



**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE YEAR ENDED  
DECEMBER 31, 2007**

# CU Inc.

## Management's Discussion and Analysis (MD&A) For the year ended December 31, 2007

This MD&A should be read in conjunction with the Company's unaudited consolidated financial statements for the three months ended December 31, 2007 and the audited consolidated financial statements for the year ended December 31, 2007. This MD&A is dated February 19, 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 adjustment 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.

**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

CU Inc. was incorporated under the laws of Canada on March 12, 1999. The company has assets of approximately \$4.9 billion and more than 3,700 employees.

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.

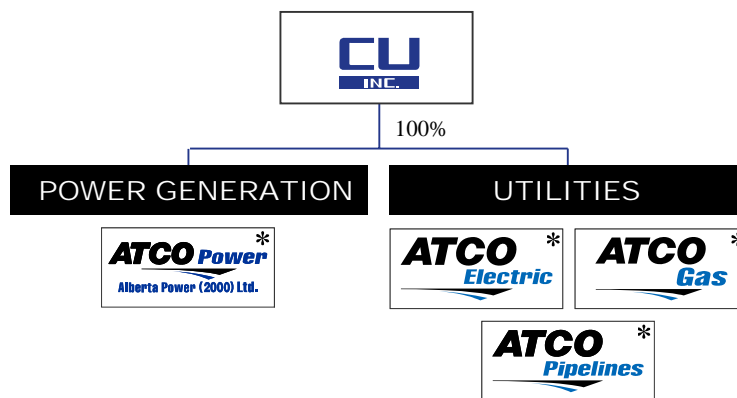
The Company operates in the following business segments:

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 21 of the consolidated financial statements.

## Simplified Organizational Structure



\* Regulated operations include ATCO Electric, ATCO Gas, ATCO Pipelines and the Battle River and Sheerness generating plants of Alberta Power (2000) Ltd.

## 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” and “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 adjustment 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 – Reconciliation of Earnings Attributable to Class A and Class B shares and Adjusted Earnings section.

## **Controls and Procedures**

### **DISCLOSURE CONTROLS AND PROCEDURES**

As of December 31, 2007, the Company's management evaluated the effectiveness of the design and operation of its disclosure controls and procedures as defined under rules adopted by the Canadian Securities Administrators. This evaluation was performed under the supervision of, and with the participation of, the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO).

Disclosure controls are procedures designed to ensure that information required to be disclosed in documents filed with securities regulatory authorities is recorded, processed, summarized and reported on a timely basis, and is accumulated and communicated to the Company's management, including the CEO and the CFO, as appropriate, to allow timely decisions regarding required disclosure.

The Company's management, inclusive of the CEO and the CFO, does not expect that CU Inc.'s disclosure controls and procedures will prevent or detect all error and all fraud. The inherent limitations in all control systems are such that they can provide only reasonable, not absolute, assurance that all control issues and instances of fraud or error, if any, within CU Inc. have been detected.

Based on this evaluation, the CEO and the CFO have concluded that, subject to the inherent limitations noted above, CU Inc.'s disclosure controls are effective in providing reasonable assurance that material information relating to the Company and its consolidated subsidiaries is made known to the CEO and the CFO by others within those entities.

### **INTERNAL CONTROL OVER FINANCIAL REPORTING**

As of December 31, 2007, management of the Company is responsible for evaluating the design of internal control over financial reporting, as defined under rules adopted by the Canadian Securities Administrators. This evaluation was performed under the supervision of, and with the participation of, the CEO and the CFO. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements.

There were no changes in the Company's internal controls over financial reporting that have occurred during the three months ended December 31, 2007, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

# Annual Results of Operations

## SELECTED INFORMATION

(\$ millions, except per share data, outstanding shares and % return on equity) <sup>(1)</sup> <sup>(2)</sup> <sup>(8)</sup>	For the Year Ended December 31		
	2007	2006	Change to 2007 (2007-2006)
Revenues	1,414.2	1,401.8	0.9%
Earnings attributable to Class A and Class B shares	177.3	147.1	20.5%
Adjusted Earnings <sup>(3)</sup>	163.2	154.1	5.9%
Total assets	4,860.1	4,523.7	7.4%
Long term debt	2,459.4	2,267.5	8.5%
Equity preferred shares	245.0	256.5	(4.5)%
Class A and Class B Share owner's equity	1,675.5	1,493.0	12.2%
Return on equity	11.2	10.0	12.0%
Cash flow from operations	467.1	333.6	40.0%
Funds generated by operations	452.8	394.8	14.7%
Capital expenditures	615.4	536.1	14.8%
Cash dividends declared per share:			
Series Preferred Shares:			
Series 1 <sup>(4)</sup>	0.71	-	-
Preferred shares of subsidiaries issued to Canadian Utilities			
Series Second Preferred Shares:			
Series Q <sup>(5)</sup>	0.68	1.48	
Series R <sup>(5)</sup>	0.61	1.33	
Series S <sup>(5)</sup>	0.77	1.65	
Series U <sup>(6)</sup>	1.09	1.26	(13.5)%
Series V <sup>(7)</sup>	1.28	1.31	(2.3)%

### Notes:

- (1) There were no discontinued operations or extraordinary items during these periods.
- (2) 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.
- (3) Refer to Significant Non-Operating Financial Items section for a description of adjustments to arrive at Adjusted Earnings.
- (4) Series 1 Preferred Shares were issued on April 18, 2007.
- (5) Series Second Preferred Shares Q, R and S were redeemed on May 18, 2007.
- (6) The dividend rate was reset to \$1.09 (from 5.05% to 4.35%) for dividend periods commencing between December 2, 2006, and December 2, 2011.
- (7) The dividend rate was reset to \$1.18 (from 5.25% to 4.70%) for dividend periods commencing between October 3, 2007, and October 3, 2012.
- (8) 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.

## 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 adjustment 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). A description of each of the adjustments is provided in the Significant Non-Operating Financial Items section.

(\$ millions)	For the Year Ended December 31	
	2007	2006
Earnings attributable to Class A and Class B shares	177.3	147.1
H.R. Milner Income Tax Reassessment (1)	-	12.4
2007 Change in the Taxation of Preferred Share Dividends (2)	(5.5)	-
2007 Changes in Income Taxes and Rates (3)	0.9	-
2006 Changes in Income Taxes and Rates (4)	-	(1.7)
ATCO Gas Tax Reassessments (5)	(9.5)	-
Calgary Stores Block (6)	-	(3.7)
Adjusted Earnings	163.2	154.1

## SIGNIFICANT NON-OPERATING FINANCIAL ITEMS

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

### (1) H.R. Milner Income Tax Reassessment

In 2006, the CRA issued a reassessment for Alberta Power (2000)'s 2001 taxation year. The CRA's reassessment treats the proceeds received from the sale of the H.R. Milner generating plant to the Alberta Balancing Pool as income rather than as a sale of an asset. The Company has appealed the reassessment to the Tax Court of Canada. The impact of the reassessment was a \$12.4 million increase in interest and income tax expense, a \$12.4 million decrease in earnings (\$8.0 million recorded in the second quarter of 2006 and \$4.4 million recorded in the third quarter of 2006), and a \$28.8 million payment associated with the tax and interest assessed. It is expected that \$16.4 million of this cash payment will be recovered by reducing income taxes payable through higher capital cost allowance claims in taxation years subsequent to the reassessed year.

