



MANAGEMENT'S DISCUSSION AND ANALYSIS

**FOR THE NINE MONTHS ENDED
SEPTEMBER 30, 2008**

CU Inc.
Management's Discussion and Analysis (MD&A)
For the Nine Months Ended September 30, 2008

This MD&A should be read in conjunction with the Company's unaudited interim consolidated financial statements for the nine months ended September 30, 2008, and the audited consolidated financial statements and MD&A for the year ended December 31, 2007 (2007 MD&A). **Information contained in the 2007 MD&A that is not discussed in this document remains substantially unchanged.** This MD&A is dated October 27, 2008. Additional information relating to the Company, including the Company's Annual Information Form, is available on SEDAR at www.sedar.com.

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Glossary

Adjusted Earnings means earnings attributable to Class A and Class B shares after adjustments for items that are not in the normal course of business nor a result of day-to-day operations. These items are usually of a non-recurring or one-time nature. Refer to Reconciliation of Earnings Attributable to Class A and Class B shares and Adjusted Earnings section for a description of these items (non GAAP items).

AESO means the Alberta Electric System Operator.

Alberta Power Pool means the market for electricity in Alberta operated by AESO.

AUC means the Alberta Utilities Commission and its predecessor, the Alberta Energy and Utilities Board.

Availability means a measure of time, expressed as a percentage of continuous operation, that a generating unit is capable of producing electricity, regardless of whether the unit is actually generating electricity.

Class A shares means Class A non-voting shares of the Company.

Class B shares means Class B common shares of the Company.

Company means CU Inc. and, unless the context otherwise requires, includes its subsidiaries.

GAAP means Canadian generally accepted accounting principles.

GHG means any greenhouse gas which has the potential to retain heat in the atmosphere, including water vapour, carbon dioxide, methane, nitrous oxide and hydrofluorocarbons.

Gigajoule (GJ) means a unit of energy equal to approximately 948.2 thousand British thermal units.

Megawatt (MW) means a measure of electric power equal to 1,000,000 watts.

Megawatt hour (MWh) means a measure of electricity consumption equal to the use of 1,000,000 watts of power over a one-hour period.

Placeholder means an AUC approved interim cost which has been included in utility customer rates pending an AUC review in a separate proceeding. This cost is subject to adjustment once the proceeding is completed and may result in refunds to or recoveries from customers.

PPA means Power Purchase Arrangements that became effective on January 1, 2001, as part of the process of restructuring the electric utility business in Alberta. The PPAs are legislatively mandated and approved by the AUC.

Company Overview

The consolidated financial statements include the accounts of CU Inc. and all of its subsidiaries. The consolidated financial statements have been prepared in accordance with GAAP and the reporting currency is the Canadian dollar.

The Company operates in the following business segments:

The **Utilities** Business Group includes the regulated distribution of natural gas by ATCO Gas, the regulated transmission and distribution of water by CU Water, the regulated transmission of natural gas by ATCO Pipelines, the regulated distribution and transmission of electric energy by ATCO Electric and its subsidiaries, Northland Utilities (NWT), Northland Utilities (Yellowknife) and Yukon Electrical.

The **Power Generation** Business Group includes the regulated supply of electricity by Alberta Power (2000).

Transactions between business segments are eliminated in all reporting of the Company's consolidated financial information. For additional information on the Company's business segments, refer to Note 8 to the unaudited interim consolidated financial statements for the nine months ended September 30, 2008.

Board of Directors

On May 7, 2008, Messrs. R.D. Southern, W.L. Britton, B.K. French and H.M. Neldner retired from the Board of Directors of the Company and Ms. L.M. Charlton, Mr. J.W. Simpson, Ms. N.C. Southern, Mr. R.J. Urwin and Ms. K.M. Watson were appointed to the Board of Directors of the Company.

FINANCIAL MARKETS

Significant challenges are currently being experienced in domestic and international financial markets. These challenges are having an impact on the ability of certain borrowers to finance existing operations and capital programs. To date, these issues in the financial markets have not had a direct impact on the operations of the Company. As discussed elsewhere in this MD&A, the Utilities Business Group has a capital program of approximately \$3.1 billion over the next three years. The Company completed a \$325 million debenture issue in May 2008 to fund the 2008 portion of the Utilities Business Group's capital program and to fund scheduled maturities of previous debenture issues. In addition, the Company has cash balances of \$186.1 million and available committed and uncommitted lines of credit of \$329.1 million which can be utilized for general corporate purposes.

While the current financial situation has not directly impacted the Company's ability to fund capital projects and ongoing operations, future borrowing may be impacted by these financial markets through increased carrying costs and the ability to raise debt and capital. The Company is unable to determine what future changes in the financial markets could occur and how these changes could affect the Company.

Forward-Looking Information

Certain statements contained in this MD&A constitute forward-looking information. Forward-looking information is often, but not always, identified by the use of words such as "anticipate", "plan", "estimate", "expect", "may", "will", "intend", "should", and similar expressions. Forward-looking information involves known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information. The Company believes that the expectations reflected in the forward-looking information are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking information should not be unduly relied upon.

In particular, this MD&A contains forward-looking information pertaining to contractual obligations, planned capital expenditures and the impact of changes in government regulation. Actual results could differ materially from those anticipated in this forward-looking information as a result of regulatory decisions, competitive factors in the industries in which the Company operates, prevailing economic conditions, and other factors, many of which are beyond the control of the Company.

Non-GAAP Measures

The Company uses the measures "funds generated by operations", "Adjusted Earnings" in this MD&A. These measures do not have any standardized meaning under GAAP and might not be comparable to similar measures presented by other companies.

Funds generated by operations is defined as cash flow from operations before changes in non-cash working capital. In management's opinion, funds generated by operations is a significant performance indicator of the Company's ability to generate cash during a period to fund its capital expenditures without regard to changes in non-cash working capital during the period.

Adjusted Earnings is defined as earnings attributable to Class A and Class B shares after adjustments for items that are not in the normal course of business nor a result of day-to-day operations. These items are usually of a non-recurring or one-time nature. Management believes Adjusted Earnings allow for a more effective analysis of operating performance and trends. A reconciliation of Adjusted Earnings to earnings attributable to Class A and Class B shares is presented in the Results of Operations – Selected Quarterly Information section.

Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the three months ended September 30, 2008, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Results of Operations

SELECTED QUARTERLY INFORMATION

| (\$ millions except per share data) | For the Three Months Ended ^{(1) (2) (3) (4)} | | | |
|---|---|---------|---------|---------|
| | Mar. 31 | Jun. 30 | Sep. 30 | Dec. 31 |
| | <i>(unaudited)</i> | | | |
| 2008 | | | | |
| Revenues | 443.4 | 363.9 | 352.6 | - |
| Earnings attributable to Class A and Class B shares | 77.7 | 33.5 | 30.9 | - |
| Adjusted Earnings ⁽⁵⁾ | 77.7 | 33.5 | 27.9 | - |
| 2007 | | | | |
| Revenues | 415.7 | 341.4 | 262.9 | 394.2 |
| Earnings attributable to Class A and Class B shares | 60.2 | 38.3 | 25.4 | 53.4 |
| Adjusted Earnings ⁽⁵⁾ | 60.2 | 32.8 | 25.4 | 44.8 |
| 2006 | | | | |
| Revenues | - | - | - | 391.7 |
| Earnings attributable to Class A and Class B shares | - | - | - | 47.8 |
| Adjusted Earnings | - | - | - | 47.8 |

Notes:

- ⁽¹⁾ There were no discontinued operations or extraordinary items during these periods.
- ⁽²⁾ Due to certain factors, revenues, earnings and Adjusted Earnings for any quarter, are not necessarily indicative of operations on an annual basis. These factors include the seasonal nature of the Company's operations, changes in electricity prices in Alberta and the timing of rate decisions.
- ⁽³⁾ The above data (other than Adjusted Earnings) has been extracted from the financial statements, which have been prepared in accordance with GAAP and the reporting currency is the Canadian dollar.
- ⁽⁴⁾ As all the Class A and Class B shares of the Company are owned by Canadian Utilities Limited, the disclosure of earnings per share is not provided as it is not considered to be meaningful.
- ⁽⁵⁾ Refer to Significant Non-Operating Financial Items section for a description of the adjustments made to earnings attributable to Class A and Class B shares to obtain Adjusted Earnings.

The principal factors that caused variations in **financial condition** and **results of operations** over the past eight quarters necessary to understand general trends that have developed and the seasonality of the businesses disclosed in the 2007 MD&A remain substantially unchanged.

RECONCILIATION OF EARNINGS ATTRIBUTABLE TO CLASS A AND CLASS B SHARES AND ADJUSTED EARNINGS

Adjusted Earnings are referred to in various sections of this MD&A. The following table reconciles Adjusted Earnings, which are earnings attributable to Class A and Class B shares after adjustments for items that are not in the normal course of business nor a result of day-to-day operations. These items are usually of a non-recurring or one-time nature. A description of each adjustment is provided in the Significant Non-Operating Financial Items section.

| (\$ millions) | For the Three Months Ended September 30 | | | For the Nine Months Ended September 30 | | |
|---|--|------|----------------------------------|---|-------|----------------------------------|
| | 2008 | 2007 | Change to 2008 (2008-2007) | 2008 | 2007 | Change to 2008 (2008-2007) |
| | <i>(unaudited)</i> | | | | | |
| Earnings attributable to Class A and Class B shares | 30.9 | 25.4 | 22% | 142.1 | 123.9 | 15% |
| 2007 Change in the Taxation of Preferred Share Dividends ⁽¹⁾ | - | - | - | - | (5.5) | - |
| Federal Court of Appeal Decision – Mining Assets ⁽²⁾ | (3.0) | - | - | (3.0) | - | - |
| Adjusted Earnings | 27.9 | 25.4 | 10% | 139.1 | 118.4 | 17% |

SIGNIFICANT NON-OPERATING FINANCIAL ITEMS

Consolidated and segmented financial results include the following Significant Non-Operating Financial Items.

(1) 2007 Change in the Taxation of Preferred Share Dividends

On June 15, 2007, the federal government announced an amendment to tax legislation pertaining to Part VI.1 tax (the tax payable on preferred share dividends paid by corporations). Prior to this change, corporations that had Part VI.1 tax payable were entitled to an income tax deduction equal to 9/4ths of the Part VI.1 tax payable. Effective January 1, 2003, this deduction was increased to three times the amount of the Part VI.1 tax payable. The Canada Revenue Agency (CRA) has been assessing corporate tax returns based on this proposed change being in effect since January 1, 2003, resulting in a reduction of taxes paid to the Canadian government. In the second quarter of 2007, the Company recorded a one-time reduction to current income tax expense which resulted in increased earnings of \$5.5 million relating to years prior to 2007. Funds generated by operations increased by \$5.5 million, offset by a similar reduction in changes in non-cash working capital, leaving the Company's cash position unchanged.

The earnings impact of the Part VI.1 tax adjustment by Business Group was as follows:

| (\$ millions) | Years Prior to 2007 |
|------------------|------------------------|
| Utilities | 4.2 |
| Power Generation | 1.3 |
| Total | 5.5 |

(2) Federal Court of Appeal Decision – Mining Assets

On May 22, 2008, the Federal Court of Appeal issued a decision overturning previous CRA reassessments pertaining to the computation of resource allowances and corresponding capital cost allowances for mining assets related to the Company's coal-fired power generation business. On July 8, 2008, the CRA advised that it would not seek leave to appeal to the Supreme Court of Canada in respect of this matter. This appeal and subsequent court decision applies to the 1997 to 1998 taxation years and allows ATCO Electric, and Alberta Power (2000) (as successor to ATCO Electric in the coal-fired generating plants), to claim additional resource allowance and capital cost allowance. ATCO Electric and Alberta Power (2000) have recorded a reduction in current income tax expense and a decrease in interest expense which resulted in increases to the Company's earnings of \$3.0 million for the three and nine months ended September 30, 2008.

The earnings impact of this Federal Court of Appeal Tax Decision by Business Group was as follows:

| (\$ millions) | Total |
|------------------|-------|
| Utilities | 2.2 |
| Power Generation | 0.8 |
| Total | 3.0 |

CONSOLIDATED REVENUES AND EARNINGS

Revenues for the three months ended September 30, 2008, **increased** by \$89.7 million (34%) over the same period of 2007. This increase was primarily attributable to a \$85.5 million (46%) increase in revenues in the Utilities segment and a \$4.1 million (5%) increase in revenues in the Power Generation segment.

Increases in revenues for the three months ended September 30, 2008, were primarily attributable to the 2007 refund of future income tax balances with a corresponding decrease in revenues, and the impact of higher 2008 AUC approved customer rates resulting from the 2007 and 2008 ATCO Electric general tariff decision (ATCO Electric GTA). In addition, AUC approved interim customer rates in ATCO Gas associated with the 2008 and 2009 general rate application (ATCO Gas Interim Rates) contributed to the increase in revenues.

Revenues for the nine months ended September 30, 2008, **increased** by \$139.9 million (14%) over the same period of 2007. This increase was primarily attributable to a \$128.4 million (16%) increase in revenues in the Utilities segment and a \$11.4 million (5%) increase in revenues in the Power Generation segment.

Increases in revenues for the nine months ended September 30, 2008, were primarily attributable to the 2007 refund of future income tax balances with a corresponding decrease in revenues, and the impact of

higher AUC approved customer rates resulting from the ATCO Electric GTA. In addition, ATCO Gas Interim Rates and the impact of higher franchise fees collected on behalf of cities and municipalities in ATCO Gas contributed to the increase in revenues.

Earnings for the three months ended September 30, 2008, were \$30.9 million, an **increase** of \$5.5 million (22%) over the same period of 2007, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

For the three months ended September 30, 2008, **Adjusted Earnings** were \$27.9 million, an **increase** of \$2.5 million (10%) over the same period of 2007. The primary reason for the increased Adjusted Earnings were a reduction in income tax expense relating to the treatment of major maintenance expenses in Alberta Power (2000). These increases were partially offset by the earnings impact of \$5.3 million due to the change in quarterly depreciation expense allocation in ATCO Gas (ATCO Gas Depreciation Expense Adjustment, refer to Segmented Information – Utilities - Depreciation Expense Adjustment section).

