CU INC.
An ATCO Company

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FOR THE SIX MONTHS ENDED JUNE 30, 2006

CU INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ("MD&A")

The following discussion and analysis of financial condition and results of operations of CU Inc. (the "Corporation") should be read in conjunction with the Corporation's unaudited interim consolidated financial statements for the six months ended June 30, 2006, and the audited consolidated financial statements and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2005 ("2005 MD&A"). Information contained in the 2005 MD&A that is not discussed in this document remains substantially unchanged. Additional information relating to the Corporation, including the Corporation's Annual Information Form, is available on SEDAR at www.sedar.com.

The equity securities of the Corporation consist of Class A non-voting shares ("Class A shares") and Class B common shares ("Class B shares").

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FORWARD-LOOKING INFORMATION

Certain statements contained in this MD&A constitute forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "anticipate", "plan", "estimate", "expect", "may", "will", "intend", "should", and similar expressions. These statements involve 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 statements. The Corporation believes that the expectations reflected in the forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking statements should not be unduly relied upon.

In particular, this MD&A contains forward-looking statements pertaining to purchase obligations and the impact of changes in government regulation. The Corporation's actual results could differ materially from those anticipated in these forward-looking statements as a result of regulatory decisions, competitive factors in the industries in which the Corporation operates, prevailing economic conditions, and other factors, many of which are beyond the control of the Corporation.

BUSINESS OF THE CORPORATION

The Corporation's financial statements are consolidated from two segments: utilities and power generation (refer to Note 5 of the unaudited interim consolidated financial statements for the six months ended June 30, 2006). Transactions between segments are eliminated in all reporting of the Corporation's consolidated financial information.

H.R. MILNER INCOME TAX REASSESSMENT

The Canada Revenue Agency ("CRA") has stated it will reassess Alberta Power (2000)'s 2001 taxation year. The CRA will treat 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 Corporation has made submissions to the CRA opposing the CRA's position. The impact of the reassessment is an $8.0 million increase in interest and income tax expense, an $8.0 million decrease in earnings and a $28.8 million payment associated with the tax and interest assessed. It is expected that $20.8 million of this cash payment will be recovered by reducing income taxes payable through higher capital cost allowance claims, of which $3.8 million is expected to be recovered in the current year and $17.0 million will be recovered in future years. Due to the uncertainty as to whether the reassessment will ultimately be resolved in the Corporation's favour, the Corporation reduced earnings by $8.0 million in the second quarter of 2006. The Corporation paid the $28.8 million to CRA in the third quarter of 2006.

RECENT CHANGES IN INCOME TAXES AND RATES

Federal and provincial governments have recently announced a number of changes to income taxes and rates. As these changes are considered to have been substantively enacted, the Corporation has made an adjustment to income taxes amounting to $1.7 million in the second quarter of 2006, most of which relates to future income taxes. The adjustment increased 2006 earnings by $1.7 million, all of which relates to the Utilities segment.

SELECTED QUARTERLY INFORMATION

	For the Three Months Ended			
($ Millions)	**Mar. 31**	**Jun. 30**	**Sep. 30**	**Dec. 31**
		(unaudited)		
2006				
Revenues (1) (3)	400.8	316.6	....	....
Earnings attributable to Class A and Class B shares (2) (3)	53.0	21.4	....	....
2005				
Revenues (3)	505.7	307.7	294.4	382.2
Earnings attributable to Class A and Class B shares (2) (3)	58.3	27.3	24.9	45.6
2004				
Revenues (3)	....	....	266.3	371.7
Earnings attributable to Class A and Class B shares (2) (3)	....	....	24.0	53.5

Notes:

(1) *Reduced recoveries of natural gas costs in revenues in 2006 as ATCO Gas ceased selling natural gas from its natural gas storage facilities on March 31, 2005, in accordance with Alberta Energy and Utilities Board directives.*

(2) *There were no discontinued operations or extraordinary items during these periods.*

(3) *Due to the seasonal nature of the Corporation's operations, revenues and earnings for any quarter are not necessarily indicative of operations on an annual basis.*

(4) *As all Class A and Class B shares of the Corporation are owned by Canadian Utilities Limited, the disclosure of earnings per share is not provided as it is not considered to be meaningful.*

(5) The above data has been extracted from the financial statements which have been prepared in accordance with Canadian generally accepted accounting principles and the reporting currency is the Canadian dollar.