### (2) 2007 Change in the Taxation of Preferred Share Dividends

In 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 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. 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. An additional increase to earnings of \$0.3 million was recorded relating to the first quarter of 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	First Quarter of 2007	Total
Utilities	4.2	0.2	4.4
Power Generation	1.3	0.1	1.4
Total	5.5	0.3	5.8

### (3) 2007 Changes in Income Taxes and Rates

In 2007, the federal government announced a reduction in corporate tax rates from 19% to 15% by 2012. As a result of these changes, the Company made an adjustment to future income taxes amounting to \$(0.9) million in the fourth quarter of 2007. The adjustment decreased the Company's 2007 earnings by \$0.9 million, all of which related to Alberta Power (2000).

### (4) 2006 Changes in Income Taxes and Rates

In 2006, federal and provincial governments announced a reduction in corporate tax rates from 22.12% to 19% by 2011 and from 11.5% to 10% by 2007 respectively. As a result of these changes, the Company made an adjustment to income taxes amounting to \$1.7 million in the second quarter of 2006, most of which related to future income taxes. The adjustment increased the Company's 2006 earnings by \$1.7 million, all of which related to the Utilities segment.

### (5) ATCO Gas Tax Reassessments

In the fourth quarter of 2007, ATCO Gas successfully appealed previous CRA reassessments which resulted in an \$8.8 million decrease in income taxes and an increase in interest income (net of tax) of \$0.7 million for an overall increase to the Company's earnings of \$9.5 million. These appeals applied to the 1999 to 2006 taxation years and allow ATCO Gas to treat previously reported capital outlays as current expenditures for income tax purposes.

### (6) Calgary Stores Block

In October 2001, the AUC approved the sale by ATCO Gas of certain properties in the City of Calgary, known as the Calgary Stores Block, for \$6.6 million (excluding costs of disposition) and directed that \$4.1 million of the proceeds be allocated to customers. ATCO Gas appealed the decision through the courts until the matter was addressed by the Supreme Court of Canada on February 9, 2006. The Supreme Court decision upheld ATCO Gas' rights to these proceeds and directed the AUC to issue a new decision to this effect. In the third quarter of 2006, ATCO Gas recorded an additional \$4.1 million net proceeds from the sale, which increased ATCO Gas' earnings by \$3.7 million.

## CONSOLIDATED REVENUES AND EARNINGS

Consolidated **revenues** in 2007 were **substantially unchanged**, with an increase of \$12.4 million (0.9%) over 2006.

Increases in revenues were primarily attributable to colder temperatures, higher sales per customer and customer growth in ATCO Gas, the impact of finalization of customer rates offset by the refund of future income tax balances resulting from the ATCO Electric 2007-2008 GTA Decision (refer to Regulatory Developments – ATCO Electric section) and the recording of GHG emission fees by Alberta Power (2000) 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).

**Earnings** in 2007 were \$177.3 million, an **increase** of \$30.2 million (20.5%), over 2006, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

In 2007, **Adjusted Earnings** were \$163.2 million, an **increase** of \$9.1 million (5.9%), over 2006. The primary reasons for the increased Adjusted Earnings in 2007 were colder temperatures, higher sales per customer and customer growth in ATCO Gas. This increase was partially offset by increased operation and maintenance and depreciation expenses in ATCO Gas due to customer growth and increased capital expenditures.

**Interest and other income decreased** by \$3.9 million to \$18.0 million mainly due to the Calgary Stores Block decision in 2006 in ATCO Gas partially offset by increased income earned on cash balances due to higher short term interest rates.

## CONSOLIDATED EXPENSES

(\$ millions)	For the Year Ended December 31		
	2007	2006	Change to 2007 (2007-2006)
Operating expenses:			
Natural gas supply	2.1	2.5	(16.0)%
Purchased power	49.9	46.1	8.2%
Operation and maintenance	383.6	348.5	10.1%
Selling and administrative	208.0	199.4	4.3%
Franchise fees	151.2	150.4	0.5%
	<b>794.8</b>	746.9	6.4%
Depreciation and amortization	271.2	268.0	1.2%
Interest	165.8	165.9	(0.1)%
Dividends on equity preferred shares	13.2	14.0	(5.7)%
Income taxes	9.9	81.8	(87.9)%

In 2007, **operating expenses increased** by \$47.9 million (6.4%). Increases were primarily due to increased business activity ATCO Gas and ATCO Electric and the recording of GHG emission fees by Alberta Power (2000) 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).

**Depreciation and amortization expenses increased** primarily due to capital additions in 2006 and 2007 in the Utilities segment, partially offset by a one-time amortization expense charge of certain deferred items approved by the AUC for ATCO Gas in 2006.

**Interest expense** for 2007 was **substantially unchanged** from 2006, as higher new debenture amounts in 2007 and 2006 were completed with lower interest rates than the interest rates paid on redeemed debentures.

**The impact of tax adjustments** in 2006 and 2007 was a **decrease** in income taxes of \$71.9 million (87.9%). The following table summarizes these impacts:

(\$ millions)	For the Year Ended December 31		
	2007	2006	Total
H.R. Milner Tax Reassessment	-	(7.2)	(7.2)
2006 Change in Income Taxes and Rates	-	1.7	1.7
2007 Change in Income Taxes and Rates	0.9	-	0.9
2007 Change in Taxation of Preferred Share Dividends	(5.5)	-	(5.5)
2007/2006 ATCO Gas Tax Reassessments	(8.8)	1.0	(7.8)
2006 ATCO Gas refund of future income taxes	-	4.0	4.0
2007 ATCO Electric change in tax methodology:			
• refund of future income taxes	(34.4)	-	(34.4)
• refund of current income taxes	(5.2)	-	(5.2)
• impact on 2007 income taxes	(11.8)	-	(11.8)
2007 Provincial, Federal and Preferred Share Dividends tax changes on 2007 earnings	(2.6)	-	(2.6)
Other	(4.0)	-	(4.0)
	<b>(71.4)</b>	(0.5)	(71.9)

## SEGMENTED INFORMATION

**For the Year Ended  
December 31**

(\$ millions)	Utilities	Power Generation	Corporate & Other	Intersegme Eliminations	Total
<b>2007</b>					
Revenues	<b>1,114.6</b>	<b>299.8</b>	-	<b>(0.2)</b>	<b>1,414.2</b>
Earnings attributable to Class A and Class B shares	<b>138.2</b>	<b>39.0</b>	<b>0.1</b>	-	<b>177.3</b>
2007 Changes in the Taxation of Preferred Share Dividends (2)	<b>(4.2)</b>	<b>(1.3)</b>	-	-	<b>(5.5)</b>
2007 Changes in Income Taxes and Rates (3)	-	<b>0.9</b>	-	-	<b>0.9</b>
ATCO Gas Tax Reassessments (5)	<b>(9.5)</b>	-	-	-	<b>(9.5)</b>
Adjusted Earnings	<b>124.5</b>	<b>38.6</b>	<b>0.1</b>	-	<b>163.2</b>
Capital expenditures	<b>588.8</b>	<b>26.6</b>	-	-	<b>615.4</b>
Operating expenses	<b>641.1</b>	<b>153.8</b>	-	<b>(0.1)</b>	<b>(794.8)</b>
<b>2006</b>					
Revenues	1,109.2	292.8	-	(0.2)	1,401.8
Earnings attributable to Class A and Class B shares	120.0	27.0	0.1	-	147.1
H.R. Milner Income Tax Reassessment (1)	-	12.4	-	-	12.4
2006 Changes in Income Taxes and Rates (4)	(1.7)	-	-	-	(1.7)
Calgary Stores Block (6)	(3.7)	-	-	-	(3.7)
Adjusted Earnings	114.6	39.4	0.1	-	154.1
Capital expenditures	505.0	31.1	-	-	536.1
Operating expenses	601.9	145.2	-	(0.2)	746.9

Note:

(1) Number references refer to order of items disclosed in the Significant Non-Operating Financial Items section.