Earnings for the nine months ended September 30, 2008, were \$142.1 million, an **increase** of \$18.2 million (15%) over the same period of 2007, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

For the nine months ended September 30, 2008, **Adjusted Earnings** were \$139.1 million, an **increase** of \$20.7 million (17%) over the same period of 2007. The primary reasons for the increased Adjusted Earnings were ATCO Gas Interim Rates net of cost increases and colder temperatures in ATCO Gas and the impact of the ATCO Electric GTA.

Interest and other income for the three and nine months ended September 30, 2008, **increased** by \$2.9 million to \$7.3 million and by \$7.0 million to \$18.4 million, respectively, mainly due to increased interest income on higher cash balances.

CONSOLIDATED EXPENSES

| (\$ millions) | For the Three Months Ended September 30 | | | For the Nine Months Ended September 30 | | |
|---|--|--------|----------------------------------|---|-------|----------------------------------|
| | 2008 | 2007 | Change to 2008 (2008-2007) | 2008 | 2007 | Change to 2008 (2008-2007) |
| | <i>(unaudited)</i> | | | | | |
| Operating expenses: | | | | | | |
| Natural gas supply | 0.7 | 0.4 | 75% | 2.1 | 1.7 | 24% |
| Purchased power | 11.9 | 11.1 | 7% | 39.2 | 36.3 | 8% |
| Operation and maintenance | 104.3 | 95.0 | 10% | 299.0 | 277.0 | 8% |
| Selling and administrative | 55.3 | 48.9 | 13% | 165.5 | 146.3 | 13% |
| Franchise fees | 26.7 | 20.6 | 30% | 132.7 | 113.8 | 17% |
| | 198.9 | 176.0 | 13% | 638.5 | 575.1 | 11% |
| Depreciation and amortization | 82.5 | 58.8 | 40% | 222.9 | 197.3 | 13% |
| Interest | 45.3 | 41.8 | 8% | 134.1 | 123.2 | 9% |
| Dividends on equity preferred shares | 2.8 | 3.1 | (10%) | 8.5 | 10.2 | (17%) |
| Income taxes | (0.5) | (37.8) | 99% | 32.2 | 1.7 | 1,794% |

Operating expenses for the three and nine months ended September 30, 2008, **increased** by \$22.9 million (13%) and by \$63.4 million (11%), respectively, over the same periods in 2007. Operation

and maintenance expenses were higher primarily as a result of the recording of GHG emission fees by Alberta Power (2000) recovered from its customers in accordance with the PPAs which cover costs of the recent changes in environmental laws (refer to Business Risks - Environmental Matters section). Selling and administrative expenses increased primarily as a result of the impact of inflation and increased employment costs associated with higher employment levels resulting from increased growth. Increased franchise fees, recovered on a flow through basis, were paid in ATCO Gas.

For the three and nine months ended September 30, 2008, **depreciation and amortization expenses increased** by \$23.7 million (40%) and by \$25.6 million (13%), respectively, over the same periods in 2007, primarily due to the ATCO Gas Depreciation Expense Adjustment and capital additions in 2007 and 2008 in the Utilities segment.

Interest expense for the three and nine months ended September 30, 2008, **increased** by \$3.5 million (8%) and by \$10.9 million (9%), respectively, over the same periods in 2007, primarily due to increased amounts of debt outstanding (net of redemptions) resulting from new financings issued in 2007 and 2008 to fund capital expenditures in the Utilities segment.

Dividends on equity preferred shares for the three and nine months ended September 30, 2008, **decreased** by \$0.3 million (10%) and by \$1.7 million (17%), respectively, over the same periods in 2007, primarily due to lower dividend rates and lower number of equity preferred shares outstanding.

For the three months ended September 30, 2008, **income taxes increased** by \$37.3 million (99%) over the same period in 2007, primarily due to the impact of the ATCO Electric GTA. The decision directed ATCO Electric to change its income tax methodology for the recording of federal income taxes in the third quarter of 2007. This change in methodology does not affect earnings as ATCO Electric's revenues and income tax expense were reduced by similar amounts. These increases were partially offset in 2008 by a reduction in income tax expense relating to the treatment of major maintenance expenses in Alberta Power (2000).

For the nine months ended September 30, 2008, **income taxes increased** by \$30.5 million (1,794%) over the same period in 2007, primarily due to the impact of the ATCO Electric GTA. The decision directed ATCO Electric to change its income tax methodology for the recording of federal income taxes in the third quarter of 2007 and a \$5.5 million Part VI.1 Tax Adjustment in 2007 (refer to Significant Non-Operating Financial Items - 2007 Change in Taxation of Preferred Share Dividends section). These increases were partially offset by lower corporate income tax rates and a reduction in income tax expense relating to the treatment of major maintenance expenses in Alberta Power (2000).

SEGMENTED INFORMATION

For the Three Months Ended September 30

| (\$ millions) | Utilities | Power Generation | Corporate & Other <i>(unaudited)</i> | Intersegment Eliminations | Total |
|---|-----------|---------------------|--|------------------------------|-------|
| 2008 | | | | | |
| Revenues | 273.1 | 79.5 | - | - | 352.6 |
| Earnings attributable to Class A and Class B shares | 14.4 | 16.4 | 0.1 | - | 30.9 |
| Federal Court of Appeal Decision – Mining Assets ⁽²⁾ | (2.2) | (0.8) | - | - | (3.0) |
| Adjusted Earnings | 12.2 | 15.6 | 0.1 | - | 27.9 |
| 2007 | | | | | |
| Revenues | 187.6 | 75.4 | - | (0.1) | 262.9 |
| Earnings attributable to Class A and Class B shares and Adjusted Earnings | 14.2 | 11.1 | 0.1 | - | 25.4 |

Note:

⁽²⁾ Refer to Significant Non-Operating Financial Items section for a description of the adjustments.

For the Nine Months Ended September 30

| (\$ millions) | Utilities | Power Generation | Corporate & Other <i>(unaudited)</i> | Intersegment Eliminations | Total |
|---|-----------|---------------------|--|------------------------------|---------|
| 2008 | | | | | |
| Revenues | 930.5 | 229.4 | - | - | 1,159.9 |
| Earnings attributable to Class A and Class B shares and Adjusted Earnings | 103.3 | 38.7 | 0.1 | - | 142.1 |
| Federal Court of Appeal Decision – Mining Assets ⁽²⁾ | (2.2) | (0.8) | - | - | (3.0) |
| Adjusted Earnings | 101.1 | 37.9 | 0.1 | - | 139.1 |
| 2007 | | | | | |
| Revenues | 802.1 | 218.0 | - | (0.1) | 1,020.0 |
| Earnings attributable to Class A and Class B shares | 90.9 | 33.0 | - | - | 123.9 |
| 2007 Change in the Taxation of Preferred Share Dividends ⁽¹⁾ | (4.2) | (1.3) | - | - | (5.5) |
| Adjusted Earnings | 86.7 | 31.7 | - | - | 118.4 |

Notes:

⁽¹⁾⁽²⁾ Refer to Significant Non-Operating Financial Items section for a description of the adjustments.

Utilities

Utilities **revenues** for the three months ended September 30, 2008, **increased** by \$85.5 million (46%) over the same period in 2007. Items that contributed to increased revenues were the 2007 refund of future income tax balances with a corresponding decrease in revenues, and the impact of higher AUC approved customer rates resulting from the ATCO Electric GTA and ATCO Gas Interim Rates.

