



An **ATCO** Company

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE THREE MONTHS ENDED  
MARCH 31, 2008**

# CU Inc.

## Management's Discussion and Analysis (MD&A) For the Three Months Ended March 31, 2008

This MD&A should be read in conjunction with the Company's unaudited interim consolidated financial statements for the three months ended March 31, 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 April 28, 2008. Additional information relating to the Company, including the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://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.

**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.

**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 7 to the unaudited interim consolidated financial statements for the three months ended March 31, 2008.

## 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 flows 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. **For the three months ended March 31, 2008 and March 31, 2007 there were no adjustments to earnings attributable to Class A and Class B shares and therefore earnings and Adjusted Earnings are the same.**

## Internal Control Over Financial Reporting

There were no changes in the Company’s internal controls over financial reporting that have occurred during the three months ended March 31, 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 <sup>(1) (2) (3) (4)</sup>			
	Mar. 31	Jun. 30	Sep. 30	Dec. 31
	<i>(unaudited)</i>			
<b>2008</b>				
Revenues	443.4	-	-	-
Earnings attributable to Class A and Class B shares	77.7	-	-	-
Adjusted Earnings	77.7	-	-	-
<b>2007</b>				
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	60.2	32.8	25.4	44.8
<b>2006</b>				
Revenues	-	316.6	292.7	391.7
Earnings attributable to Class A and Class B shares	-	21.4	24.9	47.8
Adjusted Earnings	-	27.7	25.6	47.8

### Notes:

- (1) There were no discontinued operations or extraordinary items during these periods.
- (2) Due to the seasonal nature of the Company's operations, changes in electricity prices in Alberta and the timing of rate decisions, revenues, earnings and Adjusted Earnings for any quarter are not necessarily indicative of operations on an annual basis.
- (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.

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

As noted previously, for the three months ended March 31, 2008 and March 31, 2007 there were no adjustments to earnings attributable to Class A and Class B shares and therefore Earnings and Adjusted Earnings are the same.

## SIGNIFICANT NON-OPERATING FINANCIAL ITEMS

There are no Significant Non-Operating Financial Items which have impacted the consolidated and segmented financial results for the three months ended March 31, 2008 and March 31, 2007.

## CONSOLIDATED REVENUES AND EARNINGS

**Revenues increased** by \$27.7 million (6.7%), over the first quarter of 2007, primarily attributable to AUC approved interim customer rates associated with the 2008 and 2009 general rate application (ATCO Gas Interim Rates), the impact of customer growth, higher franchise fees collected on behalf of cities and municipalities and colder temperatures in ATCO Gas and higher AUC approved customer rates associated with the 2007 and 2008 general tariff application in ATCO Electric (ATCO Electric GTA).

For the three months ended March 31, 2008, **earnings and Adjusted Earnings** were \$77.7 million, an **increase** of \$17.5 million (29.1%), over the same period of 2007. The primary reasons for the increased Adjusted Earnings were the impact of customer growth and ATCO Gas Interim Rates net of cost increases, the change in quarterly depreciation expense allocation (ATCO Gas Depreciation Expense Adjustment, refer to Segmented Information - ATCO Gas section) and colder temperatures in ATCO Gas.

**Interest and other income increased** for the first quarter of 2008 by \$0.7 million to \$4.1 million mainly due to increased interest earned on higher cash balances.

## CONSOLIDATED EXPENSES

(\$ millions)	For the Three Months Ended March 31		
	2008	2007	Change to 2008 (2008-2007)
Operating expenses:			
Natural gas supply	0.7	0.7	0.0%
Purchased power	15.3	13.8	10.9%
Operation and maintenance	92.8	87.9	5.6%
Selling and administrative	55.3	48.8	13.3%
Franchise fees	62.7	58.5	7.2%
	<b>226.8</b>	<b>209.7</b>	<b>8.2%</b>
Depreciation and amortization	69.7	73.7	(5.4)%
Interest	43.6	40.7	7.1%
Dividends on equity preferred shares	2.8	3.5	(20.0)%
Income taxes	26.9	31.3	(14.1)%

**Operating expenses** for the three months ended March 31, 2008, **increased** by \$17.1 million (8.2%) over the same period 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, increased salaries and project development costs. Higher franchise fees were collected in ATCO Gas.

