46)	(77)
Net cash flow	1,135	2,183

During 2005, we received cash distributions from Aliant ActiMedia of \$29.2 million (2004 - \$25.4 million), which are reflected above in cash flow from operating activities.

22 CONTINGENCIES

Litigation

- (a) On September 21, 2005, the lawsuit that was commenced against Aliant Telecom Inc. in New Brunswick by 132 former employees who took early retirement under a 1998 early retirement incentive program was discontinued on the basis that the parties bear their own legal costs.
- (b) On December 22, 2005, the lawsuit that was commenced against us by Exigen Ltd. (Exigen) that stemmed from the sale of Connectivity Contact Centre Solutions Inc. to Exigen, the termination of certain commercial agreements and claims of interference with Exigen's commercial relations was settled. The settlement amount did not significantly exceed the reserves previously accrued in the financial statements.
- (c) On August 9, 2004, a lawsuit was filed in Saskatchewan against several Canadian wireless and cellular service providers, including Aliant Telecom Inc. The suit was brought by several alleged customers or former customers of the defendants, who seek court permission to proceed by way of class action under the Saskatchewan Class Actions Act. The claim relates to certain system access fees that the defendants charge to their customers. In the claim, the plaintiffs allege, among other things, breach of contract, misrepresentation, negligence, collusion and breach of statutory obligations under the Competition Act (Canada) in relation to the system access fees, and seek unspecified damages, including punitive and exemplary damages. The certification hearing for the claim to proceed as a class action was completed in May 2005, but no decision has yet been filed. We have defenses to this claim, but the outcome of this matter is not determinable at this time.

22 CONTINGENCIES *(continued)*

- (d) During 2005, the defense of the lawsuit brought by Canada Life Assurance Company in the Supreme Court of Nova Scotia against the Province of Nova Scotia, which included Aliant Telecom Inc. as a third party by virtue of consulting services we provided, was assumed by our insurers, subject to the payment of the policy deductible.
- (e) On November 30, 2005, a lawsuit was filed against us in the Supreme Court of Nova Scotia by Ellph.com Solutions Inc. seeking approximately \$9 million for alleged breach of a software license contract. We have defenses to this claim, but the outcome of the matter is not determinable at this time.

We become involved in various other claims and litigation as a regular part of our business. While we cannot predict the final outcome of claims and litigation that were pending at December 31, 2005, management believes that the resolution of these claims and litigation will not have a material effect on our consolidated financial position or results of operations.

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Deferral account

On May 30, 2002, the CRTC released its price cap decision that prescribed new rules to determine the rates charged for certain telecommunications services provided by incumbent local exchange carriers (ILECs) for the four years beginning June 1, 2002. The price cap decision requires the use of a new mechanism, the deferral account, to mitigate the potential adverse effects on competition in the local market as a result of mandated rate reductions. The deferral account may be reduced by one or a combination of the following:

- Rate reductions for residential local services that are proposed as the result of competitive pressures;
- Certain rate reductions for services provided to competitors;
- The approval of exogenous factors for matters beyond control of the ILECs;
- Rate increases less than the amount by which inflation exceeds productivity;
- Subscriber rebates; and
- Funding initiatives that would benefit residential customers in other ways.

We await clarification from the CRTC regarding application of the deferral account rules and allowable cost mitigation features. Accordingly, we have not recognized the deferral account as a liability in our financial statements. Given the circumstances outlined, we estimate the deferral account balance could be between \$6 million and \$39 million. A liability, should one arise, will be charged to operating income or capital investments, as appropriate.

23 SUBSEQUENT EVENTS

Deferral account

On February 16, 2006, the CRTC issued its decision regarding the application of the deferral account rules, indicating that ILECs should clear the accumulated balances in their deferral accounts by expanding broadband services to rural and remote areas that are currently unserved and would not otherwise be served, and by improving the accessibility to telecommunications services for persons with disabilities. Our deferral account is estimated at \$22.0 million.

Derivative financial instruments

On March 1, 2006, our series AD first mortgage bonds were redeemed, prior to maturity, at a price equal to 101 per cent of their \$50 million principal amount. Effective March 2, 2006, an outstanding interest rate swaption related to the call option on our series AD debt was exercised by the counterparty.

As a result, we were placed into an interest rate swap agreement, whereby we are required to pay a fixed interest rate of 10.45 per cent and receive the three month Banker's Acceptance floating rate on a notional principal amount of \$50 million. On March 2, 2006, the swap was valued at \$17.9 million in favor of the counterparty, and was recorded as a derivative liability. An unamortized premium amount of \$4.7 million related to the swaption was also extinguished, and the resulting charge to income was \$13.2 million.

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Income trust formation

On March 7, 2006, we jointly announced with BCE Inc. the combining of our wireline operations, Bell Canada's wireline operations in its regional territories in Ontario and Quebec, and Bell's 63.4 per cent interest in the Bell Nordiq Partnerships, to form a new income trust. As part of the proposed transaction, Bell Canada will acquire our wireless operations as well as DownEast Ltd. The transaction is expected to close as early as the third quarter of 2006, upon receipt of regulatory, shareholder and other required approvals.

