

**SEA BREEZE POWER CORP.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2009 AND 2008**  
**(Stated In Canadian Dollars)**



## AUDITORS' REPORT

To the Shareholders of  
Sea Breeze Power Corp.

We have audited the consolidated balance sheets of Sea Breeze Power Corp. as at December 31, 2009 and 2008, and the consolidated statements of net loss and comprehensive loss, cash flows and shareholders' deficiency for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our 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, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Vancouver, Canada

April 29, 2010

*"Morgan & Company"*

Chartered Accountants

**SEA BREEZE POWER CORP.****Consolidated Balance Sheets**  
(Stated in Canadian Dollars)

	<b>DECEMBER 31</b>	
	<b>2009</b>	<b>2008</b>
<b>ASSETS</b>		
<b>Current</b>		
Cash	\$ 15,384	\$ 194,337
Accounts receivable	36,200	103,503
Related party receivable (Note 6)	65,240	7,755
Prepaid expenses and deposits	24,710	23,833
	<u>141,534</u>	<u>329,428</u>
<b>Security Deposits (Note 5)</b>	<b>107,085</b>	<b>76,255</b>
<b>Investments (Note 6)</b>	<b>1</b>	<b>1</b>
<b>Property And Equipment (Note 8)</b>	<b>185,862</b>	<b>214,723</b>
	<u>\$ 434,482</u>	<u>\$ 620,407</u>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 725,010	\$ 446,753
Loans payable (Note 9)	835,041	2,763,428
	<u>1,560,051</u>	<u>3,210,181</u>
<b>Convertible Debentures (Note 11)</b>	<b>8,139,872</b>	<b>4,438,617</b>
	<u>9,699,923</u>	<u>7,648,798</u>
<b>SHAREHOLDERS' DEFICIENCY</b>		
<b>Equity Portion Of Convertible Debenture (Note 11)</b>	<b>2,730,767</b>	<b>2,202,408</b>
<b>Commitment To Issue Shares</b>	<b>1,871,663</b>	<b>804,738</b>
<b>Share Capital (Note 12)</b>	<b>21,057,459</b>	<b>21,047,459</b>
<b>Contributed Surplus</b>	<b>11,118,449</b>	<b>10,472,430</b>
<b>Deficit</b>	<b>(46,043,779)</b>	<b>(41,555,426)</b>
	<u>(9,265,441)</u>	<u>(7,028,391)</u>
	<u>\$ 434,482</u>	<u>\$ 620,407</u>

Approved on Behalf of the Board of Directors:

\_\_\_\_\_  
"Paul B. Manson"  
Director

\_\_\_\_\_  
"Henry P. Anderson, III"  
Director

See accompanying notes to consolidated financial statements.

**SEA BREEZE POWER CORP.****Consolidated Statements of Net Loss and Comprehensive Loss**  
(Stated in Canadian Dollars)

	YEARS ENDED DECEMBER 31	
	2009	2008
<b>Service Income</b>	\$ 40,875	\$ 26,961
<b>Cost Of Service Income</b>	(38,081)	(18,741)
<b>Income On Service Activity</b>	<u>2,794</u>	<u>8,220</u>
<b>Project Development Costs (Note 13)</b>	<u>1,089,853</u>	<u>2,587,801</u>
<b>Administration Expenses</b>		
Amortization	28,861	33,002
Bank charges and interest	123,884	156,135
Consulting	23,542	13,090
Foreign exchange loss (gain)	(111,552)	505,998
Interest on convertible debentures	1,657,609	867,035
Office and rent	359,019	483,437
Professional fees	262,203	298,658
Public relations and travel	49,533	111,839
Shareholder's information	28,414	23,196
Stock based compensation	646,019	1,116,677
Salaries and benefits	318,235	607,176
Transfer agent and filing fees	19,598	16,349
<b>Total Administration Expenses</b>	<u>3,405,365</u>	<u>4,232,592</u>
<b>Loss Before The Following</b>	<u>(4,492,424)</u>	<u>(6,812,173)</u>
<b>Write Off On Marketable Securities</b>	-	(2,560)
<b>Interest Income</b>	<u>4,071</u>	<u>7,167</u>
<b>Net Loss For The Year</b>	<u>(4,488,353)</u>	<u>(6,807,566)</u>
<b>Other Comprehensive Income</b>		
Reclassification of loss on disposal of available-for-sale investments to income	-	1,810
<b>Comprehensive Loss For The Year</b>	<u>\$ (4,488,353)</u>	<u>\$ (6,805,756)</u>
<b>Loss Per Share - Basic and diluted</b>	<u>\$ (0.06)</u>	<u>\$ (0.09)</u>
<b>Weighted Average Common Shares Outstanding</b>	<u>78,270,112</u>	<u>76,519,818</u>

See accompanying notes to consolidated financial statements.

**SEA BREEZE POWER CORP.****Consolidated Statements of Cash Flows**  
(Stated in Canadian Dollars)

	<b>YEARS ENDED DECEMBER 31</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash Provided By (Used In):</b>		
<b>Cash Flows From Operating Activities</b>		
Net loss for the year	<b>\$ (4,488,353)</b>	\$ (6,807,566)
Items not affecting cash:		
Interest to be paid in common shares	<b>1,066,925</b>	590,502
Amortization	<b>28,861</b>	33,002
Loss on marketable securities	-	2,560
Interest on loans payable	<b>98,782</b>	148,943
Stock based compensation	<b>646,019</b>	1,116,677
Unrealized foreign exchange (gain) loss	<b>(55,617)</b>	530,480
Accretion of interest on convertible debentures	<b>586,990</b>	275,451
Shares issued for project development costs	<b>10,000</b>	
Changes in non-cash operating working capital items:		
Accounts receivable	<b>67,303</b>	12,462
Accounts payable and accrued liabilities	<b>278,257</b>	85,654
Prepaid expenses	<b>(877)</b>	37,502
Related party receivable	<b>(57,485)</b>	(7,755)
	<b>(1,819,195)</b>	(3,982,088)
<b>Cash Flows From Financing Activities</b>		
Loans payable received	<b>1,568,556</b>	3,768,310
Convertible debentures issued	<b>104,186</b>	-
Common shares issued for cash	-	279,350
	<b>1,672,742</b>	4,047,660
<b>Cash Flows From Investing Activities</b>		
Purchase of equipment	-	(42,270)
Security deposits	<b>(32,500)</b>	1,000
	<b>(32,500)</b>	(41,270)
<b>(Decrease) Increase In Cash</b>	<b>(178,953)</b>	24,302
<b>Cash, Beginning Of The Year</b>	<b>194,337</b>	170,035
<b>Cash, End Of The Year</b>	<b>\$ 15,384</b>	<b>\$ 194,337</b>

**Supplemental Disclosure For Non-Cash Financing And Investing Activities (Note 14)**

See accompanying notes to consolidated financial statements.