Temperatures in ATCO Gas for the three months ended September 30, 2008, were 17% warmer than normal, compared to 9.9% colder than normal in the corresponding period in 2007 (refer to Business Risks - Regulated Operations - Temperatures section).

Utilities **revenues** for the nine months ended September 30, 2008, **increased** by \$128.4 million (16%) over the same period in 2007. Items that contributed to increased revenues were the 2007 refund of future income tax balances with a corresponding decrease in revenues, and the impact of higher AUC approved customer rates resulting from the ATCO Electric GTA and ATCO Gas Interim Rates and the impact of higher franchise fees collected on behalf of cities and municipalities in ATCO Gas.

Temperatures in ATCO Gas for the nine months ended September 30, 2008, were 1.8% colder than normal, compared to 2% warmer than normal in the corresponding period in 2007 (refer to Business Risks - Regulated Operations - Temperatures section).

Earnings for the three months ended September 30, 2008, were \$14.4 million, an **increase** of \$0.2 million (1%) over the same period of 2007, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

For the three months ended September 30, 2008, **Adjusted Earnings** were \$12.2 million, a **decrease** of \$2.0 million (14%) over the same period of 2007. The primary reason for the decrease was the ATCO Gas Depreciation Expense Adjustment and warmer temperatures in ATCO Gas, partially offset by the suspension of the Carbon natural gas storage facility rate riders in ATCO Gas (refer to Regulatory Developments – ATCO Gas- Carbon Natural Gas Storage Facility) and the impact of the ATCO Electric GTA.

Earnings for the nine months ended September 30, 2008, were \$103.3 million, an **increase** of \$12.4 million (14%) over the same period of 2007, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

For the nine months ended September 30, 2008, **Adjusted Earnings** were \$101.1 million, an **increase** of \$14.4 million (17%) over the same period of 2007. The primary reasons for the increase were the ATCO Gas Interim Rates net of cost increases and colder temperatures in ATCO Gas and the impact of the ATCO Electric GTA. These increases were partially offset by the ATCO Gas Depreciation Expense Adjustment.

Depreciation Expense Adjustment

Effective January 1, 2008, ATCO Gas prospectively changed the allocation of annual depreciation and amortization expense on a quarterly basis. The method of quarterly allocation has been changed from an estimate based on the timing of revenues to the straight line basis. This resulted in an increase to ATCO Gas' depreciation and amortization expense for the three and nine months ended September 30, 2008, of \$7.5 million and by \$4.9 million, respectively, as compared to the methodology used for the depreciation and amortization expense recorded in the corresponding periods of 2007. The annual depreciation and amortization expense continues to be on the straight line basis and therefore, this change does not affect the total depreciation and amortization expense recognized for the year. This resulted in a decrease to the

Company's earnings for the three and nine months ended September 30, 2008, of \$5.3 million and \$3.5 million, respectively, as compared to the methodology used in the corresponding periods of 2007.

Regulatory Developments

The AUC administers acts and regulations regarding rates, financing, accounting, construction, operation, and service area. The return on common equity for regulated utility operations was established by the AUC using its standardized rate of return methodology for utilities in Alberta. The rate of return was established in 2004 and is adjusted annually by 75% of the change in long term Government of Canada bond yield, similar to the adjustment mechanism used by the National Energy Board. The rate of return for 2007 was 8.51% and for 2008 has been set at 8.75%. If no rate applications are filed for a particular year, then there will be no adjustment to the common equity rate of return for that year.

In February 2008, the AUC initiated a generic proceeding to determine whether the standardized rate of return methodology and the utility capital structures should be reviewed. A regulatory process has been established by the AUC with a hearing currently scheduled for May 5, 2009 to review the generic return on equity formula as well as to review the capital structure for each of the Alberta utilities. The AUC also indicated that any changes which result from this proceeding would be applied beginning in 2009. As ATCO Gas and ATCO Pipelines have filed general rate applications, for 2008 and 2009 a separate module within the generic proceeding will address 2008 cost of capital issues relating to the capital structure for ATCO Gas and the capital structure and rate of return on common equity for ATCO Pipelines, respectively, as inclusion of these items has been removed from their current 2008/2009 general rate applications.

Benchmarking

ATCO Electric, ATCO Gas, and ATCO Pipelines purchase information technology services from ATCO I-Tek. ATCO Electric and ATCO Gas also purchase customer care and billing services from ATCO I-Tek. The recovery of these costs in customer rates is subject to AUC approval. Since 2003, the costs have been approved on a placeholder basis, and are subject to final AUC approval after completion of a collaborative benchmarking process. The benchmarking report, dealing with the period of 2003-2007, was received on January 23, 2008. In February 2008, the benchmarking report along with an application to adjust the placeholder rates was filed with the AUC. In April 2008, an agreement with the customer group concerning the adjustment to placeholders was submitted to the AUC for approval. Should this agreement be approved by the AUC it is not expected to have a material impact on consolidated earnings. The AUC is currently deliberating on whether any further process is required to approve the agreement with the customer group and its consequent impact on customer rates.

Effective January 1, 2008, price changes for ATCO I-Tek's information technology services to ATCO Electric, ATCO Gas and ATCO Pipelines were implemented. Price changes relating to ATCO I-Tek's customer care and billing contract services for ATCO Gas and ATCO Electric were effective March 1, 2008. For 2008 and beyond, a new regulatory process will be set up to approve rates for information technology and customer care and billing services provided by ATCO I-Tek that can be included in customer rates.

Utility Asset Disposition Rate Review Proceeding

In March 2008, the AUC initiated a proceeding to consider the potential rate related implications for Alberta utilities of the Supreme Court of Canada's 2006 Calgary Stores Block Decision (Stores Block Decision). The Calgary Stores Block matter involved the disposition by ATCO Gas of its Calgary Stores Block facility and adjacent property in downtown Calgary. The Supreme Court held that utility shareholders were entitled to receive all proceeds resulting from the sale.

The AUC has indicated that the Stores Block Decision may have various implications with respect to regulation of Alberta utility companies (including the potential impact of the Carbon Natural Gas Storage Facility discussed below). The AUC would like to develop a comprehensive understanding of these potential implications through this proceeding and then apply this understanding in a consistent manner in future decisions. At the conclusion of this proceeding, the AUC will issue a decision reflecting its conclusions with respect to the interpretation and application of the guidance provided by the courts and the resulting implications to be used in future proceedings.

ATCO Gas

2005, 2006, and 2007 General Rate Application

In May 2006, the City of Calgary filed a Review and Variance application with the AUC, alleging that the AUC made errors in ATCO Gas' 2005-2007 general rate application decision related to the calculation of working capital needed by ATCO Gas to operate its Carbon natural gas storage facility. The AUC issued a decision on January 17, 2007, denying the City of Calgary's application. On February 15, 2007, the City of Calgary filed for leave to appeal this decision with the Alberta Court of Appeal. On June 19, 2007 the appeal was heard with the court granting the City of Calgary leave to appeal on August 31, 2007. The original hearing date of the appeal, September 9, 2008, has been postponed, allowing the AUC time to address the Alberta Court of Appeal decision related to the removal of the Carbon assets from regulation.

