



An **ATCO** Company

MANAGEMENT'S DISCUSSION AND ANALYSIS

**FOR THE NINE MONTHS ENDED
SEPTEMBER 30, 2009**

CU Inc.
Management’s Discussion and Analysis (MD&A)
For the Nine Months Ended September 30, 2009

This MD&A should be read in conjunction with the Company’s unaudited interim consolidated financial statements for the nine months ended September 30, 2009, and the audited consolidated financial statements and MD&A for the year ended December 31, 2008 (2008 MD&A). **Information contained in the 2008 MD&A that is not discussed in this document remains substantially unchanged.** This MD&A is dated October 30, 2009. Additional information relating to the Company, including the Company’s annual information form, is available on SEDAR at www.sedar.com.

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Glossary

Adjusted Earnings means earnings attributable to Class A and Class B Shares after adjustment for items that are not in the normal course of business or 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 item).

AESO means the Alberta Electric System Operator.

ATCO I-Tek means ATCO I-Tek Inc., a wholly-owned subsidiary of Canadian Utilities Limited.

ATCO Midstream means ATCO Midstream Ltd., a wholly-owned subsidiary of Canadian Utilities.

AUC means the Alberta Utilities Commission.

Availability is 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.

Cap and Trade means a form of market emission control regulation whereby permits must be surrendered for environmental emissions. A specified number of permits are created (the cap) and distributed. These can be traded amongst market participants to meet their compliance needs. The intended result is that environmental emissions bear a cost associated with obtaining the requisite permits and that creates a financial incentive to reduce the emissions.

Canadian Utilities means Canadian Utilities Limited.

Capacity Charges means a form of compensation to the owners of PPA generating units for their fixed operating and capital costs including return on rate base (debt & equity) and income taxes.

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.

Excess Energy Charges means a form of compensation to the owners of PPA generating units for electrical energy supplied in excess of the committed output capacity defined in the PPA.

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.

IFRS means International Financial Reporting Standards.

Megawatt (MW) is 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.

Petajoule (PJ) means a unit of energy equal to approximately 948.2 billion British thermal units.

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

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

U.S. means United States of America.

Company Overview

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

The Company operates in the following business groups:

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; and
- the regulated distribution and transmission of electric energy by ATCO Electric and its subsidiaries, Northland Utilities (NWT), Northland Utilities (Yellowknife) and Yukon Electrical.

The **Energy** Business Group includes:

- the regulated supply of electricity by Alberta Power (2000).

Effective the third quarter of 2009, the **Power Generation** Business Group has been renamed the **Energy** Business Group.

Transactions between business groups are eliminated in all reporting of the Company's consolidated financial information. For additional information on the Company's business groups, refer to Note 11 to the unaudited interim consolidated financial statements for the nine months ended September 30, 2009.

CARBON NATURAL GAS STORAGE FACILITY

ATCO Gas owns a 43.5 petajoule natural gas storage facility located at Carbon, Alberta (Carbon Facility). ATCO Gas leases 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.

As a result of numerous regulatory and legal proceedings, ATCO Gas has removed the Carbon Facility from regulation for accounting purposes in the third quarter of 2009. Furthermore, ATCO Gas has received approval from the AUC to suspend customer rate riders (Carbon Rate Riders) that were approved in the past to distribute net revenues related to the Carbon Facility to customers.

On an annual basis, the amount refunded to customers for the Carbon Rate Riders was approximately \$25.0 million. In addition, on an annual basis, the revenue recovered from customers as a result of costs for the Carbon Facility was approximately \$13.5 million. Therefore, the annual pre-tax financial impact to ATCO Gas of the suspension of Carbon Rate Riders net of the costs for the Carbon Facility is approximately \$11.5 million per year. The annual increase to ATCO Gas' earnings is approximately \$8.3 million (Net Change). These amounts can vary on a year to year basis as a result of changes in the price of natural gas and the impacts of weather. In the third quarter of 2008, ATCO Gas recorded the impact of this Net Change for the period starting July 1, 2008 based on a decision received on June 20, 2008. In the third quarter of 2009, ATCO Gas recorded the impact of this Net Change for the period January 1, 2008 to June 30, 2008 based on a decision received on July 28, 2009.

The financial impacts of these developments recorded in the third quarter of 2009 are as follows:

- ATCO Gas removed the Carbon Facility from regulation. As a result, ATCO Gas has derecognized all previously recorded regulatory assets and liabilities relating to the Carbon

Facility as these amounts are no longer recoverable from or payable to ATCO Gas' customers. The one-time impact of this discontinuation of regulatory accounting for the Carbon Facility was to increase ATCO Gas' earnings by \$1.9 million.

- ATCO Gas recognized increased revenues of \$13.8 million for the impact of the Carbon Rate Rider revenue for the period January 1, 2008 to June 30, 2008 which was previously refunded to customers and decreased revenues of \$7.6 million as a result of excluding any costs for the Carbon Facility in its 2008-2009 general rate application. The net increase to ATCO Gas' earnings as a result of this was \$4.5 million.

ATCO Gas is seeking to recover from customers additional amounts that would result in an estimated increase to its earnings of \$20.5 million, excluding interest, related to the removal of the Carbon Facility from regulation for the period April 1, 2005 – December 31, 2007. The determination of these amounts is subject to the finalization of the effective date of removal from regulation in addition to other related matters by the AUC. As a result, these additional amounts have not yet been recognized by ATCO Gas.