## SEA BREEZE POWER CORP.

### Consolidated Statements of Shareholders' Deficiency Years ended December 31, 2009 and 2008

	COMMON SHARES		EQUITY PORTION OF CONVERTIBLE DEBENTURES	CONTRIBUTED SURPLUS	SPECIAL WARRANTS	COMMITMENT TO ISSUE SHARES	OTHER COMPREHENSIVE LOSS	DEFICIT	TOTAL
	NUMBER	AMOUNT							
Balance, December 31, 2007	72,808,960	\$ 18,916,167	\$ 1,309,918	\$ 9,362,015	\$ 245,048	\$ 1,814,868	\$ (1,810)	\$ (34,747,860)	\$ (3,101,654)
Issued for cash pursuant to:									
Exercise of special warrants at \$0.15	1,815,668	272,350	-	-	-	-	-	-	272,350
Exercise of stock options at \$0.35	20,000	7,000	-	-	-	-	-	-	7,000
Special warrants valuation	-	245,048	-	-	(245,048)	-	-	-	-
Stock options valuation	-	6,262	-	(6,262)	-	-	-	-	-
Conversion of convertible debenture	3,721,278	1,600,632	-	-	-	(1,600,632)	-	-	-
Equity portion of convertible debentures	-	-	892,490	-	-	-	-	-	892,490
Interest payable in shares	-	-	-	-	-	590,502	-	-	590,502
Unrealized gain on marketable securities	-	-	-	-	-	-	1,810	-	1,810
Stock based compensation	-	-	-	1,116,677	-	-	-	-	1,116,677
Net loss for the year	-	-	-	-	-	-	-	(6,807,566)	(6,807,566)
Balance, December 31, 2008	78,365,906	21,047,459	2,202,408	10,472,430	-	804,738	-	(41,555,426)	(7,028,391)
Shares issued for property use (Note 13)	50,000	10,000	-	-	-	-	-	-	10,000
Fractional shares cancelled and returned to treasury	(33)	-	-	-	-	-	-	-	-
Equity portion of convertible debentures	-	-	528,359	-	-	-	-	-	528,359
Interest payable in shares	-	-	-	-	-	1,066,925	-	-	1,066,925
Stock based compensation	-	-	-	646,019	-	-	-	-	646,019
Net loss for the year	-	-	-	-	-	-	-	(4,488,353)	(4,488,353)
<b>Balance, December 31, 2009</b>	<b>78,415,873</b>	<b>\$ 21,057,459</b>	<b>\$ 2,730,767</b>	<b>\$ 11,118,449</b>	<b>\$ -</b>	<b>\$ 1,871,663</b>	<b>\$ -</b>	<b>\$ (46,043,779)</b>	<b>\$ (9,265,441)</b>

See accompanying notes to consolidated financial statements.

# **SEA BREEZE POWER CORP.**

## **Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)**

### **1. NATURE OF OPERATIONS AND GOING CONCERN**

Sea Breeze Power Corp. (the "Company") is a public company incorporated under the Business Corporations Act of British Columbia, Canada. The Company's principal business activity is the development of hydro-electric projects, wind power generation projects and transmission projects in British Columbia, Canada.

These consolidated financial statements have been prepared on a going-concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business.

The Company reported net losses of \$4,488,353 and \$6,807,566 for the years ended December 31, 2009 and 2008, respectively, and has an accumulated deficit of \$46,043,779 at December 31, 2009. These recurring losses and the need for continued funding, discussed below, raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments to the recoverability and classification of recorded assets, or the amounts of, and classification of liabilities that would be necessary if the going concern assumption were not appropriate. Such adjustments could be material.

The Company is in the development stage and currently derives no revenues from its projects. The Company's ability to meet its obligations in the ordinary course of business is dependent upon its ability to establish profitable operations and to obtain additional funding through public or private equity financing, collaborative, or other arrangements with corporate or other sources. To date, the Company has financed its operations principally through equity financing and loans. The current financial equity market conditions, the challenging funding environment and the low price of the Company's common shares make it difficult to raise funds by private placements of shares. The industry has been severely impacted by the world economic situation, as it is considered to be a high-risk investment. There is no assurance that the Company will be successful with any financing ventures. It is dependent upon the continuing financial support of shareholders and obtaining financing in order to continue development of its hydro-electric, wind power generation and transmission projects. While the Company is expending its best efforts to achieve its plans by continuing to raise capital through private placement equity financing there is no assurance that any such activity will generate funds that will be available for operations. The application of the going concern concept is dependent upon continuing rights to the areas, the obtaining of necessary regulatory approvals, the ability to obtain the necessary financing to complete development, and the successful development and sale of electricity.

Management is working to obtain sufficient working capital from external sources in order to continue operations, as well as further developing the Company's business model to obtain revenues from its wind, hydro-electric power generation, and transmission projects. There is, however, no assurance that the aforementioned events, including the receipt of additional funding, will occur or be successful.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### a) Principles of Consolidation

These consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada, and include the accounts of the Company and its subsidiaries:

	OWNERSHIP INTEREST	BASIS OF PRESENTATION
Powerhouse Developments Inc.	100%	Consolidated
Powerhouse Electric Corp.	100%	Consolidated
Sea Breeze Energy Inc.	100%	Consolidated
Sea Breeze Management Services Inc.	100%	Consolidated
Sea Breeze Power Projects Inc.	100%	Consolidated
SBJF Holding Corp.	100%	Consolidated
Knob Hill Holdings Corp.	100%	Consolidated
SB Peace (01) Holding Corp.	100%	Consolidated
SB Peace (02) Holding Corp.	100%	Consolidated
SB Peace (03) Holding Corp.	100%	Consolidated
0849549 BC Ltd.	100%	Consolidated
Harrison Lake Hydro Inc.	100%	Consolidated
Sea Breeze Pacific Regional Transmission Systems, Inc.	50%	Proportionately consolidated
Sea Breeze High Desert Conversion LP	47.5%	Equity method

All significant inter-company balances and transactions have been eliminated upon consolidation. The Company uses the equity method to account for investments over which the Company exerts significant influence. The Company uses the proportionate consolidation method of accounting to account for the Company's interest in jointly controlled entities.

##### b) Financial Instruments

Effective January 1, 2007, the Company adopted three new accounting standards related to financial instruments that were issued by the Canadian Institute of Chartered Accountants ("CICA") in 2005. These accounting policy changes were adopted on a prospective basis with no restatement to prior period financial statements. The new standards and accounting policy changes are as follows:

##### Financial Instruments – Recognition and Measurement (CICA Handbook Section 3855)

In accordance with the new standard the Company now classifies all financial instruments as either held-to-maturity, available-for-sale, held for trading or loans and receivables. Financial assets held to maturity, loans and receivables and financial liabilities other than those held for trading, are measured at amortized cost. Available-for-sale instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive income. Instruments classified as held for trading are measured at fair value with unrealized gains and losses recognized on the statement of loss.