### Utilities

Utilities **revenues** in 2007 were **substantially unchanged** with an increase of \$5.4 million (0.5%) from 2006. Items that contributed to increased revenues were colder temperatures, higher sales per customer and customer growth in ATCO Gas and the impact of finalization of customer rates offset by the refund of future income tax balances resulting from the ATCO Electric 2007-2008 GTA Decision (refer to Regulatory Developments – ATCO Electric section).

Temperatures in ATCO Gas in 2007 were 1.0% warmer than normal, compared to 5.5% warmer than normal in 2006.

**Earnings** for 2007 were \$138.2 million, an **increase** of \$18.2 million (15.2%) over 2006, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

In 2007, **Adjusted Earnings** were \$124.5 million, an **increase** of \$9.9 million (8.6%) over 2006. The primary reason for higher Adjusted Earnings in 2007 was colder temperatures, higher sales per customer and customer growth in ATCO Gas. This increase was partially offset by increased operation and maintenance and depreciation expenses in ATCO Gas due to customer growth and increased capital expenditures.

**Capital expenditures** to maintain capacity and meet planned growth were \$588.8 million in 2007. Capital expenditures rose by \$83.8 million from 2006 as a result of the rapid growth of the Alberta economy, customer growth, and safety and reliability enhancements. Capital expenditures for 2008 to 2010 are expected to be approximately \$3.0 billion for the Utilities segment.

### ***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 in 2007 was 8.51% and for 2008 has been set at 8.75%. The rate of return in 2006 was 8.93%.

### **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. A benchmarking report was received on January 23, 2008, and an application is anticipated to be made to the AUC by the end of February 2008 to finalize the placeholder costs. An AUC decision is expected before the end of the second quarter of 2008.

Adjustments to ATCO I-Tek's fees as a result of the benchmarking report for information technology services will be retroactive to January 1, 2008. Price changes relating to ATCO I-Tek's customer care and billing contract services for ATCO Gas and ATCO Electric will be applied following renegotiation of a new fee schedule.

### ***ATCO Electric***

#### **2007 and 2008 General Tariff Application**

In November 2006, ATCO Electric filed a general tariff application (GTA) with the AUC for 2007 and 2008 requesting, among other things, increased revenues to recover increased financing, depreciation and operating costs associated with increased rate base in Alberta. ATCO Electric also filed an application requesting interim refundable rates for transmission and distribution operations, pending the AUC's decision on the GTA. In December 2006, ATCO Electric received a decision from the AUC approving interim refundable rate increases amounting to 50% of ATCO Electric's requested increases for transmission and distribution operations.

In September 2007, the AUC issued a decision on ATCO Electric's GTA for 2007 and 2008 (ATCO Electric GTA Decision). The decision established, among other things, the amount of revenue to be collected in 2007 and 2008 from customers for transmission and distribution services. The AUC also approved a return on common equity of 8.51% for 2007, as determined by its standardized rate of return methodology. The effect of this decision on the earnings of ATCO Electric was not material as higher revenues primarily resulting from increased capital expenditures and previously approved interim customer rates were offset by a lower approved rate of return on common equity (8.51% in 2007 versus 8.93% in 2006) and other adjustments.

The decision also directed ATCO Electric to change its income tax methodology for federal purposes. This change in tax methodology does not affect earnings as ATCO Electric's revenues and income tax expense were reduced by similar amounts. Accordingly, in the third quarter, ATCO Electric recorded a reduction in future income tax liabilities of \$34.4 million and a liability to customers of \$49.3 million, offset by a regulatory asset of \$14.9 million which represents current income tax savings to be realized in future periods. Unrecorded future income tax liabilities increased by \$34.4 million as a result of this decision. In December 2007, ATCO Electric refunded \$16.1 million of the liability to transmission customers, thereby realizing \$5.2 million of current income tax savings, which further reduced revenues, and reduced the future income taxes to be refunded by \$10.9 million, and will be refunding the remaining \$23.5 million balance to distribution customers over a five year period commencing in 2008.

## **Transmission Infrastructure Projects**

In August 2006, the AUC approved the AESO application for increased transmission infrastructure in northwest Alberta. The AESO has approval to assign to the transmission facility owner, ATCO Electric, work consisting of several distinct projects that is expected to result in 725 kilometres of new transmission lines to be constructed by 2011.

The first of these projects was assigned by the AESO in June 2007, with final approval received from the AUC on November 23, 2007. This first project consists of the construction of a 226 kilometre transmission line with an estimated cost of \$210 million and anticipated completion by March 31, 2010.

As a result of price escalation caused by the change in completion date of the remaining distinct projects (post 2010), coupled with the increasing costs of construction in Alberta, ATCO Electric is unable to estimate the cost of the entire project at this time.

In addition to the increased transmission infrastructure in northwestern Alberta, ATCO Electric anticipates that an additional 180 kilometres of transmission line projects will be required in its service area over the next five years.

## ***ATCO Gas***

### **2005, 2006, and 2007 General Rate Application**

On January 27, 2006, ATCO Gas received a decision on its general rate application which was filed with the AUC in May 2005 for 2005, 2006, and 2007. The decision established the amount of revenue ATCO Gas can recover through distribution rates for natural gas distribution service to its customers for 2005 through 2007. The AUC also approved a rate of return on common equity of 9.5% for 2005, 8.93% for 2006 and 8.51% for 2007, as determined by its standardized rate of return methodology.

In May 2006, the City of Calgary filed a review and variance application with the AUC, alleging that the AUC made errors in the decision related to the calculation of working capital needed by ATCO Gas to operate its Carbon natural gas storage facility. The AUC issued its 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 review and variance decision with the Alberta Court of Appeal. On June 19, 2007, the application was heard with the court granting the City of Calgary leave to appeal on August 31, 2007. The appeal is scheduled to be presented at a hearing set for September 9, 2008.

In October 2006, ATCO Gas filed a review and variance application with the AUC for the ATCO Gas general rate application (GRA) decision. The application alleges that the AUC made errors in the ATCO Gas GRA decision related to the approved level of administrative expense. In December 2006, the AUC issued a decision which acknowledged an error for a portion of the administrative expense in question. On April 18, 2007, the AUC agreed to review its original decision. On November 27, 2007, a decision on this matter was received granting ATCO Gas \$4.7 million in costs to be collected during the first two quarters of 2008, with a total increase to ATCO Gas' 2007 earnings of \$3.2 million.

### **2008 and 2009 General Rate Application**

In November 2007, ATCO Gas filed a general rate application with the AUC for 2008 and 2009 requesting, among other things, increased revenues to recover increased financing, depreciation and operating costs associated with increased rate base in Alberta. ATCO Gas also filed an application requesting interim adjustable rates pending the AUC's decision on the general rate application. In December 2007, ATCO Gas received a decision from the AUC approving interim adjustable rate increases amounting to 50% of ATCO Gas' requested revenue increase.

## **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 requires 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 (refer to Business Risks - Regulated Operations – Carbon Natural Gas Storage Facility section). The Alberta Court of Appeal granted ATCO Gas' leave to appeal on October 24, 2007. A hearing has been set for May 9, 2008.