RESULTS OF OPERATIONS

The principal factors that have caused variations in **revenues** and **earnings** over the eight most recently completed quarters necessary to understand general trends that have developed and the seasonality of the businesses disclosed in the 2005 MD&A remain substantially unchanged, except for the H.R. Milner Income Tax Reassessment, and Recent Changes in Income Taxes and Rates.

Consolidated Operations

Revenues and earnings attributable to Class A and Class B shares were as follows:

	For the Three Months Ended June 30		**For the Six Months Ended June 30**	
($ Millions)	**2006**	2005	**2006**	2005
		(unaudited)		
Revenues (1) (3)	**316.6**	307.7	**717.4**	813.4
Earnings attributable to Class I and Class II shares (2) (3)	**21.4**	27.3	**74.4**	85.6

Notes:
(1) Reduced recoveries of natural gas costs in revenues in 2006 as ATCO Gas ceased selling natural gas from its natural gas storage facilities on March 31, 2005, in accordance with Alberta Energy and Utilities Board directives.
(2) There were no discontinued operations or extraordinary items during these periods.
(3) Due to the seasonal nature of the Corporation's operations, revenues and earnings for any quarter are not necessarily indicative of operations on an annual basis.
(4) As all Class A and Class B shares of the Corporation are owned by Canadian Utilities Limited, the disclosure of earnings per share is not provided as it is not considered to be meaningful.
(5) The above data has been extracted from the financial statements which have been prepared in accordance with Canadian generally accepted accounting principles and the reporting currency is the Canadian dollar.

Revenues for the three months ended June 30, 2006, increased by $8.9 million to $316.6 million, primarily due to:
- customer rate increases for ATCO Electric and ATCO Gas (refer to Regulatory Matters - ATCO Electric and ATCO Gas sections). The impact of the ATCO Electric GTA Decision and the ATCO Gas GRA Decision on the second quarter of 2006 was positive as ATCO Electric and ATCO Gas had lower customer rates during the second quarter of 2005.

This increase was partially offset by:
- lower income taxes recovered from ATCO Electric's customers on a flow through basis, reflecting lower income tax rates in 2006; and
- Alberta Energy and Utilities Board ("AEUB") decision adjusting the 2001 and 2002 revenue requirements for changes in deferred income taxes recorded in ATCO Electric in 2005 (refer to Regulatory Matters - ATCO Electric section).

Revenues for the six months ended June 30, 2006, decreased by $96.0 million to $717.4 million, primarily due to:
- reduced recoveries of natural gas costs in revenues in 2006 as ATCO Gas ceased selling natural gas from its natural gas storage facilities on March 31, 2005, in accordance with AEUB directives; and
- lower income taxes recovered from ATCO Electric's customers on a flow through basis, reflecting lower income tax rates in 2006.

This decrease was partially offset by:

- customer rate increases for ATCO Electric and ATCO Gas (refer to Regulatory Matters - ATCO Electric and ATCO Gas sections). The impact of the ATCO Electric GTA Decision and the ATCO Gas GRA Decision on the first six months of 2006 was positive as ATCO Electric and ATCO Gas had lower customer rates during the first six months of 2005.

Earnings attributable to Class A and Class B shares for the three months ended June 30, 2006, decreased by $5.9 million to $21.4 million, primarily due to:

- H.R. Milner Income Tax Reassessment (refer to H.R. Milner Income Tax Reassessment section); and
- AEUB decision adjusting the 2001 and 2002 revenue requirements for changes in deferred income taxes recorded in ATCO Electric (refer to Regulatory Matters - ATCO Electric section).