## **SEA BREEZE POWER CORP.**

### **Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)**

#### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

##### b) Financial Instruments (Continued)

###### Comprehensive Income (CICA Handbook Section 1530)

Comprehensive Income is the change in shareholders' equity during a period from transactions and other events and circumstances from non-owner sources. In accordance with this new standard, when applicable, the Company's financial statements will include a consolidated statement of comprehensive income/loss and accumulated other comprehensive income/loss will be added to the Shareholders' Equity section of the consolidated balance sheet. The components of this new category will include unrealized gains and losses on financial assets classified as available-for-sale and the effective portion of cash flow hedges, if any.

###### Hedges (CICA Handbook Section 3865)

The new standard specifies the criteria under which hedge accounting can be applied and how hedge accounting can be executed. The Company has not designated any hedging relationships.

##### c) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the reporting period. Actual results could differ from these estimates.

##### d) Foreign Currency

The Company's reporting currency is the Canadian dollar. Transactions in foreign currencies have been translated into Canadian dollars using the temporal method as follows:

- i) Monetary items at the rate prevailing at the balance sheet date;
- ii) Non-monetary items at the historical exchange rate;
- iii) Revenues and expenses at the average rate in effect during the applicable accounting period; and
- iv) Gains or losses arising on foreign currency translation are included in the statements of loss and deficit.

##### e) Cash and Cash Equivalents

Cash is comprised of cash on hand and demand deposits. Cash equivalents are short-term, highly liquid investments with maturities within three months held for the purpose of meeting short-term cash commitments rather than for investing purposes. The Company did not have cash equivalents as of December 31, 2009 and 2008.

##### f) Marketable Securities

The Company classifies its marketable securities as "available-for-sale" and records the marketable securities at their fair value.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

##### g) Property and Equipment

Property and equipment are carried at cost and the equipment is being amortized as follows:

Computer equipment and software	45% declining balance basis
Automotive equipment	30% declining balance basis
Office and field equipment	20% declining balance basis

##### h) Stock Based Compensation

The Company follows the recommendations of CICA Handbook Section 3870 – “Stock Based Compensation and Other Stock Based Payments” to account for stock based transactions with officers, directors, employees, and outside consultants. Accordingly, the fair value of stock options is charged to operations with an offsetting credit to contributed surplus. The fair value of stock options which vest immediately is recorded at the date of grant; the fair value of options which vest in the future is recognized on a straight-line basis over the vesting period. Any consideration received on exercise of stock options together with the related portion of contributed surplus is credited to share capital.

##### i) Fair Value of Warrants

Proceeds from unit placements are allocated between shares and warrants issued according to their relative fair value using the residual method to determine the fair value of warrants issued. Warrants issued to brokers are evaluated using the Black-Scholes method.

##### j) Loss Per Share

Basic loss per share is calculated using the weighted average number of shares outstanding during the year. The Company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments on loss per share. Under the treasury stock method, only instruments with exercise amounts less than market prices impact the diluted calculations. In computing diluted loss per share, no shares were added to the weighted average number of common shares outstanding during the year ended December 31, 2009 for the dilutive effect of employee stock options and warrants as they were all anti-dilutive. No adjustments were required to reported loss from operations in computing diluted per share amounts.

##### k) Income Taxes

The Company uses the asset and liability method of accounting for income taxes whereby future income tax assets are recognized for deductible temporary differences and operating loss carry forwards, and future income tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Future income tax assets are recognized only to the extent that management determines that it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment. The income tax expense or benefit is the income tax payable or refundable for the period plus or minus the change in future income tax assets and liabilities during the period.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

l) Asset Impairment

On an annual basis or when impairment indicators arise, the Company evaluates the future recoverability of capital assets and project related development costs. Impairment losses or write downs are recorded in the event that the net book value of such assets exceeds the estimated indicated future cash flows attributable to such assets.

m) Service Revenues

The Company provides wind generation research and consulting services to third parties. Revenues from consulting services are recognized over the contract period, which is the period during which the services were provided and the related expenses were incurred.

n) Variable Interest Entities

The Company follows the Canadian Institute of Chartered Accountants (CICA) Accounting Guideline 15 – “Consolidation of Variable Interest Entities” (VIE). The guideline establishes that a VIE is to be consolidated by the primary beneficiary based upon the determination of who will receive the majority of a VIE’s expected losses, expected residual returns, or both, defined as a variable interest, rather than solely based on the voting interests. Variable interests are ownership interests or contractual relationships that enable the holder to share in the financial risks and rewards resulting from the activities of a VIE.

The accounting guideline specifies that an entity is a VIE if either of the following criteria are met:

1. total equity invested is insufficient to finance the entity without additional subordinated financial support; or
2. the holders of the equity investment, as a group:
  - i) do not have the right to make decisions about an entity’s activities that have a significant effect on the success of the entity; or
  - ii) are protected either directly or indirectly from variability in cash flows from the entity; or
  - iii) do not have the right to all of the residual returns of the entity.

The Company has considered the provisions of the guideline for all subsidiaries and their related investments.

As a result of this review, the Company determined that the wholly-owned subsidiary that holds the Company’s interest in the Juan de Fuca partnership is considered a VIE as the equity invested was not sufficient to finance the entity without additional subordinated financial support. The Company then determined that the subsidiary is not the primary beneficiary of the VIE and does not consolidate the entity. Accordingly, the Company’s general and limited partner interests in the partnership are presented as an equity investment and the results from operations are presented as equity income (loss) on the consolidated statement of loss. There was no impact to net earnings as a result of adoption of this accounting guideline.

## **SEA BREEZE POWER CORP.**

### **Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)**

#### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

o) Project Development Costs

The Company expenses project related development costs until such time as final development decisions with respect to each specific project are made. After a final positive development production decision is made on a project, the project related development costs will be capitalized and amortized over the expected life of the project.

p) Future Accounting Pronouncements

- i) The CICA issued Section 1582 - Business Combinations, Section 1601 - Consolidated Financial Statements and Section 1602 - Non-controlling Interests. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These new sections will be applicable to financial statements relating to the Company's interim and fiscal year beginning on or after January 1, 2011. The Company has not yet determined the impact of the adoption of these new sections on the consolidated financial statements.
- iii) Canada's Accounting Standards Board ratified a plan that will result in Canadian GAAP being converged with International Financial Reporting Standards ("IFRS") by 2011. Management has performed a preliminary analysis and highlighted areas where its current Canadian accounting practices differ from IFRS. The impact on the Company's consolidated financial statements has not yet been determined.

q) Comparative Figures

Certain of the comparative figures have been reclassified to conform with the current year's presentation.