For the three months ended March 31, 2008, **depreciation and amortization expenses decreased** by \$4.0 million (5.4%) over the same period in 2007 primarily due to the ATCO Gas Depreciation Expense Adjustment, partially offset by capital additions in 2007 and 2008 in the Utilities segment.

**Interest expense increased** for the first quarter of 2008 by \$2.9 million (7.1%) over the first quarter of 2007 primarily due to increased interest on new financings issued in 2007 to fund capital expenditures in the Utilities segment.

**Dividends on equity preferred shares decreased** for the first quarter of 2008 by \$0.7 million (20.0%) over the first quarter of 2007 primarily due to lower dividend rates and lower number of equity preferred shares outstanding.

For the three months ended March 31, 2008, **income taxes decreased** by \$4.4 million (14.1%) over the first quarter of 2007 primarily due to lower corporate income tax rates and lower future income taxes in the Utilities segment resulting from the ATCO Electric GTA, which required ATCO Electric, in the third quarter of 2007, to change its income tax methodology for the recording of Federal Income Taxes. This change in methodology does not affect earnings as ATCO Electric's revenues and income tax expense were reduced by similar amounts. Offsetting this decrease was higher earnings.

## SEGMENTED INFORMATION

(\$ millions)	For the Three Months Ended		
	March 31		
	Utilities	Power Generation	Total
<b>2008</b>			
Revenues	<b>369.2</b>	<b>74.2</b>	<b>443.4</b>
Earnings attributable to Class A and Class B shares	<b>66.4</b>	<b>11.3</b>	<b>77.7</b>
Adjusted Earnings	<b>66.4</b>	<b>11.3</b>	<b>77.7</b>
<b>2007</b>			
Revenues	343.9	71.8	415.7
Earnings attributable to Class A and Class B shares	48.4	11.8	60.2
Adjusted Earnings	48.4	11.8	60.2

### Utilities

Utilities **revenues** in the first quarter of 2008 **increased** by \$25.3 million (7.4%) from the first quarter of 2007. Items that contributed to increased revenues were the ATCO Gas Interim Rates, the impact of customer growth, higher franchise fees collected on behalf of cities and municipalities and colder temperatures in ATCO Gas and the impact of the ATCO Electric GTA.

Temperatures in ATCO Gas in the first quarter of 2008 were 0.3% warmer than normal, compared to 5.1% warmer than normal in the first quarter of 2007.

In the first quarter of 2008, **earnings and Adjusted Earnings** were \$66.4 million, an **increase** of \$18.0 million (37.2%) over the first quarter of 2007. The primary reasons for the increase were the ATCO Gas Interim Rates net of cost increases, customer growth, the ATCO Gas Depreciation Expense Adjustment and colder temperatures in ATCO Gas and the impact of the ATCO Electric GTA.

### 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, resulting in a reduction to ATCO Gas' depreciation and amortization expense of \$7.1 million in the first quarter of 2008 as compared to the depreciation and amortization expense recorded in the first quarter 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 change in allocation resulted in an increase to ATCO Gas' earnings of \$4.9 million for the three months ended March 31, 2008, compared to the three months ended March 31, 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 if the standardized rate of return methodology established in 2004 should be reviewed. This proceeding will determine if the current methodology continues to yield a fair return on equity for utility companies. Furthermore the AUC is addressing whether the existing AUC approved capital structures for all utility companies should be reviewed in a generic proceeding or, alternatively, to continue to address changes in capital structure in utility company specific rate applications. A decision from the AUC on whether to proceed, and how to proceed, on these issues is expected in the second quarter of 2008.

### **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. An AUC decision on the agreement is expected in the second quarter of 2008.

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. 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*

### **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 January 3, 2008 decision with the Alberta Court of Appeal.

### *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's first quarter 2008 **revenues increased** by \$2.4 million (3.3%) over the first quarter of 2007, 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).

**Earnings and Adjusted Earnings** for the three months ended March 31, 2008, were **substantially unchanged** at \$11.3 million.