This decrease was partially offset by:

- higher customer rates for ATCO Gas and ATCO Electric in the second quarter of 2006. While the ATCO Electric GTA Decision (refer to Regulatory Matters - ATCO Electric section) was expected to decrease 2006 earnings, the impact of the ATCO Electric GTA Decision on the second quarter of 2006 was positive as ATCO Electric had lower customer rates during the second quarter of 2005; and
- $1.7 million adjustment to reflect recent tax changes (refer to Recent Changes in Income Taxes and Rates section).

Earnings attributable to Class A and Class B shares for the six months ended June 30, 2006, decreased by $11.2 million to $74.4 million, primarily due to:

- H.R. Milner Income Tax Reassessment (refer to H.R. Milner Income Tax Reassessment section); and
- AEUB decision adjusting the 2001 and 2002 revenue requirements for changes in deferred income taxes recorded in ATCO Electric (refer to Regulatory Matters - ATCO Electric section).

This decrease was partially offset by:

- higher customer rates for ATCO Gas and ATCO Electric in the first six months of 2006. While the ATCO Electric GTA Decision (refer to Regulatory Matters - ATCO Electric section) was expected to decrease 2006 earnings, the impact of the ATCO Electric GTA Decision on the first six months of 2006 was positive as ATCO Electric had lower customer rates for 2005 during the first six months of 2005; and.
- $1.7 million adjustment to reflect recent tax changes (refer to Recent Changes in Income Taxes and Rates section).

Operating expenses (consisting of natural gas supply, purchased power, operation and maintenance, selling and administrative and franchise fee costs) for the three months ended June 30, 2006, were substantially unchanged.

Operating expenses for the six months ended June 30, 2006, decreased by $104.7 million to $375.7 million, primarily due to:

- reduced natural gas supply costs in 2006 as ATCO Gas ceased selling natural gas from its natural gas storage facilities on March 31, 2005, in accordance with AEUB directives.

Depreciation and amortization expenses for the three and six months ended June 30, 2006, increased by $17.5 million to $72.7 million, and by $23.3 million to $141.5 million, respectively, primarily due to:

- capital additions in 2006 and 2005; and
- one-time amortization charge of certain deferred items approved by the AEUB in the ATCO Gas GRA Decision recorded in the second quarter of 2006.

Interest expense for the three and six months ended June 30, 2006, increased by $8.2 million to $46.0 million, and by $8.2 million to $84.5 million , respectively, primarily due to:

- H.R. Milner Income Tax Reassessment (refer to H.R. Milner Income Tax Reassessment section).

Interest and other income for the three and six months ended June 30, 2006, increased by $1.1 million to $4.1 million, and by $0.9 million to $6.3 million , respectively, primarily due to:

- higher short term interest rates on larger cash balances.

Income taxes for the three and six months ended June 30, 2006, decreased by $7.8 million to $7.9 million, and by $10.7 million to $40.6 million, respectively, primarily due to:

- lower earnings; and
- adjustment to reflect recent tax changes (refer to Recent Changes in Income Taxes and Rates section).

Segmented Information

Segmented revenues for the three and six months ended June 30, 2006, were as follows:

	For the Three Months Ended June 30		For the Six Months Ended June 30	
($ Millions)	**2006**	2005	**2006**	2005
	(unaudited)			
Utilities (1)	**245.0**	236.1	**573.3**	668.0
Power Generation	**71.6**	71.6	**144.1**	145.5
Intersegment eliminations	**-**	-	**-**	(0.1)
Total	**316.6**	307.7	**717.4**	813.4

Note:

(1) Reduced recoveries of natural gas costs in revenues in 2006 as ATCO Gas ceased selling natural gas from its natural gas storage facilities on March 31, 2005, in accordance with AEUB directives.