## **Deferred Gas Account**

ATCO Gas has 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 decision resulted in a decrease to ATCO Gas' 2005 revenues and earnings of \$1.8 million and \$1.2 million, respectively. The City of Calgary filed a leave to appeal the AUC's decision. ATCO Gas filed a cross appeal of the AUC's decision. The leave to appeal was heard by the Alberta Court of Appeal on April 18, 2006. 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, for 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 September 5, 2007, the AUC commenced proceedings to address the jurisdictional question. On January 3, 2008, the AUC issued a decision confirming its jurisdiction to approve the prior period adjustment it had approved previously.

## ***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 on the general rate application is not expected until the fourth quarter of 2008.

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.

## Competitive Proceedings

During 2007, the AUC reinstated its review of the competitive natural gas pipeline issues under its jurisdiction. This review will address competitive issues between ATCO Pipelines and NOVA Gas Transmission Ltd. (NOVA). This review process is continuing.

## 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** in 2007 **increased** by \$7.0 million (2.4%) over 2006, primarily as a result of the recording of GHG emission fees in 2007 by Alberta Power (2000) 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). This increase was partially offset by lower excess energy sales at the Sheerness generating plant.

**Earnings** for 2007 were \$39.0 million, an **increase** of \$12.0 million (44.4%) over 2006 including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

**Adjusted Earnings** were **substantially unchanged** over 2006.

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

	For the Year Ended December 31		
	2007	2006	Change to 2007 (2007-2006)
Alberta Power (2000)	90.2%	90.0%	0.2%

## Other Power Generation Developments

On January 30, 2008, Alberta Power (2000)'s 150 MW Battle River Unit 4 experienced an unplanned outage due to a failure in the unit's generator. It is anticipated that the unit will remain off-line until mid March 2008. Alberta Power (2000) has claimed Force Majeure relief under the provisions of its PPA. If the claim for relief is successful, Alberta Power (2000) does not expect any material financial impact. If the claim for relief is not successful, the cash impact will be approximately \$10 million. Due to the availability incentive pool deferral account, Alberta Power (2000) does not expect any material earnings impact in 2008 as a result of this outage.

## Alberta Power (2000)

The generating plants of Alberta Power (2000) were regulated by the AUC until December 31, 2000, but are now governed by legislatively mandated PPAs that were approved by the AUC. These plants are included in regulated operations primarily because the PPAs are designed to allow the owners of generating plants constructed before January 1, 1996, to recover their forecast fixed and variable costs and to earn a return at the rate specified in the PPAs. Each plant will become deregulated upon the earlier of one year after the expiry of its PPA or a decision to continue to operate the plant. For PPAs expiring prior to 2019, Alberta Power (2000) has one year after the expiry of a PPA to determine whether to decommission the generating plant in order to fully recover plant decommissioning costs or to continue to operate the plant and be responsible for decommissioning costs. For PPAs expiring after 2018 decommissioning costs are the responsibility of the plant owner. Each PPA is to remain in effect until the earlier of the last day of the estimated life of the related generating plant or December 31, 2020.

Alberta Power (2000) operated the Rainbow generating plant during 2006 and the electricity generated was sold to the Alberta Power Pool. Alberta Power (2000) had one year after the expiry of the PPA for the Rainbow generating plant (December 31, 2005) to determine whether to decommission the plant in order to fully recover plant decommissioning costs or to continue to operate the plant. In 2007, the AESO and Alberta Power (2000) executed a contract resulting in Alberta Power (2000) continuing to operate the plant and thus be responsible for future decommissioning costs. These costs are included in Alberta Power (2000)'s asset retirement obligation liability. Under the terms of the agreement, the Company makes the plant available for transmission support services and can continue to sell energy into the Alberta Power Pool.

Over 99% of the electricity generated by Alberta Power (2000) is sold pursuant to PPAs. Under the PPAs, Alberta Power (2000) is required to make the generating capacity for each generating unit available to the purchaser of the PPA for that unit. In return, Alberta Power (2000) is entitled to recover its forecast fixed and variable costs for that unit from the PPA purchaser, including a return on common equity equal to the long term Government of Canada bond rate plus 4.5% based on a deemed common equity ratio of 45%. Many of the forecast costs will be determined by indices, formulae or other means for the entire period of the PPA. Alberta Power (2000)'s actual results will vary and depend on performance compared to the forecasts on which the PPAs were based. The return on common equity rate used in its PPA tariff calculations for Alberta Power (2000) was 8.65% in 2007 and 8.75% for 2006. The rate of return on common equity for 2008 is 8.88%.

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.

Accumulated incentives in excess of accumulated penalties are deferred. For any of the individual PPAs, should accumulated incentives plus estimated future incentives exceed accumulated penalties plus estimated future penalties, the excess will be amortized to revenues on a straight-line basis over the remaining term of the PPAs. Should accumulated penalties plus estimated future penalties exceed accumulated incentives plus estimated future incentives, the shortfall will be expensed in the year the shortfall occurs.

During 2007, the deferred availability incentive account increased by \$2.2 million to \$41.8 million at December 31, 2007, due to additional availability incentives received for plant availability in excess of amortization and planned outages. During 2007, the amortization of deferred availability incentives, recorded in revenues, increased by \$1.2 million to \$11.8 million, compared to 2006.

### **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. CU Inc. 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 Year Ended December 31		
	2007	2006	Change to 2007 (2007-2006)
<b>Cash position, beginning of period</b>	<b>(97.5)</b>	35.1	(377.8)%
Cash provided by (used in)			
Operating activities	<b>467.1</b>	333.6	40.0%
Investing activities	<b>(562.6)</b>	(495.1)	13.6%
Financing activities	<b>193.3</b>	28.9	568.9%
<b>Cash position, end of period</b>	<b>0.3</b>	(97.5)	100.3%

### OPERATING ACTIVITIES

**Cash flow from operations increased** by 40.0% in 2007, primarily due to increases in funds generated by operations. **Funds generated by operations increased** by 14.7% in 2007 primarily due to higher earnings and increased deferred availability incentives in Alberta Power (2000).

### INVESTING ACTIVITIES

In 2007, cash used in **investing activities increased** 13.6% due to higher capital expenditures in 2007, changes in non-current deferred electricity costs. Capital expenditures increased by \$79.3 million due to increased investment in regulated electric distribution and transmission and regulated natural gas distribution projects.

CAPITAL EXPENDITURES (\$ millions)	For the Year Ended December 31		
	2007	2006	Change to 2007 (2007-2006)
Utilities	<b>588.8</b>	505.0	16.6%
Power Generation	<b>26.6</b>	31.1	(14.5)%
	<b>615.4</b>	536.1	14.8%

**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 operations. Capital expenditures for 2008 to 2010 are expected to be approximately \$3.0 billion for the Utilities segment.

### FINANCING ACTIVITIES

In 2007, the Company had **net debt increases** of \$205.0 million. **Issuance** of debt included \$220.0 million of 5.556% Debentures due October 2037, and \$35.0 million of 4.883% Debentures due November 2012. **Redemptions** were comprised of \$50.0 million of 4.801% Debentures due November 2007.

On April 18, 2007, CU Inc. issued \$115.0 million Cumulative Redeemable Preferred Shares Series 1 at a price of \$25.00 per share for cash. The dividend rate was fixed at 4.60%. The net proceeds of the issue were used in part to redeem all of the outstanding Cumulative Redeemable Second Preferred Shares Series Q, R and S (Series Q, R and

S Preferred Shares) of ATCO Electric, ATCO Gas and ATCO Pipelines (\$91.8 million). In addition, on May 18, 2007, Alberta Power (2000) redeemed all of its outstanding Series Q, R and S Preferred Shares (\$34.7 million). All of the Series Q, R and S Preferred Shares were held by Canadian Utilities Limited, CU Inc.'s parent corporation.