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

	<b>For the Three Months Ended March 31</b>		
	<b>2008</b>	2007	Change to 2008 (2008-2007)
Alberta Power (2000)	<b>92.0%</b>	94.9%	(2.9)%

### *Other Power Generation Developments*

On January 30, 2008, Unit 4 at Alberta Power (2000)'s 150 MW Battle River generating plant experienced an unplanned outage due to a failure in the unit's generator. The unit returned to service on March 27, 2008. Alberta Power (2000) has 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. If the claim for relief is not successful, the cash impact will be approximately \$11.8 million. Due to the availability incentive pool deferral account, Alberta Power (2000) does not expect any material earnings impact as a result of this outage.

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 March 31, 2008, the deferred availability incentive account increased by \$0.9 million to \$42.7 million, mainly due to incentives received in the first quarter due to good availability, partially offset by penalties paid for the Battle River generating plant forced outage. During the three months ended March 31, 2008, the amortization of deferred availability incentives, recorded in revenues, increased by \$0.1 million to \$3.0 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 commercial paper borrowings and short term bank loans to provide flexibility in the timing and amounts of long term financing.

SUMMARY OF CASH FLOW (\$ millions)	For the Three Months Ended March 31		
	2008	2007	Change to 2008 (2008-2007)
<b>Cash position, beginning of period</b>	<b>0.3</b>	(97.5)	100.3%
Cash provided by (used in)			
Operating activities	<b>172.6</b>	230.1	(25.0)%
Investing activities	<b>(103.0)</b>	(120.3)	(14.4)%
Financing activities	<b>(14.1)</b>	0.3	(4,800.0)%
<b>Cash position, end of period</b>	<b>55.8</b>	12.6	342.9%

### OPERATING ACTIVITIES

For the three months ended March 31, 2008, **cash flow from operations** was \$172.6 million, a **decrease** of \$57.5 million (25.0%) over the same period in 2007, primarily due to changes in non-cash working capital. **Funds generated by operations** was \$148.1 million, an **increase** of \$6.7 million (4.7%) over the first quarter of 2007, primarily due to higher earnings, partially offset by decreased deferred availability incentives in Alberta Power (2000).

### INVESTING ACTIVITIES

For the three months ended March 31, 2008, cash used in **investing activities decreased** 14.4%, primarily due to increased contributions by utility customers for extensions to plant, changes in non-cash working capital and changes in non-current deferred electricity costs. These decreases were partially offset by higher capital expenditures in 2008. Capital expenditures increased by \$44.6 million primarily due to increased investment in regulated electric distribution and transmission and regulated natural gas distribution projects.

**Capital expenditures** to maintain capacity, meet planned growth, and fund future development activities are expected to be approximately \$0.8 billion in 2008, an increase of 30.0% from 2007. The majority of these expenditures are uncommitted and relate primarily to the Utility segment. Capital expenditures for 2008 to 2010 are expected to be approximately \$3.0 billion for the Utilities segment.

## FINANCING ACTIVITIES

In the first quarter of 2008, the Company did not **issue or redeem** any long term debt.

## 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.

## LINES OF CREDIT

At March 31, 2008, the Company had the following credit lines that enable it to obtain funding for general corporate purposes.

	<b>Total</b>	<b>Used</b>	<b>Available</b>
(\$ millions)			
Short term committed	300.0	10.0	290.0
Uncommitted	29.0	0.5	28.5
<b>Total</b>	<b>329.0</b>	<b>10.5</b>	<b>318.5</b>

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 March 31, 2008.

## CURRENT AND LONG TERM FUTURE INCOME TAX LIABILITY

**Current and long term future income tax liabilities** of \$27.2 million at March 31, 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.

## Share Capital

At April 25, 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.**

## 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 on 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 transition to fixed emission caps in the 2020 to 2025 time period. 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. Amendments to the air pollutant section of the regulatory framework are expected in the spring of 2008.

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 payments for 2007 GHG obligations were submitted to Alberta Environment on March 31, 2008. For Alberta Power (2000)'s coal-fired units, the PPA counterparties provided payments for their 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 coal emissions commencing January 1, 2011. A full scale test is planned for Unit 5 at the Battle River generating plant in 2008 to evaluate 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**

### **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.

## **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 4 to the unaudited interim consolidated financial statements for the three months ended March 31, 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 5 to the unaudited interim consolidated financial statements for the three months ended March 31, 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 three months ended March 31, 2008).

## **FUTURE ACCOUNTING CHANGES**

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 Company is evaluating the effect of these recommendations on its financial statements.

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