Segmented earnings attributable to Class A and Class B shares for the three and six months ended June 30, 2006, were as follows:

	For the Three Months Ended June 30		For the Six Months Ended June 30	
($ Millions)	**2006**	2005	**2006**	2005
	(unaudited)			
Utilities	**17.8**	15.7	**58.1**	60.1
Power Generation	**3.7**	11.5	**16.3**	25.4
Corporate and Other	**(0.1)**	0.1	**-**	0.1
Intersegment eliminations	**-**	-	**-**	-
Total	**21.4**	27.3	**74.4**	85.6

Utilities

Revenues from the Utilities segment for the three months ended June 30, 2006, increased by $8.9 million to $245.0 million, primarily due to:

- customer rate increases for ATCO Electric and ATCO Gas (refer to Regulatory Matters - ATCO Electric and ATCO Gas sections). The impact of the ATCO Electric GTA Decision and the ATCO Gas GRA Decision on the second quarter of 2006 was positive as ATCO Electric and ATCO Gas had lower customer rates during the second quarter of 2005.

This increase was partially offset by:

- lower income taxes recovered from ATCO Electric's customers on a flow through basis, reflecting lower income tax rates in 2006;
- AEUB decision adjusting the 2001 and 2002 revenue requirements for changes in deferred income taxes recorded in ATCO Electric in 2005 (refer to Regulatory Matters - ATCO Electric section); and
- warmer temperatures in ATCO Gas.

Temperatures in ATCO Gas for the three months ended June 30, 2006, were 25.7% warmer than normal, compared to 12.4% warmer than normal for the corresponding period in 2005.

Revenues for the six months ended June 30, 2006, decreased by $94.7 million to $573.3 million, primarily due to:

- reduced recoveries of natural gas costs in revenues in 2006 as ATCO Gas ceased selling natural gas from its natural gas storage facilities on March 31, 2005, in accordance with AEUB directives;
- lower income taxes recovered from ATCO Electric's customers on a flow through basis, reflecting lower income tax rates in 2006;
- warmer temperatures in ATCO Gas; and
- AEUB decision adjusting the 2001 and 2002 revenue requirements for changes in deferred income taxes recorded in ATCO Electric in 2005 (refer to Regulatory Matters - ATCO Electric section).

This decrease was partially offset by:

- customer rate increases for ATCO Electric and ATCO Gas (refer to Regulatory Matters - ATCO Electric and ATCO Gas sections). The impact of the ATCO Electric GTA Decision and the ATCO Gas GRA Decision on the first six months of 2006 was positive as ATCO Electric and ATCO Gas had lower customer rates during the first six months of 2005;
- higher franchise fees collected by ATCO Gas on behalf of cities and municipalities; and
- customer growth in ATCO Gas.

Temperatures in ATCO Gas for the six months ended June 30, 2006, were 10.7% warmer than normal, compared to 6.1% warmer than normal for the corresponding period in 2005.

Earnings for the three months ended June 30, 2006, increased by $2.1 million to $17.8 million, primarily due to:

- higher customer rates for ATCO Gas and ATCO Electric in the second quarter of 2006. While the ATCO Electric GTA Decision (refer to Regulatory Matters - ATCO Electric section) was expected to decrease 2006 earnings, the impact of the ATCO Electric GTA Decision on the second quarter of 2006 was positive as ATCO Electric had lower customer rates during the second quarter of 2005.

This increase was partially offset by:

- AEUB decision adjusting the 2001 and 2002 revenue requirements for changes in deferred income taxes recorded in ATCO Electric (refer to Regulatory Matters - ATCO Electric section); and
- warmer temperatures in ATCO Gas.

Earnings for the six months ended June 30, 2006, decreased by $2.0 million to $58.1 million, primarily due to:

- AEUB decision adjusting the 2001 and 2002 revenue requirements for changes in deferred income taxes recorded in ATCO Electric (refer to Regulatory Matters - ATCO Electric section); and
- warmer temperatures in ATCO Gas.

This decrease was partially offset by:

- higher customer rates for ATCO Gas and ATCO Electric in the first six months of 2006. While the ATCO Electric GTA Decision (refer to Regulatory Matters - ATCO Electric section) was expected to decrease 2006 earnings, the impact of the ATCO Electric GTA Decision on the first six months of 2006 was positive as ATCO Electric had lower customer rates during the first six months of 2005; and
- customer growth in ATCO Gas.