Carbon Natural Gas Storage Facility

ATCO Gas owns a 43.5 petajoule natural gas storage facility located at Carbon, Alberta. ATCO Gas has leased the entire storage capacity of the facility to ATCO Midstream. ATCO Gas has taken the position that the facility is no longer required for utility service and should be removed from regulation.

In the process of obtaining AUC approval a number of significant events have occurred. In July 2004, the AUC initiated a written process to consider its role in regulating the operations of the facility. In June 2005, the AUC issued a decision with respect to this process. In addition to addressing other matters, the decision found that the AUC has the authority, when necessary in the public interest, to direct a utility to utilize a particular asset in a specific manner, even over the objection of the utility. ATCO Gas filed for leave to appeal the decision with the Alberta Court of Appeal.

In October 2005, the AUC established processes to review the use of the facility for utility purposes. A hearing to review the use of the facility for revenue generation was held in April 2006, and a hearing to review the use of the facility for load balancing was held in June 2006. On October 11, 2006, the AUC issued a decision confirming ATCO Gas' position that the facility is no longer required for utility service with respect to the use of the facility for load balancing purposes. The City of Calgary then filed a leave to appeal and a review and variance application of this decision.

On February 5, 2007, the AUC issued a decision in which it determined that a legitimate utility use for the facility is that it be used for purposes of generating revenues to offset customer rates. This decision required ATCO Gas to maintain the status quo with respect to the use of the facility including the lease of the entire facility to ATCO Midstream.

On February 26, 2007, ATCO Gas filed for leave to appeal this decision with the Alberta Court of Appeal. The Alberta Court of Appeal granted ATCO Gas' leave to appeal on October 24, 2007. On May 9, 2008, the Alberta Court of Appeal heard the appeal and subsequently issued a decision on May 27, 2008. The Court found that the AUC had erred in law or jurisdiction when it included the Carbon storage

facilities in rate base for the purpose of generating revenues to offset customer rates. On August 22, 2008, the City of Calgary filed a leave to appeal this decision with the Supreme Court of Canada.

As a result of the Alberta Court of Appeal's May 27, 2008 decision, ATCO Gas requested and received approval from the AUC to suspend rate riders to customer rates on an interim basis effective July 1, 2008. These riders were approved by the AUC in the past to distribute net revenues related to the facility to customers. As a result of the suspension of the rate riders, ATCO Gas recognized revenues of \$4.9 million and earnings of \$3.4 million in the third quarter of 2008 for the period July 1, 2008 to September 30, 2008. Due to certain factors, revenues and earnings from this matter in the third quarter are not necessarily indicative of revenues or earnings on an annual basis.

Additionally, ATCO Gas, on July 11, 2008, filed a compliance application with the AUC requesting removal of the facility from the utility rate base and revenue requirement effective April 1, 2005, consistent with the Alberta Court of Appeal decision. This application, in addition to the amounts recognized above, is seeking to recover from customers an additional \$29.1 million, excluding interest, related to those amounts refunded to customers over the April 1, 2005, to June 30, 2008, period. This additional \$29.1 million and related interest has not been recorded in ATCO Gas' earnings and is pending an AUC decision on the compliance application. On September 29, 2008, the AUC suspended ATCO Gas' compliance application submitted on July 11, 2008, pending the completion of the Utility Asset Disposition Rate Review Proceeding. On October 15, 2008, ATCO Gas filed an application with the Alberta Court of Appeal to direct the AUC to comply with its May 27, 2008, decision. At this time it is unknown what the final outcome of these processes will be (refer to Business Risks - Regulated Operations - Carbon Natural Gas Storage Facility section).

Deferred Gas Account

ATCO Gas filed an application with the AUC to address, among other things, corrections required to historical transportation imbalances (the process whereby third party natural gas supplies are reconciled to amounts actually shipped in the Company's pipelines) that have impacted ATCO Gas' deferred gas account. In April 2005, the AUC issued a decision resulting in a 15% decrease in the transportation imbalance adjustments sought by ATCO Gas. The City of Calgary filed a leave to appeal the AUC's decision. ATCO Gas filed a cross appeal of the AUC's decision. On July 7, 2006, the Alberta Court of Appeal issued its decision granting the City of Calgary's leave to appeal on the question of whether the AUC erred in law or jurisdiction in assuming that it had the authority to allow recovery in 2005 of costs relating to prior years. At a hearing on April 13, 2007, the Alberta Court of Appeal declined to consider the City of Calgary's appeal and referred the jurisdictional question back to the AUC. On January 3, 2008, the AUC issued a decision confirming its jurisdiction to approve the prior period adjustment it had approved previously. In February 2008, the City of Calgary filed a leave to appeal the AUC's January 3, 2008, decision with the Alberta Court of Appeal. The hearing date for the appeal has been changed from September 9, 2008, to December 16, 2008.

ATCO Pipelines

2008 and 2009 General Rate Application

On October 1, 2007, ATCO Pipelines filed a general rate application for the 2008 and 2009 test years requesting increased revenues to recover increased financing, depreciation, and operating costs associated with an increased rate base in Alberta. In November 2007, ATCO Pipelines filed an application requesting interim adjustable rates pending the AUC's decision on the general rate application. In December 2007, ATCO Pipelines received a decision from the AUC approving interim adjustable rate increases amounting to 40% of ATCO Pipelines' requested revenue increase. A decision from the AUC is not expected until the second quarter of 2009.

On October 5, 2007, the AUC approved ATCO Pipelines' request to negotiate, until January 11, 2008, a settlement with customers for revenue requirements. On January 11, 2008, ATCO Pipelines informed the AUC that a negotiated settlement had not been reached. On October 3, 2008, ATCO Pipelines requested permission from the AUC to resume negotiations on all aspects of revenue requirements, including capital structure and return on equity. On October 9, 2008, the AUC granted consent to resume negotiations.

Recent Developments

On September 8, 2008, ATCO Pipelines and Nova Gas Transmission Ltd. (NGTL) announced that they had reached a proposed agreement to provide natural gas transmission service to their customers. The proposal will allow ATCO Pipelines and NGTL to combine physical assets under a single rates and services structure with a single commercial interface for Alberta customers. Each company would separately manage assets within distinct operating territories within Alberta. This proposal, if approved by the AUC, is expected to end duplicate tolling and operational activities and result in more efficient regulatory processes.

Other Matters

The Company has a number of other regulatory filings and regulatory hearing submissions before the AUC for which decisions have not been received. The outcome of these matters cannot be determined at this time.

Power Generation

Power Generation **revenues** for the three and nine months ended September 30, 2008, **increased** by \$4.1 million (5%) and by \$11.4 million (5%), respectively, over the corresponding periods in 2007, primarily as a result of GHG emissions fees recovered from customers in accordance with the PPAs.

Earnings for the three and nine months ended September 30, 2008, were \$16.4 million, an **increase** of \$5.3 million (48%) and \$38.7 million, an **increase** of \$5.7 million (17%), respectively, over the corresponding periods in 2007, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

Adjusted Earnings for the three months ended September 30, 2008, were \$15.6 million, an **increase** of \$4.5 million (41%) over the corresponding period in 2007, primarily due to a reduction in income tax expense relating to the treatment of major maintenance expenses in Alberta Power (2000).