The dividend rate on the ATCO Electric, ATCO Gas, and ATCO Pipelines Perpetual Cumulative Second Preferred Shares Series V was reset to \$1.18 (from 5.25% to 4.70%) for the period between October 3, 2007, and October 3, 2012.

On December 20, 2007 CU Inc. issued \$5.3 million of Class A and Class B shares to Canadian Utilities Limited, its parent company.

### **SHORT TERM INVESTMENT POLICY**

It is the Company's policy to not invest any of its cash balances in asset-backed commercial paper.

### **LINES OF CREDIT**

At December 31, 2007, 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	29.1	0.5	28.6
<b>Total</b>	<b>329.1</b>	<b>10.5</b>	<b>318.6</b>

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

## CONTRACTUAL OBLIGATIONS

Contractual obligations for the next five years and thereafter are as follows:

	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>After 5 Years</b>
(\$ millions)					
Long term debt	2,459.4	100.0	254.5	135.0	1,969.9
Operating leases	22.9	8.9	9.7	3.8	0.5
Purchase obligations:					
ATCO Gas natural gas purchase contracts <sup>(1)</sup>	3.5	0.5	1.0	1.0	1.0
Alberta Power (2000) coal purchase contracts <sup>(2)</sup>	554.6	49.3	101.7	107.3	296.3
Alberta Power (2000) operating and maintenance agreements <sup>(3)</sup>	5.1	1.6	3.5	-	-
Capital expenditures <sup>(4)</sup>	75.2	75.2	-	-	-
Other	5.2	3.2	1.8	0.2	-
<b>Total</b>	<b>3,125.9</b>	<b>238.7</b>	<b>372.2</b>	<b>247.3</b>	<b>2,267.7</b>

### Notes:

- <sup>(1)</sup> ATCO Gas has ongoing obligations to purchase fixed quantities of natural gas from various gas producers at market prices that are in effect at the time the quantities are purchased. These obligations relate primarily to operational contracts pertaining to the Carbon natural gas storage facility, which continues to be subject to AUC regulation. Some of these obligations are for the life of the gas reserves. The estimated value of these purchase obligations is based on the market price of natural gas in effect on December 31, 2007, and assumes a remaining life of 10 years for the gas reserves commencing January 1, 2004. Direct Energy has agreed to purchase the natural gas purchased under these contracts at the prices paid by ATCO Gas.
- <sup>(2)</sup> Alberta Power (2000) has fixed price long term contracts to purchase coal for its coal-fired generating plants. These costs are recoverable pursuant to the PPAs.
- <sup>(3)</sup> Alberta Power (2000) has various contracts with suppliers to provide operating and maintenance services at certain of its generating plants.
- <sup>(4)</sup> Various contracts to purchase goods and services with respect to capital expenditure programs.

## CURRENT AND LONG TERM FUTURE INCOME TAX LIABILITY

**Current and long term future income tax liabilities** of \$28.3 million at December 31, 2007, 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 April 12, 2006, CU Inc. filed a **base shelf prospectus** which permits CU Inc. to issue up to an aggregate of \$850.0 million of debentures over the twenty-five month life of the prospectus. As at December 31, 2007 the following debentures had been issued:

- on November 20, 2006, the Company issued \$160.0 million of 4.801% Debentures due November 22, 2021, at a price of 100 to yield 4.801% and \$160.0 million of 5.032% Debentures due November 20, 2036, at a price of 100 to yield 5.032%. The proceeds of these two issues were advanced to ATCO Electric, ATCO Gas and ATCO Pipelines for use in funding capital expenditures, repay indebtedness and for other general corporate purposes.
- on November 1, 2007, the Company issued \$220.0 million of 5.556% Debentures due October 30, 2037, at a price of 100 to yield 5.556%. The proceeds of this issue were advanced to ATCO Electric, ATCO Gas and ATCO Pipelines for use in funding capital expenditures, repay indebtedness and for other general corporate purposes.
- on November 1, 2007, the Company issued \$35.0 million of 4.883% Debentures due November 1, 2012, at a price of 100 to yield 4.883%. The proceeds of this issue were advanced to Alberta Power (2000) for use in funding capital expenditures, 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 February 15, 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

### ENVIRONMENTAL MATTERS

CU Inc'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 April 26, 2007, the federal government released a plan that proposes mandatory GHG emission targets on industry. The proposed plan requires an initial reduction in 2010 of 18% from 2006 levels followed thereafter by annual reductions of an additional 2%. 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. 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. Specific details on the regulations have yet to be released and will be required to assess the financial impact of the federal framework. It is anticipated that the PPAs will allow the Company to recover most of the costs associated with complying with the new regulations.

On April 20, 2007 and June 27, 2007, respectively, the Government of Alberta approved Bill 3, Climate Change and Emissions Management Amendment Act and the Specified Gas Emitters Regulation Amendment that requires Alberta facilities that emit 100,000 tonnes or more of GHG to reduce facility emission intensities by 12% starting July 1, 2007. Units commissioned before January 1, 2000, or that have less than nine years of commercial operation are required to reduce their emission intensity by 2% per year starting in the fourth year of commercial operation to a maximum of 12% in the ninth year of commercial operation. Cogeneration units with emissions less than a deemed emission target based on a stand-alone natural gas combined cycle unit and conventional boiler will be eligible for credits. It is anticipated that the PPAs will allow the Company to recover most of the costs associated with complying with the new regulations.

The Alberta government implemented a mercury emission regulation in March 2006. The regulation requires coal-fired plant operators, including Alberta Power (2000), to monitor mercury emissions and capture at least 70% of the mercury in the coal starting January 1, 2011. It is anticipated that the PPAs will allow the Company to recover most of the costs associated with complying with the new regulation.

## **REGULATED OPERATIONS**

Regulated operations are conducted by the following subsidiaries: ATCO Electric and its subsidiaries, ATCO Gas, ATCO Pipelines, and CU Water. Alberta Power (2000)'s two largest generating plants are also considered regulated operations because they are governed by legislatively mandated PPAs, approved by the AUC.

ATCO Electric, ATCO Gas, ATCO Pipelines and CU Water 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 may approve interim rates or approve the recovery of costs, including capital and operating costs, on a placeholder basis, subject to final determination. These subsidiaries 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 by the AUC, of costs incurred. The Company's ability to recover the actual costs of providing service and to earn the approved rates of return depends on achieving the forecasts established in the rate-setting process.

### **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. On February 5, 2007, the AUC issued a decision to ATCO Gas that leaves in question these placeholder rates and the effect that these placeholder rates will have on future ATCO Gas revenues.

### **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. A benchmarking report was received on January 23, 2008, and an application is anticipated to be made to the AUC by the end of February 2008 to finalize the placeholder costs. An AUC decision is expected before the end of the second quarter of 2008.

### **Transfer of the Retail Energy Supply Businesses**

On May 4, 2004, ATCO Gas and ATCO Electric transferred their retail energy supply businesses to Direct Energy and one of its affiliates (collectively Direct Energy), a subsidiary of Centrica plc. ATCO Gas and ATCO Electric continue to own and operate the natural gas and electricity distribution systems used to deliver energy.

Although ATCO Gas and ATCO Electric transferred to Direct Energy certain retail functions, including the supply of natural gas and electricity to customers and billing and customer care functions, the legal obligations of ATCO Gas and ATCO Electric remain if Direct Energy fails to perform. In certain events (including where Direct Energy fails to supply natural gas and/or electricity and ATCO Gas and/or ATCO Electric are ordered by the AUC to do so), the functions will revert to ATCO Gas and/or ATCO Electric with no refund of the transfer proceeds to Direct Energy by ATCO Gas and/or ATCO Electric.