Power Generation

Revenues from the Power Generation segment for the three months ended June 30, 2006, were unchanged at $71.6 million.

Revenues for the six months ended June 30, 2006, were substantially unchanged.

Earnings for the three months ended June 30, 2006, decreased by $7.8 million to $3.7 million, primarily due to:

- H.R. Milner Income Tax Reassessment (refer to H.R. Milner Income Tax Reassessment section); and
- lower PPA tariffs due to declining rate bases at Alberta Power (2000)'s Battle River and Sheerness generating plants and a decline in the return on common equity rate (2006 – 8.75%, 2005 – 9.49%) that is based on long term Government of Canada bond yields plus 4.5%.

Earnings for the six months ended June 30, 2006, decreased by $9.1 million to $16.3 million, primarily due to:

- H.R. Milner Income Tax Reassessment (refer to H.R. Milner Income Tax Reassessment section); and
- lower PPA tariffs due to declining rate bases at Alberta Power (2000)'s Battle River and Sheerness generating plants and a decline in the return on common equity rate (2006 – 8.75%, 2005 – 9.49%) that is based on long term Government of Canada bond yields plus 4.5%.

On May 8, 2006, EPCOR Utilities Inc. announced the sale of its interest in the Power Purchase Arrangement ("PPA") for Alberta Power (2000)'s Battle River generating plant to Enmax Corporation. The sale is not expected to have a material impact on the Corporation's operations or earnings.

During the three months ended June 30, 2006, Alberta Power (2000)'s **deferred availability incentive** account decreased by $3.7 million to $68.4 million. The decrease was due to lower availability incentives received due mainly to a planned outage at the Sheerness Plant. During the three months ended June 30, 2006, the amortization of deferred availability incentives, recorded in revenues, increased by $0.6 million to $2.6 million as compared to the same period in 2005.

During the six months ended June 30, 2006, Alberta Power (2000)'s **deferred availability incentive** account increased by $8.7 million to $68.4 million. The increase was due to additional availability incentives received for improved plant availability. During the six months ended June 30, 2006, the amortization of deferred availability incentives, recorded in revenues, increased by $1.2 million to $5.3 million as compared to the same period in 2005.

REGULATORY MATTERS

Regulated operations are conducted by wholly owned subsidiaries of the Corporation:

- ATCO Electric and its subsidiaries Northland Utilities (NWT), Northland Utilities (Yellowknife) and Yukon Electrical;
- the ATCO Gas and ATCO Pipelines divisions of ATCO Gas and Pipelines Ltd.; and
- the generating plants of Alberta Power (2000).

Regulated operations in Alberta (except for the generating plants of Alberta Power (2000)) are subject to a generic cost of capital regime:

- in July 2004, the AEUB issued the generic cost of capital decision which established, among other things:
    - a standardized approach for each utility company regulated by the AEUB for determining the rate of return on common equity;
        - rate of return adjusted annually by 75% of the change in long term Government of Canada bond yield as forecast; and
        - adjustment mechanism similar to the method the National Energy Board uses in determining its formula based rate of return;
    - the appropriate capital structure for each utility regulated by the AEUB.
- in November 2005, the AEUB announced a generic return on common equity of 8.93% for 2006; and
- in January 2006, the AEUB clarified that the generic return on equity determined on an annual basis in accordance with the generic cost of capital decision should apply to each year of the test period in the companies' applications. 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 June 2005, as part of their rate applications, ATCO Electric and ATCO Gas submitted a filing to the AEUB that addressed certain common matters. ATCO Pipelines is also a party to this filing as the concerns are common to all three utilities:

- this filing included evidence regarding:
    - the appropriate ratemaking approach in the determination of utility revenue requirements;
    - treatment of pension costs, executive compensation and head office rent expense; and
    - the continued use of preferred shares as a form of financing for the three utilities;
- AEUB heard this filing in May 2006; and
- AEUB decision expected in the fourth quarter of 2006.