Adjusted Earnings for the nine months ended September 30, 2008, were \$37.9 million, an **increase** of \$6.2 million (20%) over the corresponding period in 2007, primarily due to a reduction in income tax expense relating to the treatment of major maintenance expenses in Alberta Power (2000) and improved operations at Alberta Power (2000)'s Rainbow generating plant.

Availability of Alberta Power (2000)'s generating plants is set forth below:

| | For the Three Months Ended September 30 | | | For the Nine Months Ended September 30 | | |
|-------------------------------------|--|-----------|----------------------------------|---|-----------|----------------------------------|
| | 2008 % | 2007 % | Change to 2008 (2008-2007) | 2008 % | 2007 % | Change to 2008 (2008-2007) |
| Alberta Power (2000) ⁽¹⁾ | 96.0 | 88.9 | 7.1% | 90.3 | 90.3 | -% |

Note:

⁽¹⁾ *Generating plant availability will fluctuate on a quarterly basis resulting from the timing and duration of outages.*

Other Power Generation Developments

On January 30, 2008, the 150 MW Unit 4 at Alberta Power (2000)'s Battle River generating plant experienced an unplanned outage due to a failure in the unit's generator (Battle River Unplanned Outage). The unit returned to service on March 27, 2008. Alberta Power (2000) claimed relief under the force majeure provisions of its PPA. These provisions provide protection for the operator against mechanical failures which last more than forty-two days, except for circumstances where it is found that the operator failed to follow good operating practices. On July 11, 2008, the Balancing Pool notified Alberta Power (2000) that it disagrees with Alberta Power (2000)'s claim for relief under the force majeure provisions of the PPA. Unless settlement on the claim can be reached with the PPA counterparty, it is anticipated that this claim will proceed to arbitration. The cash impact resulting from this outage is approximately \$11.8 million, however, due to Alberta Power (2000)'s availability incentive pool deferral account there will be no material earnings impact.

Under the terms of the PPAs, Alberta Power (2000) is subject to an incentive/penalty regime related to generating unit availability. Incentives are payable by the PPA counterparties for availability in excess of predetermined targets, and penalties are payable by Alberta Power (2000) when the availability targets are not achieved.

During the three months ended September 30, 2008, the **deferred availability incentive** account **increased** by \$12.3 million to \$45.2 million, mainly due to reduced outages in the quarter, as compared to the corresponding period in 2007. During the three months ended September 30, 2008, the amortization of deferred availability incentives, recorded in revenues, increased by \$0.1 million to \$3.1 million, compared to the corresponding period in 2007.

During the nine months ended September 30, 2008, the **deferred availability incentive** account **increased** by \$3.4 million to \$45.2 million, mainly due to additional availability incentives received for plant availability in excess of amortization and planned outages. During the nine months ended September 30, 2008, the amortization of deferred availability incentives, recorded in revenues, increased by \$0.2 million to \$9.1 million, compared to the corresponding period in 2007.

Greenhouse Gas Emissions

In 2007, Alberta Power (2000) began to record GHG emissions fees recovered from its customers in accordance with the PPAs which cover costs of recent changes in environmental laws (refer to Business Risks - Environmental Matters section). As the collection of the majority of these fees is on a flow through basis, there is minimal impact on the earnings of Alberta Power (2000).

Liquidity and Capital Resources

A major portion of the Company's operating income and funds generated by operations is generated from its utility operations. The Company uses short term bank loans and commercial paper borrowings to provide flexibility in the timing and amounts of long term financing.

SUMMARY OF CASH FLOW

| (\$ millions) | For the Three Months Ended September 30 | | | For the Nine Months Ended September 30 | | |
|---|--|---------|----------------------------------|---|---------|----------------------------------|
| | 2008 | 2007 | Change to 2008 (2008-2007) | 2008 | 2007 | Change to 2008 (2008-2007) |
| | <i>(unaudited)</i> | | | | | |
| Cash position, beginning of period | 265.3 | (46.2) | 674% | 0.3 | (97.5) | 100% |
| Cash provided by (used in) | | | | | | |
| Operating activities | 125.9 | 35.8 | 252% | 418.6 | 352.4 | 19% |
| Investing activities | (214.1) | (133.1) | 61% | (451.1) | (384.3) | 17% |
| Financing activities | - | 0.8 | (100%) | 209.3 | (13.3) | 1,674% |
| Cash position, end of period | 177.1 | (142.7) | 224% | 177.1 | (142.7) | 224% |

OPERATING ACTIVITIES

For the three months ended September 30, 2008, **cash flow from operations** was \$125.9 million, an **increase** of \$90.1 million (252%) over the same period in 2007, primarily due to increased funds generated by operations and changes in non-cash working capital. **Funds generated by operations** were \$126.5 million, an **increase** of \$48.1 million (61%) over the same period in 2007, primarily due to increased cash flow after removal of non-cash items and increased deferred availability incentives in Alberta Power (2000).

For the nine months ended September 30, 2008, **cash flow from operations** was \$418.6 million, an **increase** of \$66.2 million (19%) over the same period in 2007, primarily due to increased funds generated by operations and changes in non-cash working capital. **Funds generated by operations** were \$364.1 million, an **increase** of \$40.1 million (12%) over the same period in 2007, primarily due to increased cash flow after removal of non-cash items.

INVESTING ACTIVITIES

For the three months ended September 30, 2008, cash used in **investing activities increased** 61%, primarily due to higher capital expenditures in 2008 and changes in non-cash working capital. **Capital expenditures** for the three months ended September 30, 2008, **increased** by \$41.3 million primarily due to increased investment in regulated electric distribution and transmission projects.

For the nine months ended September 30, 2008, cash used in **investing activities increased** 17%, primarily due to higher capital expenditures in 2008. **Capital expenditures** for the nine months ended September 30, 2008, **increased** by \$136.3 million primarily due to increased investment in regulated

electric and natural gas distribution and transmission projects. These increases were partially offset by higher contributions by utility customers for extensions to plant.

Capital expenditures to maintain capacity, meet planned growth and fund future development activities are expected to be approximately \$0.9 billion in 2008, an increase of 46% from 2007. The majority of these expenditures relate to the Utilities segment. For the 2008 to 2010 period, capital expenditures in the Utilities segment are expected to be approximately \$3.1 billion.

The planned capital expenditures for the Utilities segment are based on the following assumptions:

- the AESO projects approved in principle by the AUC will proceed as currently scheduled;
- the remaining planned capital expenditures in the Utilities segment are required to maintain capacity and meet planned growth in the Company's service areas. These expenditures are consistent with the anticipated growth in the Alberta economy and in the Company's service areas; and
- The regulatory system in Alberta will remain substantially unchanged.

In the opinion of the Company, these assumptions are reasonable, but no assurance can be given that these assumptions will prove to be correct.

ATCO Electric, ATCO Gas and ATCO Pipelines are regulated primarily by the AUC, which administers acts and regulations covering such matters as rates, financing, accounting, construction, operation and service area. The AUC approves customer rates based on the revenue required to recover estimated costs of service, including a fair return on rate base, estimated operating expenses, depreciation and taxes, all in respect of a future test year. Return on rate base is designed to meet the cost of interest on long term debt and dividends on preferred shares and to provide the shareowners with a reasonable opportunity to earn a fair return on their investment.