#### **3. NEWLY ADOPTED ACCOUNTING POLICIES**

a) Goodwill and Intangible Assets

In February 2008, the CICA issued a new accounting standard, Section 3064, "Goodwill and Intangible Assets." Section 3064 replaces Sections 3062, "Goodwill and Other Intangible Assets" and 3450, "Research and Development Costs" and establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Various changes have also been made to other sections of the CICA Handbook for consistency purposes. As a result of these related amendments, principally to Section 1000, "Financial Statement Concepts," any expenses deferred pursuant to "matching" concepts and which do not otherwise meet the definition of an asset are no longer eligible for capitalization. The Company adopted the new standards on January 1, 2009 and there was no material impact on the consolidated financial statements.

## **SEA BREEZE POWER CORP.**

### **Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)**

#### **3. NEWLY ADOPTED ACCOUNTING POLICIES (Continued)**

##### b) Credit risk and the Fair Value of Financial Assets and Financial Liabilities

In January 2009, the Emerging Issues Committee of the CICA issued Abstract No. 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" ("EIC-173"). EIC-173 provides guidance on how to take into account credit risk of an entity and counterparty when determining the fair value of financial assets and liabilities, including derivative instruments. EIC-173 is applicable to the annual consolidated financial statements of the Company for the year ended December 31, 2009. The adoption of EIC-173 did not have a material impact on the Company's consolidated financial statements.

##### c) Financial Instruments

In June 2009, the CICA issued amendments to Section 3862, "Financial Instruments – Disclosures" effective for the Company's December 31, 2009 consolidated financial statements. The amendments require the Company to classify and disclose financial instruments presented at fair value on the balance sheet based on a three-level fair value hierarchy that distinguishes between market value data obtained from independent sources and market value determined based on the Company's own assumptions about market value: Level 1 – Valuations based on quoted prices in active markets for identical assets or liabilities; Level 2 – Valuations based on quoted prices in active markets for similar assets or liabilities or valuation techniques where significant inputs are based on observable market data; and Level 3 – Valuation techniques for which any significant inputs are not based on observable market data. The section has also been amended to require additional liquidity risk disclosures.

Also in June 2009, the CICA issued amendments to Section 3855, "Financial Instruments – Recognition and Measurement" effective for the Company's December 31, 2009 financial statements. The amendments clarified the application of Section 3855 with respect to the effective interest method, reclassification of financial instruments with embedded derivatives, eliminated the distinction between debt securities and other debt instruments, and changed the categories to which debt instruments are required or are permitted to be classified. These amendments did not have an impact on the Company's consolidated financial statements.

#### **4. FINANCIAL INSTRUMENTS**

##### a) Designations

The Company's financial instruments consist of cash, marketable securities, accounts receivable, deposits, accounts payable and accrued liabilities, loans payable, and convertible debentures.

In accordance with the recommendations of section 3855 "Financial Instruments – Recognition and Measurement" of the CICA Handbook, the Company has designated its marketable securities, comprising of shares listed on a recognized stock exchange, as available-for-sale securities and reports them at fair value. The amounts by which fair values of these securities differ from written down cost represent unrealized gains and losses and are recognized in other comprehensive income (loss). All realized gains and losses are recognized in the net income (loss) in the period of disposition. The fair value of these securities is market value. The market value of publicly traded securities is based on quoted market prices.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 4. FINANCIAL INSTRUMENTS (Continued)

##### a) Designations (Continued)

Cash is designated as held-for-trading; accounts receivable as loans and receivables and accounts payable and accrued liabilities, loans payable and convertible debentures as other financial liabilities.

##### b) Fair Value

During 2009, CICA Handbook Section 3862, Financial Instruments – Disclosures, was amended to require disclosures about the inputs to fair value measurements, including their classification within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and

Level 3 – Inputs that are not based on observable market data.

The fair values of financial instruments that are measured on a recurring basis comprises the Company's investments in marketable securities. These fair values are determined based on Level 1 inputs, which consist of quoted prices in active markets for identical assets. The carrying amount of all other financial instruments are a reasonable approximation of fair value.

##### c) Risk Management

The Company thoroughly examines the various financial instrument risks to which it is exposed and assesses the impact and likelihood of those risks. These risks may include currency, credit, interest rate and liquidity risks. Where material, these risks are reviewed and monitored by the Board of Directors.

##### Credit Risk

The Company's credit risk is primarily attributable to cash. Cash is held in reputable Canadian banks which are closely monitored by management. Management believes that the credit risk concentration with respect to financial instruments included in cash is minimal. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks.

##### Foreign Exchange Risk

The Company is subject to currency risk due to the fluctuation of the exchange rate between the Canadian Dollar and the United States Dollar. This relates to the cash held in the Company's United States dollar account and accounts payable denoted in United States dollars. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 4. FINANCIAL INSTRUMENTS (Continued)

##### c) Risk Management (Continued)

###### Foreign Exchange Risk (Continued)

Financial assets and liabilities denominated in currencies other than the Canadian Dollar are as follows:

	<u>FINANCIAL ASSETS</u>	<u>FINANCIAL LIABILITIES</u>
United States Dollar	\$ 74,993	\$ 1,690,892

Based on the above net exposures at December 31, 2009, and assuming that all other variables remain constant, a 10% appreciation or depreciation of the Canadian Dollar against the United States Dollar would result in an increase/decrease of \$161,596 in the Company's loss from operations.

###### Interest Rate Risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in market interest rates. Our interest rate risk mainly arises from the interest rate impact on our cash. The Company's loans payable and convertible debentures have fixed interest rates and are not exposed to interest rate risk. A change in interest rate would have a minimal effect on the profitability of the Company.

###### Liquidity Risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at December 31, 2009, the Company held cash of \$15,384 and had current liabilities of \$1,560,051. The Company currently relies on private placement equity and convertible debenture financing.

##### d) Comprehensive Income

CICA Handbook Section 1530 establishes standards for reporting and presenting comprehensive income, which is defined as the change in equity from transactions and other events from non-owner sources. Accordingly, a consolidated statement of comprehensive income (loss) forms part of the Company's consolidated financial statements and displays current period net income and other comprehensive income (loss). Other comprehensive income consists of unrealized gains on available-for-sale financial assets. The cumulative changes in other comprehensive income are included in accumulated other comprehensive income within shareholders' equity in the consolidated balance sheet.

##### e) Hedges

CICA Handbook Section 3865 specifies the criteria under which hedge accounting can be applied and how hedge accounting can be exercised. As at December 31, 2009 and 2008, the Company had not entered into any hedging relationships.

## **SEA BREEZE POWER CORP.**

### **Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)**

#### **5. SECURITY DEPOSITS**

The Company has advanced \$44,435 (2008 - \$46,105) to be held as security on corporate credit card accounts. The funds are held as security for credit advanced to the Company and, as such, may not be used for general corporate purposes. The Company has also posted \$62,650 (2008 - \$30,150) in project related security deposits.