ATCO Electric

In March 2006, AEUB issued a decision on ATCO Electric's 2005 and 2006 General Tariff Application ("ATCO Electric GTA Decision") which established, among other things:

- the amount of revenue to be collected in 2005 and 2006 from customers for transmission and distribution services;
- interim refundable rates approved by the AEUB in July 2005 (distribution services) and September 2005 (transmission services);
- 2005 earnings negatively impacted by $1.3 million, recorded in first quarter of 2006;
- 2006 earnings will be reduced by an additional $1.6 million, as compared to 2005 earnings, to be recorded throughout 2006; and
- return on common equity confirmed according to AEUB standardized rate of return methodology – 9.5% in 2005 and 8.93% in 2006.

In May 2006, the AEUB issued a decision on ATCO Electric's 2003-2004 Regulated Rate Option Tariff Non-Energy Rates application dated November 2002:

- this decision approved, on an interim refundable basis, the collection in 2006 of a shortfall of $2.7 million for 2003 and $2.2 million for 2004 that was not previously incorporated into customer rates;
- the amounts approved for collection are subject to the outcome of an existing process regarding the pricing of services provided by ATCO I-Tek; and
- the impact of this decision increased 2006 earnings by $1.9 million and was recorded in the second quarter of 2006.

In August 2002, the AEUB issued a decision in which it denied ATCO Electric's application to adjust its 2001 and 2002 transmission and distribution revenue requirements by $4.6 million for changes in the amounts of deferred income taxes recorded.

- In May 2005, the AEUB changed its August 2002 decision and allowed ATCO Electric to increase its revenues and earnings by $4.6 million. The impact of this decision was recorded in the second quarter of 2005.

ATCO Gas

In January 2006, AEUB issued a decision on ATCO Gas' 2005, 2006 and 2007 General Rate Application ("ATCO Gas GRA Decision") which, among other things:

- established the amount of revenue to be collected over the period 2005 to 2007 from customers for natural gas distribution service; and
- approved a return on common equity as determined by the AEUB's standardized rate of return methodology – 9.5% in 2005, 8.93% in 2006 and is yet to be determined for 2007.

The final impact of the decision will not be known until two subsequent regulatory processes are finalized.

In May 2006, the City of Calgary filed a Review and Variance application with the AEUB for the ATCO Gas GRA Decision:

- the application alleges that the AEUB made errors in the ATCO Gas GRA Decision related to the calculation of working capital needed by ATCO Gas to operate its Carbon natural gas storage facility;
- ATCO Gas believes that the City of Calgary's application is without merit; and
- AEUB decision on this application expected in 2006.

In October 2001, the AEUB 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). As a result of this decision:

- $4.1 million of the proceeds were allocated by the AEUB to customers and $1.8 million to ATCO Gas;
- ATCO Gas appealed the decision to the Alberta Court of Appeal which overturned the decision and directed the AEUB to allocate $5.4 million of the proceeds to ATCO Gas;
- City of Calgary appealed this decision to the Supreme Court of Canada, which also granted ATCO Gas leave to cross-appeal the decision;

- the Supreme Court of Canada rendered its decision on February 9, 2006, dismissing the City of Calgary's appeal and allowing ATCO Gas' cross-appeal. AEUB was directed to issue a new decision in accordance with the Supreme Court's ruling; and
- ATCO Gas has requested the AEUB to address the Supreme Court of Canada decision. Net proceeds totaling $4.1 million from the sale are being held pending AEUB approval.

ATCO Gas owns a 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 AEUB approval, the following events are significant:

- in July 2004, the AEUB initiated a written process to consider its role in regulating the operations of the facility;
- in June 2005, the AEUB issued a decision with respect to this process. In addition to addressing other matters, the decision found that the AEUB 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 AEUB established processes to review the use of the facility for utility purposes; and
- 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. ATCO Gas is expecting an AEUB decision in the fourth quarter of 2006.