ATCO Electric, ATCO Gas and ATCO Pipelines are subject to the normal risks faced by companies that are regulated. These risks include the approval by the AUC of customer rates that permit a reasonable opportunity to recover on a timely basis the estimated costs of providing service, including a fair return on rate base. In addition, these risks include the disallowance of capital expenditures incurred if the AUC determines that such costs were not prudently incurred. This risk is mitigated by the inclusion of capital expenditures in general rate applications approved by the AUC. Furthermore, all major electric transmission projects assigned by the AESO to ATCO Electric are required to be approved by the AUC prior to commencing construction.

Tightness in labour and materials markets in Alberta in recent years has resulted in substantial growth in costs of many construction projects, and while the Company attempts to mitigate the risk of delays and cost overruns by careful planning and entering into long term contracts when possible, there can be no assurance that significant cost overruns or delays will not occur.

On September 9, 2008, ATCO Electric announced it had entered into an agreement with UK-based Balfour Beatty and Australia-based United Group Limited for engineering, construction, procurement and project management services to supplement ATCO Electric's own expertise in completing its capital expenditure program. Individual projects assigned pursuant to this agreement will be jointly estimated and a target project cost agreed to before construction commences. Construction will be undertaken with a full disclosure of actual costs, with any savings or overruns relative to target project costs shared equally.

FINANCING ACTIVITIES

For the three months ended September 30, 2008, the Company did not **issue or redeem** any long term debt.

For the nine months ended September 30, 2008, the Company had **net debt increases** of \$225.0 million. **Issuance** of debt included \$200.0 million of 5.580% Debentures due May 2038 and \$125.0 million of 5.563% Debentures due May 2028. **Redemptions** were comprised of \$100.0 million of 6.97% Debentures which matured in June 2008.

For the three months ended September 30, 2008, the Company had **no issues or redemptions** of equity preferred shares.

For the nine months ended September 30, 2008, the Company had **no issues or redemptions** of equity preferred shares in 2008, compared to an issue of \$115 million of equity preferred shares and a redemption of \$126.5 million of equity preferred shares to parent corporation in 2007.

SHORT TERM INVESTMENT POLICY

The Company has a long-standing policy not to invest any of its cash balances in asset-backed securities; consequently, the recent turmoil in the asset-backed commercial paper market has had no impact on the Company. Cash and short term investment credit risk is reduced by investing in instruments issued by credit worthy financial institutions and in federal government issued short term investments.

LINES OF CREDIT

At September 30, 2008, the Company had the following credit lines that enable it to obtain funding for general corporate purposes.

| | Total | Used | Available |
|----------------------|--------------|-------------|------------------|
| (\$ millions) | | | |
| Short term committed | 300.0 | 30.0 | 270.0 |
| Uncommitted | 29.1 | 1.0 | 28.1 |
| Total | 329.1 | 31.0 | 298.1 |

The amount and timing of future financings will depend on market conditions and the specific needs of the Company.

CONTRACTUAL OBLIGATIONS

Contractual obligations disclosed in the 2007 MD&A remain substantially unchanged as at September 30, 2008.

CURRENT AND LONG TERM FUTURE INCOME TAXES

Current and long term future income taxes of \$26.2 million at September 30, 2008, are attributable to differences between the financial statement carrying amounts of assets and liabilities and their tax bases. These differences result primarily from recognizing revenue and expenses in different years for financial and tax reporting purposes. Future income taxes will become payable when such differences are reversed through the settlement of liabilities and realization of assets.

BASE SHELF PROSPECTUS

On May 16, 2008, the Company filed a **base shelf prospectus** which permits it to issue up to an aggregate of \$1,500.0 million of debentures over the twenty-five month life of the prospectus. As at September 30, 2008, the following debentures had been issued:

- on May 26, 2008, the Company issued \$200.0 million of 5.580% Debentures due May 26, 2038, at a price of 100 to yield 5.580%, and
- on May 26, 2008, the Company issued \$125.0 million of 5.563% Debentures due May 26, 2028, at a price of 100 to yield 5.563%.

The proceeds of these issues were advanced to ATCO Electric, ATCO Gas and ATCO Pipelines to be used to fund capital expenditures, to repay indebtedness and for other general corporate purposes.

Share Capital

The equity securities of the Company consist of Class A shares and Class B shares.

At October 24, 2008, the Company had outstanding 3,286,124 Class A shares, 2,014,076 Class B shares, all of which are owned by Canadian Utilities Limited.

Business Risks

Information contained in the 2007 MD&A related to Business Risks which is not discussed in this section remains substantially unchanged.

FINANCIAL MARKETS

Significant challenges are currently being experienced in domestic and international financial markets. These challenges are having an impact on the ability of certain borrowers to finance existing operations and capital programs. To date, these issues in the financial markets have not had a direct impact on the operations of the Company. As discussed elsewhere in this MD&A, the Utilities Business Group has a capital program of approximately \$3.1 billion over the next three years. The Company completed a \$325 million debenture issue in May 2008 to fund the 2008 portion of the Utilities Business Group's capital program and to fund scheduled maturities of previous debenture issues. In addition, the Company has cash balances of \$186.1 million and available committed and uncommitted lines of credit of \$329.1 million which can be utilized for general corporate purposes.

While the current financial situation has not directly impacted the Company's ability to fund capital projects and ongoing operations, future borrowing may be impacted by these financial markets through increased carrying costs and the ability to raise debt and capital. The Company is unable to determine what future changes in the financial markets could occur and how these changes could affect the Company.

ENVIRONMENTAL MATTERS

The Company's operating subsidiaries and the industries in which they operate are subject to extensive federal, provincial and local environmental protection laws concerning emissions to the air, discharges to

surface and subsurface waters, land use activities and the handling, manufacturing, processing, use, emission and disposal of materials and waste products.

On March 10, 2008, the government of Canada released details of its regulatory framework originally announced on April 26, 2007. Electricity sector companies must achieve an initial GHG reduction in 2010 of 18% from their company-wide emission intensity, with a 2% continuous improvement required annually thereafter. New facilities (2004 or later) are allowed a 3-year grace period after which they must improve emission intensity by 2% per year below the clean fuel standard. For cogeneration facilities, steam production GHG emissions are subjected to the reduction target and electricity production emissions are compared to a deemed emission target. Compliance may be achieved by reduction or capture, limited investment in a technology fund, emission credit trading, purchase of offset credits, *Kyoto Protocol Clean Development Mechanisms* (maximum 10%) and very limited opportunity for early action credits. The government reiterated that it still intends to implement fixed emission caps in the 2020 to 2025 time period. A draft regulation has yet to be released, however, final regulations on GHG emissions are expected to be published in the fall of 2009.

The federal government also announced plans to set targets to regulate air pollutants (sulphur dioxide, nitrogen oxides, particulate matter, volatile organic compounds and mercury) from industrial sources by 2015. Air pollutant elements will be added to the draft regulations once the regulatory framework for air pollutants has been finalized.

Alberta legislation requires large emitters to reduce GHG emission intensities by 12% starting July 1, 2007. Baseline emission values for Alberta Power (2000)'s facilities have been established and compliance reports with compensation for 2007 GHG obligations were submitted to Alberta Environment on March 31, 2008. For Alberta Power (2000)'s coal-fired units, the PPA counterparties have reimbursed Alberta Power (2000) for amounts it paid to Alberta Environment for its 2007 GHG obligations.