#### **6. INVESTMENTS**

##### **a) Investment in Juan De Fuca Cable Partnership**

During the year ended December 31, 2005, the Company became the holder of a 49.5% limited partnership interest and a 25% equity interest in the general partner (which is also a 1% limited partner) in a newly formed, special purpose (State of Delaware, USA) limited partnership, Sea Breeze Pacific Juan de Fuca Cable, L.P. ("JDFC"). The original purpose of the partnership is to develop the Juan de Fuca Transmission Cable Project ("The Project"). The Project consists of the development of a 550 MW High Voltage Direct Current submarine transmission link spanning the Strait of Juan de Fuca connecting the City of Victoria on the southern tip of Vancouver Island, British Columbia, Canada to Port Angeles, Washington State, U.S.A. The Company and its joint venture partner Boundless Energy, LLC ("Boundless") initially developed the Project and assigned their interest in the project to JDFC for a nominal amount. As a result the Company's cost of the investment in the partnership is \$Nil.

On April 6, 2005, JDFC secured a development loan (the "Loan") of up to US\$8,000,000 from US Power Fund, LP to advance permitting of the project, and to conduct a bonded bid auction ("Open Season") for capacity on the potential transmission line to be developed jointly by the Company and its partners. The proceeds of the Loan are convertible into project equity at US Power Fund's option. Advances of funds under the agreement are subject to certain milestones being met by the Company and its joint venture partner. Loan advances totalling US\$5,791,000 (2008 – US\$5,791,000) have been remitted to JDFC by US Power Fund, LP in tranches through December 31, 2009.

The loan bears 20% interest per annum, compounded annually. On December 31, 2009, the accumulated interest on the loan totalled US\$6,484,119 (2008 – US\$4,438,266). As per the amendment on May 29, 2009, the loan is automatically renewed for 60 days until, at the option of Energy Investors Funds, written notice is given to terminate the renewal period. The automatic renew process will terminate 60 days from the written notice.

All proceeds of the Loan were used by JDFC to pay costs and expenses incurred in the development of the project and in accordance with the development loan budget.

The Loan is secured by a registered security interest in all rights, assets, partners' voting rights, and partners' interests in JDFC and its subsidiaries. The loan agreement further provides for an overrun amount of up to US\$1,000,000 of costs incurred in excess of the amounts budgeted to be paid by Boundless and Sea Breeze in the event that Financial Closing has not been achieved upon full advance of the total loan amount. The overrun amount is jointly to be borne by the Company and its joint venture partner Boundless.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 6. INVESTMENTS (Continued)

##### a) Investment in Juan De Fuca Cable Partnership (Continued)

During the year ended December 31, 2005, an amendment of the original development loan agreement provided for a further transmission project (the "New Project") to be added to the purpose of the partnership. The New Project relates to a submarine transmission cable crossing the Strait of Georgia from a point near the City of Vancouver to Vancouver Island, British Columbia, Canada.

The Company's jointly held subsidiary, Sea Breeze Pacific Regional Transmission System Inc. ("SBPRTS"), sold its right, title and interest in the project to the partnership for costs incurred as at the date of signing the agreement, December 16, 2005.

During the year ended December 31, 2009, JDFC incurred \$816,354 of project related costs charged to operations, including \$1,167,301 (US\$967,751) of accrued interest related thereto. The Company accounts for its investment under the equity method and, accordingly, as its investment in the partnership is \$Nil as at December 31, 2009, Sea Breeze has not included its 49.75% proportional share of the loss of the partnership in its consolidated financial statements. The Company made payments of \$57,000 on behalf of JDFC for expenditures related to the application of government funding. This amount is outstanding as at December 31, 2009 and has no specific terms for repayment.

A summary of financial data relating to the partnership is as follows:

	<b>YEAR ENDED DECEMBER 31</b>	
	<b>2009</b>	<b>2008</b>
<b>Balance Sheets</b>		
Cash	\$ 3,387	\$ 14,473
GST recoverable and deposits	3,564	7,059
Deposits	30,141	-
	<u>37,092</u>	<u>21,532</u>
<b>Current and Total Assets</b>	<b>\$ 37,092</b>	<b>\$ 21,532</b>
<b>Liabilities and Equity</b>	<b>\$ 17,325,713</b>	<b>\$ 16,291,642</b>
<b>Partners' Deficiency</b>	<b>(17,288,621)</b>	<b>(16,270,110)</b>
	<u>37,092</u>	<u>21,532</u>
	<b>\$ 37,092</b>	<b>\$ 21,532</b>
	<b>YEAR ENDED DECEMBER 31</b>	
	<b>2009</b>	<b>2008</b>
<b>Statements Of Loss</b>		
Project development costs	\$ 731,422	\$ 1,187,541
Interest expense	2,336,523	1,822,353
Foreign exchange	(2,049,434)	2,377,794
	<u>731,422</u>	<u>1,822,353</u>
<b>Net Loss For The Year</b>	<b>\$ (1,018,511)</b>	<b>\$ (5,387,688)</b>

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 6. INVESTMENTS (Continued)

##### a) Investment in Juan De Fuca Cable Partnership (Continued)

Statements of Cash Flows	YEAR ENDED DECEMBER 31	
	2009	2008
<b>Cash Provided By (Used In):</b>		
Net loss	\$ (1,018,511)	\$ (5,387,688)
Items not affecting cash	740,764	5,560,168
Changes of non-cash operating working capital items	(28,701)	(866,080)
<b>Operating Activities</b>	<b>(306,448)</b>	<b>(693,600)</b>
<b>Financing Activities</b>	<b>295,362</b>	<b>562,625</b>
<b>Investing Activities</b>	<b>-</b>	<b>-</b>
<b>Decrease In Cash</b>	<b>(11,086)</b>	<b>(130,975)</b>
<b>Cash, Beginning Of Year</b>	<b>14,473</b>	<b>145,448</b>
<b>Cash, End Of Year</b>	<b>\$ 3,387</b>	<b>\$ 14,473</b>

##### b) Investment in Standard Hydrogen

During fiscal 2004, the Company paid \$10,000 for a 33% non-controlling interest in a private start-up Ontario corporation, Standard Hydrogen, which conducts research activities. The \$10,000 equity purchase was paid upon commencement of Standard Hydrogen's operations. The Company considers the investment in Standard Hydrogen no longer an economical asset. As of December 31, 2009, the carrying value is \$1 (2008 - \$1).