ATCO Gas has filed an application with the AEUB 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 Corporation's pipelines) that have impacted ATCO Gas' deferred gas account:

- in April 2005, the AEUB issued a decision resulting in a 15% decrease in the transportation imbalance adjustments sought by ATCO Gas. The decision resulted in a decrease to 2005 revenues and earnings of $1.8 million and $1.2 million, respectively; and
- City of Calgary filed for leave to appeal the AEUB's decision. ATCO Gas filed a cross appeal of the AEUB'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 AEUB erred in law or jurisdiction in assuming that it had the authority to allow recovery in 2005, for costs relating to prior years. ATCO Gas' cross appeal was denied. A hearing with the Alberta Court of Appeal has not yet been scheduled.

In October 2005, ATCO Gas filed an application with the AEUB to approve the sale of its Red Deer Operating Centre:

- in December 2005, the AEUB approved the sale and deferred its decision on the distribution of net proceeds of $1.0 million until the Supreme Court of Canada rendered a judgment in the appeal regarding the Calgary Stores Block disposition and allocation of proceeds discussed above;
- the Supreme Court of Canada rendered its decision on the Calgary Stores Block matter on February 9, 2006;
- in February 2006, ATCO Gas submitted a filing to the AEUB to approve the allocation of the net proceeds; and
- on March 16, 2006, the AEUB suspended the process convened to approve allocation of the net proceeds pending resolution of certain issues arising in connection with the Supreme Court's Calgary Stores Block decision. The net proceeds of the sale remain in trust pending AEUB approval.

ATCO Pipelines

The AEUB has announced that it will hold a review of competitive natural gas pipeline issues under AEUB jurisdiction in November and December of 2006. This review is expected to address competitive issues between ATCO Pipelines and NOVA Gas Transmission Ltd.

Other Matters

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

LIQUIDITY AND CAPITAL RESOURCES

Cash flow from operations provides a substantial portion of the Corporation's cash requirements. Additional cash requirements are met externally through bank borrowings and the issuance of long term and non-recourse debt and preferred shares. Commercial paper borrowings and short term bank loans are used to provide flexibility in the timing and amounts of long term financing.

Cash flow from operations for the three months ended June 30, 2006, was substantially unchanged.

Cash flow from operations for the six months ended June 30, 2006, increased by $10.2 million to $220.2 million, primarily due to:

- increased availability incentives in Alberta Power (2000), primarily due to availability incentive payments received for improved plant availability; and
- increased cash flow after removal of non-cash adjustments.

Investing for the three months ended June 30, 2006, increased by $43.3 million to $107.0 million, primarily due to:

- 2005 proceeds on transfer of retail energy supply businesses;
- H.R. Milner Income Tax Reassessment (refer to H.R. Milner Income Tax Reassessment section); and
- increased capital expenditures.

This increase was partially offset by:

- changes in non-cash working capital; and
- changes in non-current deferred electricity costs.

Capital expenditures for the three months ended June 30, 2006, increased by $11.8 million to $124.6 million, primarily due to:

- increased investment in electric distribution and transmission and natural gas distribution projects.

This increase was partially offset by:

- decreased investment in power generation projects.

Investing for the six months ended June 30, 2006, increased by $34.8 million to $205.1 million, primarily due to:

- 2005 proceeds on transfer of retail energy supply businesses;
- increased capital expenditures; and
- H.R. Milner Income Tax Reassessment (refer to H.R. Milner Income Tax Reassessment section).

This increase was partially offset by:

- changes in non-current deferred electricity costs;
- increased contributions by utility customers for extensions to plant; and
- changes in non-cash working capital.

Capital expenditures for the six months ended June 30, 2006, increased by $35.4 million to $232.9 million, primarily due to:

- increased investment in electric distribution and transmission and natural gas transportation projects.

This increase was partially offset by:

- decreased investment in natural gas distribution and power generation projects.

At June 30, 2006, the Corporation had the following credit lines that enable it to obtain funding for general corporate purposes.

($ Millions)	Total	Used	Available
Short term committed	300.0	16.0	284.0
Uncommitted	29.0	0.3	28.7
Total	329.0	16.3	312.7

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

Contractual obligations disclosed in the 2005 MD&A remain substantially unchanged as at June 30, 2006.