Alberta regulation requires coal-fired generating plant operators, including Alberta Power (2000), to monitor mercury emissions and capture at least 70% of the mercury in the coal commencing January 1, 2011. A full scale test at the Battle River generating plant, Unit 5 is underway to test the mercury control method to ensure the capture objective can be met.

It is anticipated that the PPAs will allow Alberta Power (2000) to recover most of the costs associated with complying with both the Federal and Alberta regulations during the PPA term.

REGULATED OPERATIONS

Carbon Natural Gas Storage Facility

ATCO Gas leases the entire storage capacity of the Carbon natural gas storage facility to ATCO Midstream at AUC approved placeholder rates. Additionally, at the AUC's direction ATCO Gas has been using these revenues to offset customer rates. On February 5, 2007, the AUC issued a decision that left in question these placeholder rates and the effect that these placeholder rates would have on future ATCO Gas revenues and customer rates. Subsequent to a decision received from the Alberta Court of Appeal on May 27, 2008, which set aside the February 5, 2007 AUC decision, ATCO Gas requested, and received, approval from the AUC to suspend rate riders relating to the distribution of revenues and the costs associated with the Carbon operations (refer to Utilities – Regulatory Developments - ATCO Gas - Carbon Natural Gas Storage Facility section).

Temperatures

Temperature fluctuations have a significant impact on throughput in ATCO Gas. As approximately 50% of ATCO Gas' delivery charge is recovered based on throughput, ATCO Gas' revenues and earnings are sensitive to temperature. Temperatures that are 10% warmer or colder than normal temperatures impact ATCO Gas' annual earnings by approximately \$9.7 million.

As part of its 2008 and 2009 general rate application filed with the AUC in November 2007, ATCO Gas is seeking approval from the AUC to set up a deferral account mechanism which would, if approved, eliminate the impact of temperature on ATCO Gas' earnings.

Benchmarking

ATCO Electric, ATCO Gas, and ATCO Pipelines purchase information technology services from ATCO I-Tek. ATCO Electric and ATCO Gas also purchase customer care and billing services from ATCO I-Tek. The recovery of these costs in customer rates is subject to AUC approval. Since 2003, the costs have been approved on a placeholder basis, and are subject to final AUC approval after completion of a collaborative benchmarking process. The benchmarking report, dealing with the period of 2003-2007, was received on January 23, 2008. In February 2008, the benchmarking report along with an application to adjust the placeholder rates was filed with the AUC. In April 2008, an agreement with the customer group concerning the adjustment to placeholders was submitted to the AUC for approval. Should this agreement be approved by the AUC, it is not expected to have a material impact on consolidated earnings. The AUC is currently deliberating on whether any further process is required to approve the agreement with the customer group and its consequent impact on customer rates.

Changes in Accounting Policies

Effective January 1, 2008, the Company adopted the Canadian Institute of Chartered Accountants (CICA) recommendations for capital disclosures which require disclosure of qualitative and quantitative information regarding the Company's objectives, policies and processes for managing capital (refer to Note 5 to the unaudited interim consolidated financial statements for the nine months ended September 30, 2008). The recommendation requires additional disclosure in the notes to the financial statements.

Effective January 1, 2008, the Company adopted the CICA recommendations pertaining to disclosure and presentation of financial instruments which require disclosure of the classification of the Company's financial instruments and additional qualitative and quantitative information regarding the nature and extent of risks arising from financial instruments to which the Company is exposed (refer to Note 6 to the unaudited interim consolidated financial statements for the nine months ended September 30, 2008). The recommendation requires additional disclosure in the notes to the financial statements.

Effective January 1, 2008, the Company prospectively adopted the CICA recommendations for measurement and disclosure of inventories which provide guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value, and on the cost formulas that are used to assign costs to inventories. The recommendations also clarified that major spare parts are to be included in property, plant and equipment. As a result of adopting these recommendations, the Company reclassified \$1.8 million of inventories to property, plant, and equipment related to major spare parts on January 1, 2008 (refer to Note 1 to the unaudited interim consolidated financial statements for the nine months ended September 30, 2008).

FUTURE ACCOUNTING CHANGES

Effective for the Company beginning January 1, 2009, the CICA has removed a temporary exemption in its accounting recommendations that permitted assets and liabilities arising from rate regulation to be recognized and measured on a basis other than in accordance with the primary sources of GAAP. As permitted by Canadian GAAP, the Company will use standards issued by the Financial Accounting Standards Board in the United States that allow for the recognition and measurement of rate regulated assets and liabilities as another source of Canadian GAAP. The adoption of these standards is not expected to have a material impact on the earnings of the Company. However, it is anticipated that the reserves for future removal and site restoration costs, which are currently netted against property, plant and equipment, will be reclassified to non-current liabilities, resulting in an increase to the Company's total assets and liabilities. The amount of such future removal and site restoration costs at December 31, 2007 was \$417.0 million. The CICA has also issued new recommendations that will require the recognition of future income tax assets and liabilities as well as a separate regulatory asset or liability for the amount of future income taxes expected to be included in future rates and recovered from or paid to future customers. The amount of unrecorded future income tax liabilities of the regulated operations at December 31, 2007 was \$159.4 million. These recommendations will be applied prospectively.

The CICA has issued new accounting recommendations for goodwill and intangible assets which establish standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets (including internally developed intangible assets). These recommendations are effective for the Company beginning January 1, 2009. Goodwill and intangible assets that are not assets as defined by GAAP will be derecognized and charged to the equity of the Company at that date. The adoption of these recommendations is not expected to have a material impact on the earnings or assets of the Company.

International Financial Reporting Standards

In 2006, the CICA announced that accounting standards in Canada are to converge with International Financial Reporting Standards (IFRS). The Company will begin reporting under IFRS in the first quarter of 2011 with comparative data for the prior year. IFRS uses a conceptual framework similar to Canadian GAAP, but there could be significant differences in recognition, measurement and disclosures that will need to be addressed.

The Company has established a Steering Committee, a project team, and working groups to review the adoption of IFRS. The project team and working groups provide position papers and regular updates to management, the Steering Committee and the Audit Committee. Employee education sessions have been, and will continue to be, provided to increase knowledge and awareness of IFRS and its impacts. An external expert advisor has been engaged. The Company is participating in various industry groups, including the Canadian Energy Pipeline Association, the Canadian Gas Association and the Canadian Electric Association.

The Company's IFRS Conversion Project consists of three phases: Assessment and Diagnostic; Design and Planning; and Implementation and Review. Position papers are being prepared on issue-specific accounting differences between Canadian GAAP and IFRS. As a number of the IFRS standards are changing, the position papers will be updated to reflect any changes resulting from the final standards.

The Company reviews discussion papers, exposure drafts and standards released by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee. The Company will continue to assess the impact of the proposed standards on its financial statements and disclosure as additional information becomes available. Financial impacts cannot be reasonably determined at this time.

Based on initial assessments the Company has identified that the following areas have the greatest potential impact to ATCO's accounting: property, plant and equipment, joint arrangements, leases, rate regulated operations and employee benefits. There will also be a significant amount of effort to comply with the IFRS' requirements for initial adoption of IFRS.

A more detailed analysis and evaluation of the financial impact of the issues identified in the assessment and diagnostic phases will be completed in 2009. The evaluation will include determination of financial reporting system changes required including computer systems.