#### 7. JOINT VENTURE

In May 2004, the Company incorporated Sea Breeze Pacific Regional Transmission System, Inc.; a company jointly owned and jointly operated by the Company (50%) and Boundless Energy LLC (50%). The parties signed a joint venture agreement and have agreed to jointly pursue specific merchant transmission opportunities. Summary financial information of the Company's 50% proportionate interest in the joint venture is as follows:

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 7. JOINT VENTURE (Continued)

Balance Sheets	2009	2008
Cash	\$ 773	\$ 6,384
Prepaid expenses	7,883	15,143
GST recoverable	63	1,622
Related party receivables	9,289	7,755
<b>Current Assets</b>	<b>18,008</b>	<b>30,904</b>
<b>Deposits</b>	<b>18,848</b>	<b>20,518</b>
<b>Capital Assets</b>	<b>602</b>	<b>821</b>
<b>Total Assets</b>	<b>\$ 37,458</b>	<b>\$ 52,243</b>
<b>Current Liabilities</b>	<b>42,539</b>	<b>21,139</b>
<b>Due to Affiliated Companies</b>	<b>592,294</b>	<b>579,151</b>
<b>Common Shares</b>	<b>100</b>	<b>100</b>
<b>Deficit</b>	<b>(597,475)</b>	<b>(548,147)</b>
<b>Total Liabilities And Equity</b>	<b>\$ 37,458</b>	<b>\$ 52,243</b>
Statements of Operations	2009	2008
Project related costs	41,974	33,800
Expenses	7,354	36,934
<b>Net Loss For The Year</b>	<b>\$ (49,328)</b>	<b>\$ (70,734)</b>
Statements of Cash Flows	2009	2008
Net loss	\$ (49,328)	\$ (70,734)
Items not affecting cash	219	302
Changes of non-cash operating working capital items	30,355	600
<b>Operating Activities</b>	<b>(18,754)</b>	<b>(69,832)</b>
<b>Financing Activities</b>	<b>13,143</b>	<b>73,368</b>
<b>Investing Activities</b>	<b>-</b>	<b>-</b>
<b>Increase (Decrease) In Cash</b>	<b>(5,611)</b>	<b>3,536</b>
<b>Cash, Beginning Of Year</b>	<b>6,384</b>	<b>2,848</b>
<b>Cash, End Of Year</b>	<b>\$ 773</b>	<b>\$ 6,384</b>

The Company funded 100% of the costs incurred up to December 31, 2009. As a result, the Company is entitled to a reimbursement of \$491,857 (2008 - \$478,530), which is Boundless Energy's 50% of the joint venture's costs. The Company has recorded an allowance for this amount as the recoverability is uncertain.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 8. PROPERTY AND EQUIPMENT

	2009		
	Cost	Accumulated Amortization	Net Book Value
Computer equipment	\$ 117,219	\$ 99,118	\$ 18,101
Software	5,773	3,312	2,461
Automotive equipment	44,273	24,571	19,702
Office equipment	32,019	21,053	10,966
Field equipment	39,012	29,940	9,072
Land	125,560	-	125,560
	<b>\$ 363,856</b>	<b>\$ 177,994</b>	<b>\$ 185,862</b>

  

	2008		
	Cost	Accumulated Amortization	Net Book Value
Computer equipment	\$ 117,219	\$ 86,634	\$ 30,585
Software	5,773	1,299	4,474
Automotive equipment	44,273	16,133	28,140
Office equipment	32,019	18,312	13,707
Field equipment	39,012	26,755	12,257
Land	125,560	-	125,560
	<b>\$ 363,856</b>	<b>\$ 149,133</b>	<b>\$ 214,723</b>

#### 9. LOANS PAYABLE

	2009	2008
Loans payable to directors and companies controlled by directors with interest at 10% per annum, unsecured, due on demand (US\$431,497).	\$ 453,504	\$ 2,465,206
Interest on loans payable to directors and companies controlled by directors, unsecured, due on demand (US\$325,824).	342,441	298,222
Loan payable to a third party with interest at 12% per annum, unsecured, due on demand, with a maturity date of September 28, 2010 (US\$25,000).	26,275	-
Interest on loan payable to a third party, unsecured, due on demand, with a maturity date of September 28, 2010 (US\$781).	821	-
Loan payable to a third party, no interest, unsecured, due on demand.	12,000	-
	<b>\$ 835,041</b>	<b>\$ 2,763,428</b>

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 10. RELATED PARTY TRANSACTIONS

All related party transactions and amounts owing are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Related party transactions not disclosed elsewhere in these consolidated financial statements are as follows:

a) Consulting Fees

During the year ended December 31, 2009, the Company incurred \$79,200 (2008 - \$79,200) in consulting fees to a company controlled by a director of the Company. An amount owing to this director at December 31, 2009 is \$20,400 (2008 - \$Nil). Further, the Company incurred \$79,200 (2008 - \$79,200) for consulting services to an officer of the Company. Included in accounts payable and accrued liabilities is \$27,694 (2008 - \$10,844) owing to this officer of the Company.

b) Interest Payable

As at December 31, 2009, accrued convertible debenture interest payable in shares included \$1,860,697 (2008 - \$854,726) owing to directors or companies controlled by directors.

c) Fees Charged to Partnership

During the year ended December 31, 2009, the Company charged the JDFC partnership \$274,109 (2008 - \$383,872) for travel, wages and consulting fees related to the JDF transmission project.

#### 11. CONVERTIBLE DEBENTURES

	<u>2009</u>	<u>2008</u>
Convertible debentures	<b>\$ 9,884,771</b>	\$ 6,210,589
Equity portion of convertible debentures	<b>(2,730,767)</b>	(2,202,408)
	<b>7,154,004</b>	4,008,181
Interest accretion	<b>985,868</b>	430,436
	<b>\$ 8,139,872</b>	\$ 4,438,617

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 11. CONVERTIBLE DEBENTURES (Continued)

- a) On November 25, 2009 the Company issued a convertible debenture in the amount of \$105,100 (US\$100,000), which is due and payable on November 25, 2011. The debentures are convertible into units of the Company at \$0.20 per unit. Each unit consists of one common share and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one common share at \$0.20 per share and expires on November 25, 2011. Interest on the debenture is calculated at 12% per annum. The interest payments are payable in shares and calculated semi-annually at the market price of the shares on the semi-annual calculation dates. The interest shares are to be issued on November 25, 2011 or upon conversion of the debenture, whichever is sooner.

As of December 31, 2009, accumulated interest payable was \$1,278 (2008 - \$Nil) resulting in a possible 5,820 (2008 - Nil) common shares issuable in payment thereof. The amount has been recorded as a commitment to issue shares within the Shareholders' Deficiency section of the balance sheet. The debentures are secured by a floating charge over all assets of the Company.

- b) On April 7, 2009, the Company issued convertible debentures to a director of the Company and entities controlled by the directors in the amount of \$3,700,000, which are due and payable on April 7, 2011. The debentures are convertible into units of the Company at \$0.20 per unit. Each unit consists of one common share and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one common share at \$0.20 per share and expires on April 7, 2011. Interest on the debenture is calculated at 12% per annum. The interest payments are payable in shares and calculated semi-annually at the market price of the shares on the semi-annual calculation dates. The interest shares are to be issued on April 7, 2011 or upon conversion of the debenture, whichever is sooner.

As of December 31, 2009, accumulated interest payable was \$327,222 (2008 - \$Nil) resulting in a possible 1,415,067 (2008 - Nil) common shares issuable in payment thereof. The amount has been recorded as a commitment to issue shares within the Shareholders' Deficiency section of the balance sheet. The debentures are secured by a floating charge over all assets of the Company.