Current and long term future income tax liabilities of $43.7 million at June 30, 2006, 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.

On April 12, 2006, the Corporation filed a **base shelf prospectus** which permits the Corporation to issue up to an aggregate of $850.0 million of debentures over the twenty-five month life of the prospectus.

OUTSTANDING SHARE DATA

At July 21, 2006, the Corporation had outstanding 124 Class A shares and 76 Class B shares, all of which are owned by Canadian Utilities Limited.

BUSINESS RISKS

On February 16, 2005, the Kyoto Protocol came into effect. The Corporation is unable to determine what impact the protocol may have on its operations as the Government of Canada has not yet provided industry specific details for its 2005 Climate Change Plan. It is anticipated that the Corporation's PPA's relating to its coal-fired generating plants will allow the Corporation to recover any increased costs associated with the implementation of the protocol.

ATCO Electric, ATCO Gas and ATCO Pipelines are regulated primarily by the AEUB, which administers acts and regulations covering such matters as rates, financing, accounting, construction, operation and service area. The AEUB may approve interim rates, 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 AEUB 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. The Corporation'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.

Weather

Weather fluctuations have a significant impact on throughput in ATCO Gas. Since approximately 50% of ATCO Gas' delivery charge is recovered based on throughput, ATCO Gas' revenues and earnings are sensitive to weather. Weather that is 10% warmer or colder than normal temperatures impacts annual earnings by approximately $11.4 million.

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 Marketing Limited and one of its affiliates (collectively "DEML"), a subsidiary of Centrica plc.

Although ATCO Gas and ATCO Electric transferred to DEML 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 DEML fails to perform. In certain events (including where DEML fails to supply natural gas and/or electricity and ATCO Gas and/or ATCO Electric are ordered by the AEUB to do so), the functions will revert to ATCO Gas and/or ATCO Electric with no refund of the transfer proceeds to DEML by ATCO Gas and/or ATCO Electric.

Centrica plc, DEML's parent, has provided a $300 million guarantee, supported by a $235 million letter of credit in respect of DEML's obligations to ATCO Gas, ATCO Electric and ATCO I-Tek Business Services 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 Limited has provided a guarantee of ATCO Gas', ATCO Electric's and ATCO I-Tek Business Services' payment and indemnity obligations to DEML 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. The Corporation is unable to determine at this time the impact, if any, that these decisions will have on the Corporation.

Alberta Power (2000)

Alberta Environment plans to implement mercury emission standards for coal-fired generating plants through a new provincial regulation that came into force in March 2006. Owners of coal-fired generating plants are required to submit proposals on capturing at least 70% of the mercury in the coal burned in their plants by March 2007. The proposals for mercury emission reduction must be implemented by 2010. It is anticipated that the Corporation's PPA's relating to its coal-fired generating plants will allow the Corporation to recover most of the costs associated with complying with the new regulation.

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 AEUB.

A recent AEUB 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 AEUB stated that it will consider specific applications for adjustments beyond the two year limitation period.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Corporation's consolidated financial statements in accordance with generally accepted accounting principles 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 and employee future benefits, using currently available information. Changes in facts and circumstances may result in revised estimates, and actual results could differ from those estimates. The Corporation's critical accounting estimates are discussed below.

Deferred Availability Incentives

As noted in the Business Risks section, Alberta Power (2000) is subject to an incentive/penalty regime related to generating unit availability. As at June 30, 2006, the Corporation had recorded $68.4 million of deferred availability incentives. For the three and six months ended June 30, 2006, the amortization of deferred availability incentives, which was recorded in revenues, amounted to $2.6 million and $5.3 million, respectively.

The amount to be amortized is dependent upon estimates of future generating unit availability and future electricity prices over the term of the PPA's. Each quarter, the Corporation 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.

Compared to the most likely scenario recorded in revenues for the year to date, the high case scenario would have resulted in higher revenues of approximately $2.2 million, whereas the low case scenario would have resulted in lower revenues of approximately $2.0 million.

July 24, 2006