Centrica plc, Direct Energy's parent, has provided a \$300 million guarantee, supported by a \$235 million letter of credit in respect of Direct Energy's obligations to ATCO Gas, ATCO Electric and ATCO I-Tek in respect of the ongoing relationships contemplated under the transaction agreements. However, there can be no assurance that the coverage under these agreements will be adequate to cover all of the costs that could arise in the event of a reversion of such functions.

Canadian Utilities has provided a guarantee of ATCO Gas', ATCO Electric's and ATCO I-Tek's payment and indemnity obligations to Direct Energy contemplated under the transaction agreements.

### **Late Payment Penalties on Utility Bills**

As a result of decisions of the Supreme Court of Canada in *Garland vs. Consumers' Gas Co.*, the imposition of late payment penalties on utility bills has been called into question. ATCO is unable to determine at this time the impact, if any, that these decisions will have on the Company.

### **Measurement Inaccuracies in Metering Facilities**

Measurement inaccuracies occur from time to time with respect to ATCO Electric's, ATCO Gas' and ATCO Pipelines' metering facilities. Measurement adjustments are settled between the parties based on the requirements of the Electricity and Gas Inspections Act (Canada) and applicable regulations issued pursuant thereto. There is a risk of disallowance of the recovery of a measurement adjustment if controls and timely follow up are found to be inadequate by the AUC.

An AUC decision applicable to ATCO Gas established a two-year adjustment limitation period for inaccuracies in gas supply costs, including measurement inaccuracies in metering facilities. The AUC stated that it will consider specific applications for adjustments beyond the two-year limitation period.

### **Alberta Power (2000)**

Alberta Power (2000) has two regulated operations, the Battle River and Sheerness generating plants, which were regulated by the AUC until December 31, 2000, but are now governed by legislatively mandated PPAs that were approved by the AUC. These plants are included in regulated operations primarily because the PPAs are designed to allow the owners of generating plants constructed before January 1, 1996, to recover their forecast fixed and variable costs and to earn a return at the rate specified in the PPAs. The plants will become deregulated upon the earlier of one year after the expiry of a PPA or a decision to continue to operate the plant. For PPAs expiring prior to 2019, Alberta Power (2000) has one year after the expiry of a PPA to determine whether to decommission the generating plant in order to fully recover plant decommissioning costs or to continue to operate the plant. For PPAs expiring after 2018 decommissioning costs are the responsibility of the plant owner. Each PPA is to remain in effect until the earlier of the last day of the estimated life of the related generating plant or December 31, 2020.

Over 99% of the electricity generated by Alberta Power (2000) is sold pursuant to PPAs. Under the PPAs, Alberta Power (2000) is required to make the generating capacity for each generating unit available to the purchaser of the PPA for that unit. In return, Alberta Power (2000) is entitled to recover its forecast fixed and variable costs for that unit from the PPA purchaser, including a return on common equity equal to the long term Government of Canada bond rate plus 4.5% based on a deemed common equity ratio of 45%. Many of the forecast costs will be determined by indices, formulae or other means for the entire period of the PPA. Alberta Power (2000)'s actual results will vary and depend on performance compared to the forecasts on which the PPAs were based.

Fuel costs in Alberta Power (2000) are mostly for coal supply. To protect against volatility in coal prices, Alberta Power (2000) owns or has sufficient coal supplies under long term contracts for the anticipated lives of its Battle River and Sheerness coal-fired generating plants. These contracts are at prices that are either fixed or indexed to inflation.

## Derivative Financial Instruments

In conducting its business, the Company uses various instruments, including forward contracts, swaps and options, to manage the risks arising from fluctuations in exchange rates, interest rates and commodity prices. All such instruments are used only to manage risk and not for trading purposes. For details on the financial instruments in place at December 31, 2007, see Note 18 to the consolidated financial statements.

The Canadian Institute of Chartered Accountants (CICA) recommendations require the recognition and measurement of derivative instruments embedded in host contracts that were issued, acquired or substantively modified on or after January 1, 2003. Derivative instruments embedded in host contracts that were issued, acquired or substantively modified prior to January 1, 2003 have not been identified and recognized in the consolidated financial statements as permitted by the recommendations.

The Company designates each derivative instrument as either a hedging instrument or a non-hedge derivative:

- (a) A hedging instrument is designated as either:
  - (i) a fair value hedge of a recognized asset or liability or,
  - (ii) a cash flow hedge of either:
    - a specific firm commitment or anticipated transaction or,
    - the variable future cash flows arising from a recognized asset or liability.

At inception of a hedge, the Company documents the relationship between the hedging instrument and the hedged item, including the method of assessing retrospective and prospective hedge effectiveness. At the end of each period, the Company assesses whether the hedging instrument has been highly effective in offsetting changes in fair values or cash flows of the hedged item and measures the amount of any hedge ineffectiveness. The Company also assesses whether the hedging instrument is expected to be highly effective in the future.

A hedging instrument is recorded on the consolidated balance sheet at fair value. Payments or receipts on a hedging instrument that is determined to be highly effective as a hedge are recognized concurrently with, and in the same financial category as, the hedged item. Subsequent changes in the fair value of a fair value hedge are recognized in earnings concurrently with the hedged item. For a cash flow hedge, the effective portion of changes in fair value is recognized in other comprehensive income and is subsequently transferred to earnings concurrently with the hedged item, whereas the portion of the changes in fair value that is not effective at offsetting the hedged exposure is recognized in earnings.

If a hedging instrument ceases to be highly effective as a hedge, is de-designated as a hedging instrument or is settled prior to maturity, then the Company ceases hedge accounting prospectively for that instrument; for a cash flow hedge, the gain or loss deferred to that date remains in accumulated other comprehensive income and is transferred to earnings concurrently with the hedged item. Subsequent changes in the fair value of that derivative instrument are recognized in earnings.

If the hedged item is sold, extinguished or matures prior to the termination of the related hedging instrument, or if it is probable that an anticipated transaction will not occur in the originally specified time frame, then the gain or loss deferred to that date for the related hedging instrument is immediately transferred from accumulated other comprehensive income to earnings.

Hedge gains or losses that were recognized in other comprehensive income are added to the initial carrying amount of a non-financial asset or non-financial liability when:

- (i) an anticipated transaction for a non-financial asset or non-financial liability becomes a specific firm commitment for which fair value hedge accounting is applied or,
- (ii) a cash flow hedge of an anticipated transaction subsequently results in the recognition of the non-financial asset or non-financial liability.

- (b) A non-hedge derivative instrument is recorded on the consolidated balance sheet at fair value and subsequent changes in fair value are recorded in earnings.

The Company applies settlement date accounting to the purchases and sales of financial assets. Settlement date accounting implies the recognition of an asset on the day it is received by the Company and the recognition of the disposal of an asset on the day that it is delivered by the Company. Any gain or loss on disposal is also recognized on that day.

Transaction costs that are directly attributable to the acquisition or issue of financial assets or financial liabilities that are not held for trading are added to the fair value of such assets or liabilities at time of initial recognition.

## Transactions with Related Parties

The Company's transactions with related parties are in the normal course of business and under normal commercial terms. For a description of these transactions, see Note 16 to the consolidated financial statements.