- c) On June 16, 2008, the Company issued convertible debentures to a director of the Company and entities controlled by the directors in the amount of \$2,500,000, which are due and payable on June 16, 2013. The debentures are convertible into units of the Company at \$0.32 per unit in years one and two, and increasing by 10% per unit in years three to five (year 1 to year 5: \$0.32, \$0.32, \$0.35, \$0.39, and \$0.43). Each unit consists of one common share and one share purchase warrant. Each share purchase warrant has a term of two years from the date of conversion up to June 16, 2013 and entitles the holder to purchase one common share at \$0.32 per share in years one and two, and increasing by 10% per share in years three to five (year 1 to year 5: \$0.32, \$0.32, \$0.35, \$0.39, and \$0.43). Interest on the debenture is calculated at 12% per annum. The interest payments are payable in shares and calculated semi-annually at the market price of the shares on the semi-annual calculation dates. The interest shares are to be issued on June 16, 2013 or upon conversion of the debenture, whichever is sooner.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 11. CONVERTIBLE DEBENTURES (Continued)

As of December 31, 2009, accumulated interest payable was \$463,562 (2008 - \$163,562) resulting in a possible 2,660,132 (2008 – 1,400,529) common shares issuable in payment thereof. The amount has been recorded as a commitment to issue shares within the Shareholders' Deficiency section of the balance sheet. The debentures are secured by a floating charge over all assets of the Company.

- d) On August 28, 2007 the Company issued convertible debentures to the directors of the Company and an entity controlled by a director in the amount of \$2,250,000, which are due and payable on August 28, 2012. The debentures are convertible into units of the Company at \$0.42 per unit in years one and two, and increasing by 10% per unit in years three to five (year 1 to year 5: \$0.42, \$0.42, \$0.46, \$0.51, and \$0.56). Each unit consists of one common share and one share purchase warrant. Each share purchase warrant has a term of two years from the date of conversion up to August 28, 2012 and entitles the holder to purchase one common share at \$0.42 per share in years one and two, and increasing by 10% per share in years three to five (year 1 to year 5: \$0.42, \$0.42, \$0.46, \$0.51, and \$0.56). Interest on the debenture is calculated at 12% per annum. The interest payments are payable in shares and calculated semi-annually at the market price of the shares on the semi-annual calculation dates. The interest shares are to be issued on August 28, 2012 or upon conversion of the debenture, whichever is sooner.

As of December 31, 2009, accumulated interest payable was \$633,945 (2008 – \$363,945) resulting in a possible 2,884,496 (2008 – 1,750,853) common shares issuable in payment thereof. The amount has been recorded as a commitment to issue shares within the Shareholders' Deficiency section of the balance sheet. The debentures are secured by a floating charge over all assets of the Company.

- e) On March 9, 2007 the Company issued convertible debentures to the directors of the Company and an entity controlled by a director in the amount of \$1,280,118 (US\$1,218,000), which are due and payable on March 9, 2012. The debentures are convertible into units of the Company at US\$0.34 per unit in years one and two, and increasing by 10% per unit in each subsequent year for five years (year 1 to year 5: US\$0.34, US\$0.34, US\$0.37, US\$0.41, and US\$0.45). Each unit consists of one common share and one share purchase warrant. Each share purchase warrant has a term of two years from the date of conversion up to March 9, 2012 and entitles the holder to purchase one common share at US\$0.34 per share in years one and two, and increasing by 10% per share in each subsequent year for five years (year 1 to year 5: US\$0.34, US\$0.34, US\$0.37, US\$0.41, and US\$0.45). Interest on the debenture is calculated at 12% per annum. The interest payments are payable in shares and calculated semi-annually at the market price of the shares on the semi-annual calculation dates. The interest shares are to be issued on March 9, 2012 or upon conversion of the debenture, whichever is sooner.

As of December 31, 2009, accumulated interest payable was \$435,968 (US\$414,813) (2008 - \$327,219) resulting in a possible 1,968,627 (2008 – 1,291,882) common shares issuable in payment thereof. The amount has been recorded as a commitment to issue shares within the Shareholders' Deficiency section of the balance sheet. The debentures are secured by a floating charge over all assets of the Company.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 11. CONVERTIBLE DEBENTURES (Continued)

- f) The liability component of the convertible debt is calculated as the present value of the principal, discounted at a rate approximating the interest rate that was estimated would have been applicable to non-convertible debt at the time the debt was issued. This portion of the convertible debt is accreted over its term to the full face value by charges to interest expense. The accretion is a non-cash transaction and has been excluded from the statement of cash flows.

The equity element of the convertible debt comprises the value of the conversion option, being the difference between the face value of the convertible debt and the liability component.

#### 12. SHARE CAPITAL

- a) Authorized

Unlimited common shares without par value and 20,000,000 preferred shares without par value

No preferred shares have been issued.

- b) A summary of changes in the Company's warrants for the year ended December 31, 2009 is as follows:

	NUMBER OF WARRANTS	WEIGHTED AVERAGE EXERCISE PRICE
Balance, December 31, 2007	5,498,733	\$ 0.46
Granted	2,696,623	0.41
Exercised	(1,815,668)	0.15
Expired	(6,159,100)	0.63
Balance, December 31, 2008	220,588	\$ 0.91
Expired	(220,588)	0.91
Balance, December 31, 2009	-	\$ -

- c) At December 31, 2009, the Company has a fixed stock option plan. Under the policies of the TSX Venture Exchange ("TSXV"), the Company may grant incentive stock options up to a total of 20% of the Company's issued and outstanding common shares.

On April 7, 2009, the Company granted 7,075,983 options exercisable at \$0.20 for a period of five years to officers, directors, employees and consultants of the Company. One fourth of the stock options vest after six months, one fourth vest after twelve months, one fourth vest after eighteen months and one fourth vest after twenty-four months from the date of grant.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 12. SHARE CAPITAL (Continued)

On February 25, 2008, the Company granted 3,578,542 options exercisable at \$0.31 for a period of five years to officers, directors, employees and consultants of the Company. One third of the stock options vested immediately, one third vest after six months and one third vest after eighteen months from the date of grant.

During the year ended December 31, 2009, the Company charged \$646,019 in stock based compensation expense to operations. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2009	2008
Risk free interest rate	1.90% - 2.53%	3.12% - 3.57%
Expected Life	4.5 - 5 years	4.5 - 5 years
Expected volatility	151% - 198%	108% - 114%
Expected dividend yield	-	-
Weighted average of fair value of options granted	\$0.15 - \$0.36	\$0.24 - \$0.33

The following table summarizes information about fixed stock options outstanding at December 31, 2009:

RANGE OF EXERCISE PRICES	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
	NUMBER OUTSTANDING	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE
\$ 0.20-0.42	12,892,427	3.62 years	\$ 0.28	7,847,940	\$ 0.33

A summary of changes in the Company's fixed stock option plan for the year ended December 31, 2009 is as follows:

	OPTIONS OUTSTANDING	
	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE
Balance, December 31, 2007	12,539,095	\$ 0.51
Granted	3,578,542	0.31
Exercised	(20,000)	0.35
Cancelled	(7,154,439)	0.62
Balance, December 31, 2008	8,943,198	\$ 0.36
Granted	7,075,983	0.20
Cancelled	(3,126,754)	0.32
Balance, December 31, 2009	12,892,427	\$ 0.28

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 12. SHARE CAPITAL (Continued)

- d) Of the Company's issued and outstanding shares, 100,000 are held in escrow. These shares will be returned to treasury pending management filing the required documents with the regulatory authorities.