## Off-Balance Sheet Arrangements

At December 31, 2007, unrecorded future income tax liabilities of the regulated operations amounted to \$159.4 million. This balance includes \$4.7 million in respect of Alberta Power (2000)'s generating plants, which will be recovered through future payments received in respect of the PPA's (refer to Note 5 to the consolidated financial statements).

Other than the financial instruments discussed under the Derivative Financial Instruments section, the Company does not have any off-balance sheet arrangements that have, or are likely to have, a current or future effect on the results of operations or financial condition, including, without limitation, such considerations as liquidity and capital resources.

## Contingencies

The Company is party to a number of disputes and lawsuits in the normal course of business. The Company believes that the ultimate liability arising from these matters will have no material impact on the consolidated financial statements.

## Critical Accounting Estimates

The preparation of the Company's consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. On an on-going basis, management reviews its estimates, particularly those related to depreciation and amortization methods, useful lives and impairment of long-lived assets, amortization of deferred availability incentives, asset retirement obligations, employee future benefits and the fair values of financial instruments, using currently available information. Changes in facts and circumstances may result in revised estimates, and actual results could differ from those estimates. The Company's critical accounting estimates are discussed below.

## DEFERRED AVAILABILITY INCENTIVES

Alberta Power (2000) is subject to an incentive/penalty regime related to generating unit availability. The amount to be amortized is dependent upon estimates of future generating unit availability and future electricity prices over the term of the PPAs. Each quarter, management uses these estimates to forecast high case, low case and most likely scenarios for the incentives to be received from, less penalties to be paid to, the PPA counterparties. These forecasts are added to the accumulated unamortized deferred availability incentives outstanding at the end of the quarter; the resulting total is divided by the remaining term of the PPA to arrive at the amortization for the quarter. As at December 31, 2007, the Company had recorded \$41.8 million of deferred availability incentives. The amortization of deferred availability incentives recorded in revenues amounted to \$11.8 million in 2007.

Compared to the most likely scenario recorded in revenues for the year, the high case scenario would have resulted in higher revenues of approximately \$5.3 million, whereas the low case scenario would have resulted in lower revenues of approximately \$5.3 million.

## Changes in Accounting Policies

Effective January 1, 2007, the Company adopted the CICA recommendations pertaining to financial instruments, which establish standards for the recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives. These recommendations require that fair value be used to measure financial assets that are held for trading or available for sale, financial liabilities that are held for trading and all derivative financial instruments. Other financial assets, such as loans and receivables and investments that are held to maturity, and other financial liabilities are measured at their amortized cost. This change in accounting had the following effect on the consolidated financial statements for the three months and year ended December 31, 2007:

- Restatement of opening retained earnings at January 1, 2007 associated with the recognition of certain financial assets and financial liabilities at amortized cost using the effective interest method (see Note 6 to the consolidated financial statements).
- Reclassification of deferred financing charges from other assets to long term debt (see Note 10 to the consolidated financial statements).

Effective January 1, 2007, the Company adopted the CICA recommendations pertaining to hedges, which establish standards for the identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge accounting. The purpose of hedge accounting is to ensure that gains, losses, revenues and expenses from effective hedging relationships are recorded in earnings in the same period. This change in accounting had no effect on the consolidated financial statements for the three months and year ended December 31, 2007.

Effective January 1, 2007, the Company adopted the CICA recommendations regarding the reporting and disclosure of comprehensive income. Comprehensive income consists of changes in the equity of the Company from sources other than the Company's share owners, and includes earnings of the Company and unrealized gains and losses on changes in fair values of available-for-sale assets and effective cash flow hedging instruments. Other comprehensive income comprises revenues, expenses, gains and losses that are recognized in comprehensive income but are excluded from earnings of the period. Comprehensive income is disclosed in a separate statement in the consolidated financial statements.

Effective January 1, 2007, the Company adopted the CICA recommendations regarding the presentation of equity and changes in equity. These recommendations require separate presentation of the components of equity, including retained earnings, accumulated other comprehensive income, contributed surplus, share capital and reserves, and the changes therein. As a result of this change in accounting, the Company has included disclosure regarding accumulated other comprehensive income in the notes to the consolidated financial statements (see Note 19 to the consolidated financial statements).

Effective January 1, 2007, the Company adopted the CICA recommendations that prescribe the criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. Adoption of these recommendations had no effect on the consolidated financial statements for the three months and year ended December 31, 2007, except for the disclosure of accounting changes that have been issued by the CICA but have not yet been adopted by the Company because they are not effective until a future date (see Future Accounting Changes section).

## **FUTURE ACCOUNTING CHANGES**

The CICA has issued new accounting recommendations for capital disclosures which require disclosure of both qualitative and quantitative information that enables users of financial statements to evaluate the Company's objectives, policies and processes for managing capital. These recommendations are effective for the Company beginning January 1, 2008. This recommendation requires additional disclosure in the notes to the financial statements.

The CICA has issued new accounting recommendations for disclosure and presentation of financial instruments which require disclosures of both qualitative and quantitative information that enables users of financial statements to evaluate the nature and extent of risks arising from financial instruments to which the Company is exposed. These recommendations are effective for the Company beginning January 1, 2008. This recommendation requires additional disclosure in the notes to the financial statements.

The CICA has issued new accounting recommendations for measurement and disclosure of inventories which provide guidance on the determination of cost and its subsequent recognition as an expense, including any writedown to net realizable value, and on the cost formulas that are used to assign costs to inventories. The adoption of these recommendations is not expected to have a material impact on the earnings or assets of the Company. These recommendations are effective for the Company beginning January 1, 2008.

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. The Company is evaluating the possibility of using 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 GAAP. At this time the Company is unable to determine the effect that this decision will have on earnings or assets and liabilities of the Company. The CICA has also issued new recommendations pertaining to regulated income taxes to require the recognition of future regulated 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. These recommendations are effective for the Company beginning January 1, 2009, and will be applied prospectively. This recommendation requires additional disclosure in the notes to the financial statements; however, the company believes that there will be no material impact on its earnings.

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.

# Quarterly Results of Operations

## SELECTED INFORMATION

(\$ millions except per share data)	For the Three Months Ended				
	Mar 31	Jun 30	Sep 30	Dec 31	Total
	<i>(unaudited)</i>				
<b>2007</b> <sup>(1) (2) (3)</sup>					
Revenues	415.7	341.4	262.9	394.2	1,414.2
Earnings attributable to Class A and Class B shares	60.2	38.3	25.4	53.4	177.3
Adjusted Earnings <sup>(4)</sup>	60.2	32.8	25.4	44.8	163.2
<b>2006</b> <sup>(1) (2) (3)</sup>					
Revenues	400.8	316.6	292.7	391.7	1,401.8
Earnings attributable to Class A and Class B shares	53.0	21.4	24.9	47.8	147.1
Adjusted Earnings <sup>(4)</sup>	53.0	27.7	25.6	47.8	154.1

### Notes:

<sup>(1)</sup> There were no discontinued operations or extraordinary items during these periods.

<sup>(2)</sup> Due to the seasonal nature of the Company's operations, changes in electricity prices in Alberta, the timing of rate decisions, revenues, earnings and Adjusted Earnings for any quarter are not necessarily indicative of operations on an annual basis.

<sup>(3)</sup> 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.

<sup>(4)</sup> Refer to Significant Non-Operating Financial Items section for a description of 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 were:

- the timing of utility rate decisions;
- amount of franchise fees collected by ATCO Gas on behalf of cities and municipalities;
- availability of power generating plants in Alberta Power (2000);
- fluctuations in temperatures;
- H. R. Milner Income Tax Reassessment in Alberta Power (2000) in 2006;
- 2006 and 2007 Changes in Income Taxes and Rates;
- 2007 Changes in the Taxation of Preferred Share Dividends; and
- ATCO Gas Tax Reassessments.