#### 13. PROJECT DEVELOPMENT COSTS

- a) The project development costs incurred and expensed relating to the hydroelectric, wind farm, and transmission projects are as follows:

	YEAR ENDED DECEMBER 31	
	2009	2008
Hydroelectric projects	\$ 30,857	\$ 269,287
Wind farm projects	474,485	1,197,439
Transmission projects	584,511	1,121,075
Total project related expenses for the year	<u>\$ 1,089,853</u>	<u>\$ 2,587,801</u>

Cumulative project costs incurred since the projects' inception amounted to \$17,429,546 (2008 - \$16,339,693).

- b) The project development expenses relating to hydroelectric projects in British Columbia are as follows:

	YEAR ENDED DECEMBER 31	
	2009	2008
<b>Cascade</b>	<u>\$ 30,857</u>	<u>\$ 269,287</u>
<b>Cumulative hydro project costs</b>	<u>\$ 6,143,997</u>	<u>\$ 6,113,140</u>

- c) The project related development expenses relating to wind farm projects in British Columbia are as follows:

	YEAR ENDED DECEMBER 31	
	2009	2008
Vancouver Island	\$ 348,853	\$ 917,092
Central Coast Region	18,083	36,768
Peace Region	37,392	102,156
Okanagan	49,681	144,874
Other projects under preparation	20,476	(3,451)
Total project related expenses for the period	<u>\$ 474,485</u>	<u>\$ 1,197,439</u>
<b>Cumulative wind farm project costs</b>	<u>\$ 7,122,702</u>	<u>\$ 6,648,217</u>

The Company issued 50,000 shares as part of an agreement with a private land owner near the Knob Hill wind project. A \$50,000 payment is due when the Knob Hill project begins construction.

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 13. PROJECT DEVELOPMENT COSTS (Continued)

d) The project related development expenses relating to transmission projects in Canada and the United States are as follows:

	YEAR ENDED DECEMBER 31	
	2009	2008
Transmission projects	\$ 584,511	\$ 1,121,075
<b>Cumulative transmission project costs</b>	<b>\$ 4,162,847</b>	<b>\$ 3,578,336</b>

#### 14. SUPPLEMENTAL DISCLOSURE FOR NON-CASH INVESTING AND FINANCING ACTIVITIES

During the year ended December 31, 2008 the Company had the following non-cash financing and investing activities:

- i) allocated \$272,350 to common shares pursuant to the exercise of special warrants;
- ii) issued 2,702,889 common shares pursuant to the conversion of \$913,837 of principal and \$184,835 of accrued interest thereof of convertible debentures;
- iii) issued 20,000 common shares pursuant to the exercise of stock options at strike price of \$0.35.

#### 15. INCOME TAXES

A reconciliation of income taxes at statutory rates to the Company's effective income tax expense is as follows:

	2009	2008
Statutory tax rate	30%	31%
Expected income tax recovery	\$ (1,347,000)	\$ (2,064,000)
Non-deductible differences	514,000	1,132,000
Future income tax expense resulting from change in tax rate	239,000	1,183,000
Change in valuation allowance	594,000	(251,000)
Income tax provision	\$ -	\$ -

Future tax assets (liabilities) of the Company are as follows:

	2009	2008
Project development costs	\$ 3,208,000	\$ 3,289,000
Operating losses	3,576,000	3,097,000
	6,784,000	6,386,000
Less: Valuation allowance	(6,784,000)	(6,386,000)
Future tax asset (liability) recognized	\$ -	\$ -

## SEA BREEZE POWER CORP.

### Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)

#### 15. INCOME TAXES (Continued)

As at December 31, 2009, the Company has capital losses of \$137,000 and non-capital losses totalling \$14,168,000 which expire from 2010 to 2029 as follows:

2010	\$	1,274,000
2014	\$	1,427,000
2015	\$	1,831,000
2026	\$	1,989,000
2027	\$	1,836,000
2028	\$	3,108,000
2029	\$	2,703,000

A valuation allowance has been recorded to reduce the net benefit recorded in the financial statements related to these future tax assets. The valuation allowance is deemed necessary as a result of the uncertainty associated with the ultimate realization of these tax assets.

#### 16. CAPITAL MANAGEMENT

When managing capital, the Company's objective is to ensure the entity continues as a going concern as well as to maintain optimal returns to shareholders and benefits for other stakeholders. Management adjusts the capital structure as necessary in order to support the development of the Company's projects. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management team to sustain the future development of the business.

The Company's projects are in the development stage; as such the Company is dependent on external financing to fund its activities. In order to carry out the planned development and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed. The Company will continue to assess new projects if it feels there is sufficient economic potential and if it has adequate financial resources to do so.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is appropriate.

There were no changes in the Company's approach to capital management during the year ended December 31, 2009. The Company is not subject to externally imposed capital requirements.

## **SEA BREEZE POWER CORP.**

### **Notes to Consolidated Financial Statements December 31, 2009 and 2008 (Stated in Canadian Dollars)**

#### **17. COMMITMENTS**

The Company subleases an office premises in Vancouver, Canada. The office lease commenced on October 1, 2008 and ends September 30, 2013. The Company has an option for early termination of the lease after 24 months with written notice to the landlord. The future minimum lease payments are as follows:

2010	\$	66,100
2011	\$	66,100
2012	\$	66,100
2013	\$	49,574

#### **18. SEGMENTED INFORMATION**

The Company's activities are in the power generation and transmission industry. As at December 31, 2009, all of the Company's assets were in Canada. The receivable from related party is owed from the Company's US partnership interest, Sea Breeze Olympic Converter, LP.

#### **19. SUBSEQUENT EVENTS**

Subsequent to December 31, 2009, the Company:

- Received \$147,708 in related party loans and \$7,320 in non-related party loans;
- Received \$17,664 in Government of Canada grants;
- Granted 2,780,000 stock options exercisable at \$0.20 for a period of 5 years to employees, directors and consultants of the Company.
- Issued 167,000 common shares for proceeds of \$33,400 pursuant to the exercise of stock options.
- Issued convertible debentures in the aggregate of \$700,000. The debentures have a five year term and are convertible into units of the Company at \$0.20 per unit. Each unit consists of one common share and one share purchase warrant entitling the holder to purchase one common share at \$0.20 per share. Interest on the debentures is calculated at 12% per annum.