## Fourth Quarter 2007

All quarterly information in this document is unaudited and has been shaded to differentiate it from the annual information.

SEGMENTED REVENUE (\$ millions)	For the Three Months Ended December 31		
	2007	2006	Change to 2007 (2007-2006)
	<i>(unaudited)</i>		
Utilities	312.5	319.1	(2.1)%
Power Generation	81.8	72.7	12.5%
Intersegment eliminations	(0.1)	(0.1)	0.0%
Revenues	394.2	391.7	0.6%

Notes:

- (1) There were no discontinued operations or extraordinary items during these periods.
- (2) Due to the seasonal nature of the Company's operations revenues for any quarter are not necessarily indicative of operations on an annual basis.
- (3) The above data has been extracted from the financial statements, which have been prepared in accordance with GAAP and the reporting currency is the Canadian dollar.

Fourth quarter **revenues increased** by \$2.5 million primarily due to:

- the recording of GHG emission fees by Alberta Power (2000) 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);
- the impact of the finalization of customer rates resulting from the ATCO Electric 2007-2008 GTA Decision (refer to Regulatory Developments – ATCO Electric section); and
- higher sales per customer and customer growth in ATCO Gas.

This increases were partially offset by:

- lower franchise fees collected by ATCO Gas on behalf of cites and municipalities; and
- warmer temperatures in ATCO Gas.

Temperatures in ATCO Gas for the three months ended December 31, 2007, were 0.8% colder than normal, compared to 5.2% colder than normal in 2006.

**SEGMENTED EARNINGS ATTRIBUTABLE TO  
CLASS A AND CLASS B SHARES**

**For the Three Months Ended  
December 31**

(\$ millions)			Change to
	2007	2006	2007 (2007-2006)
	<i>(unaudited)</i>		
Utilities	47.3	43.1	9.7%
Power Generation	6.0	4.7	27.7%
Corporate and Other	0.1	-	100.0%
Earnings attributable to Class A and Class B Shares	53.4	47.8	11.7%

**Notes:**

- (1) There were no discontinued operations or extraordinary items during these periods.
- (2) Due to the seasonal nature of the Company's operations earnings for any quarter are not necessarily indicative of operations on an annual basis.
- (3) The above data has been extracted from the financial statements, which have been prepared in accordance with GAAP and the reporting currency is the Canadian dollar.

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

**For the Three Months Ended  
December 31**

(\$ millions)				Total
	Utilities	Power Generation	Corporate & Other	
<b>2007</b>				
Earnings attributable to Class A and Class B Shares	47.3	6.0	0.1	53.4
2007 Changes in Income Taxes and Rates	-	0.9	-	0.9
ATCO Gas Tax Reassessments	(9.5)	-	-	(9.5)
Adjusted Earnings	37.8	6.9	0.1	44.8
<b>2006</b>				
Earnings attributable to Class A and Class B Shares	43.1	4.7	-	47.8
Adjusted Earnings	43.1	4.7	-	47.8

**Note:**

Refer to the Significant Non-Operating Financial Items section for a description of these items.

Fourth quarter **earnings increased** by \$5.6 million (11.7%) over 2006, including the impact of adjustments identified in the Significant Non-Operating Financial Items section.

Fourth quarter **Adjusted Earnings decreased** by \$3.0 million (6.3%) over 2006 primarily due to:

- increased operation and maintenance and depreciation expenses in ATCO Gas due to customer growth and increased capital expenditures; and
- warmer temperatures in ATCO Gas.

Partially offsetting the lower Adjusted Earnings were impacts from:

- higher sales per customer and customer growth in ATCO Gas; and
- lower maintenance expenses at Alberta Power (2000)'s Battle River generating plant.

During the three months ended December 31, 2007, Alberta Power (2000)'s deferred availability incentive account increased by \$4.5 million to \$41.8 million. The increase was due to availability incentives earned in the quarter net of quarterly amortization. Amortization of deferred availability incentives, recorded in revenues, was \$2.9 million, \$0.2 million higher than the same period in 2006.

**Interest and other income** for the fourth quarter were **positively impacted** by increased income earned on cash balances due to higher short term interest rates.

## OTHER EXPENSES

For the Three Months Ended  
December 31

(\$ millions)			Change to
	2007	2006	2007 (2007-2006)
	<i>(unaudited)</i>		
Operating expenses:			
Natural gas supply	0.4	0.7	(42.9)%
Purchased power	13.6	12.5	8.8%
Operation and maintenance	106.6	98.0	8.8%
Selling and administrative	61.7	60.2	2.5%
Franchise fees	37.4	42.4	(11.8)%
	<b>219.7</b>	<b>213.8</b>	<b>2.8%</b>
Depreciation and amortization expenses	73.9	73.1	1.1%
Interest expenses	42.6	41.5	2.7%
Income taxes	8.2	21.1	(61.1)%

Fourth quarter **operating expenses increased** by \$5.9 million (2.8%) over 2006. Increased operating expenses were primarily due to higher operation and maintenance and selling and administrative expenses due to customer growth and increased business activity in ATCO Gas and ATCO Electric and the recording of GHG emission expenses by Alberta Power (2000) 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). These increases were offset by lower franchise fees collected by ATCO Gas on behalf of cities and municipalities.

Fourth quarter **depreciation and amortization expenses increased** by \$0.8 million (1.1%) primarily due to increased capital additions in 2007 and 2006, mainly in the Utilities segment. This increase was partially offset by higher 2006 depreciation expense in Alberta Power (2000) due to additional asset retirement obligations.

**Interest expenses** for the fourth quarter were **substantially unchanged** from 2006.

**Income taxes** in the fourth quarter **decreased** mainly due to the ATCO Gas Tax Reassessments.

## LIQUIDITY AND CAPITAL RESOURCES

### SUMMARY OF CASH FLOW

For the Three Months Ended  
December 31

(\$ millions)			Change to
	2007	2006	2007 (2007-2006)
	<i>(unaudited)</i>		
<b>Cash position, beginning of period</b>	<b>(142.7)</b>	<b>(106.3)</b>	<b>34.2%</b>
Cash provided by (used in):			
Operating activities	114.7	60.1	90.8%
Investing activities	(178.3)	(154.0)	15.8%
Financing activities	206.6	102.7	101.2%
<b>Cash position, end of period</b>	<b>0.3</b>	<b>(97.5)</b>	<b>100.3%</b>

## OPERATING ACTIVITIES

**Cash flow from operations** for the fourth quarter **increased** by 90.8% primarily due to increases in funds generated by operations. **Funds generated by operations increased** by 36.7%, primarily due to increased deferred availability incentives in Alberta Power (2000).

## INVESTING ACTIVITIES

**Investing** in the fourth quarter **increased** by 15.8%, primarily as a result of higher capital expenditures and changes in non-cash working capital. Increases in capital expenditures reflect increased investment in regulated electric distribution and transmission and regulated natural gas distribution projects.

## FINANCING ACTIVITIES

In the fourth quarter, the Company had **net debt increases** of \$205.0 million. **Issuance** of debt included \$220.0 million of 5.556% Debentures due October 2037 and \$35.0 million of 4.883% Debentures due November 2012. **Redemptions** were comprised of \$50.0 million of 4.801% Debentures due November 2007.

On December 20, 2007, CU Inc. issued \$5.3 million of Class A and Class B shares to Canadian Utilities Limited, its parent company.