For a detailed summary of the items related to the Carbon Facility refer to Regulatory Developments – ATCO Gas – Carbon Natural Gas Storage Facility.

FINANCIAL MARKETS

Over the last year, significant challenges have been experienced in domestic and international financial markets. These challenges have an impact on the ability of certain borrowers to finance existing operations and capital expenditure programs.

As discussed elsewhere in this MD&A, the Utilities Business Group has a capital expenditure program of \$2.0 billion that, depending on infrastructure spending, could be as much as \$4.0 billion over the next three years. While the current financial situation has not directly impacted the Company's ability to fund this capital expenditure program and ongoing operations, future borrowing may be impacted by these financial markets through increased carrying costs and the ability to raise debt and equity capital.

In March 2009, the Company completed a \$270 million debenture issue and a \$160 million preferred share issue to fund the 2009 portion of the Utilities Business Group's capital expenditure program and to fund scheduled maturities of previous debenture issues.

In addition, as at September 30, 2009, the Company has cash balances of approximately \$0.3 billion and available committed and uncommitted lines of credit of approximately \$0.3 billion which can be utilized for general corporate purposes.

The Company is unable to determine what future changes in the financial markets could occur and how these changes could affect the Company. Deterioration in domestic and international economic activity may impact the operations of the Company.

PENSION PLANS

Employees are required to contribute a percentage of their salary to registered pension plans. The Company is required to contribute its share of contributions on behalf of the defined contribution members of the pension plans and to provide the balance of the funding necessary to ensure that benefits will be fully provided for at retirement for the members of the defined benefit pension plans.

Declines in stock and bond markets have resulted in a reduction in the value of the defined benefit pension plans' assets, creating funding deficits. The Company has not made material contributions since April 1, 1996, as a result of the defined benefit plans' surplus positions which have been used to fund the

employer's contributions to the defined contribution component of the pension plans. Based on the most recent actuarial valuations for funding purposes dated December 31, 2006, and December 31, 2007, and recent changes in government regulations resulting from the white paper issued by the government of Alberta in 2008, the Company does not anticipate that it will be required to make material contributions to its pension plans in 2009. However, the Company may be required to make contributions in 2009 if a decrease in market values warrants additional funding.

Depending on the outcome of future actuarial valuations, material current service and deficit funding contributions will likely be required to resume in 2010. The amounts before recovery from utility customers are expected to be in the range of \$46.0 million to \$57.0 million in 2010. For purposes of any funding requirements pertaining to utility operations, the AUC has directed that the cash basis of accounting be used in customer rate applications. Accordingly, the Company includes the cost of funding in its rate applications to the AUC, thereby, with the consent of the AUC, recovering 100% of the costs of funding its pension plans pertaining to utility operations from utility customers (refer to Segmented Information – Utilities – Regulatory Developments – Pension Hearing section). Alberta Power (2000) contracts the operations of its power generating plants to ATCO Power, a wholly-owned subsidiary of CU Inc.'s parent company, Canadian Utilities. As a result, ATCO Power is responsible for funding the appropriate pension contributions for these employees. Costs relating to pensions are recovered by Alberta Power (2000) under the terms of the PPAs.

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.

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

Adjusted Earnings is defined as earnings attributable to Class A and Class B Shares after adjustment for items that are not in the normal course of business or 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.

Internal Control Over Financial Reporting

There was no change in the Company's internal control over financial reporting that occurred during the period beginning on July 1, 2009, and ended on September 30, 2009, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Results of Operations

SELECTED QUARTERLY INFORMATION

(\$ millions)	For the Three Months Ended ^{(1) (2) (3) (4)}			
	Mar. 31	Jun. 30	Sep. 30	Dec. 31
2009				
Revenues	476.1	388.0	368.9	-
Earnings attributable to Class A and Class B Shares	90.3	49.7	56.5	-
Adjusted Earnings ⁽⁵⁾	90.3	49.7	39.7	-
2008				
Revenues	443.4	363.9	352.6	413.5
Earnings attributable to Class A and Class B Shares	77.7	33.5	30.9	58.2
Adjusted Earnings ⁽⁵⁾	77.7	33.5	27.9	53.4
2007				
Revenues	-	-	-	394.2
Earnings attributable to Class A and Class B Shares	-	-	-	53.4
Adjusted Earnings ⁽⁵⁾	-	-	-	44.8

Notes:

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

The principal factors that caused variations in **financial condition** and **results of operations** over the past eight quarters necessary to understand general trends that have developed and the seasonality of the businesses disclosed on page 35 in the 2008 MD&A remain substantially unchanged, except for:

- the impact of adopting new accounting standards for the recognition of revenues and expenses for regulated assets in ATCO Electric, ATCO Gas and ATCO Pipelines (refer to Changes in Accounting Policies – Rate Regulated Operations section).

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

Adjusted Earnings are referred to in various sections of this MD&A. The following table reconciles Adjusted Earnings, which are earnings attributable to Class A and Class B Shares after adjustments for items that are not in the normal course of business or day-to-day operations. These items are usually of a non-recurring or one-time nature. A description of each adjustment is provided in the Significant Non-Operating Financial Items section.

(\$ millions)	For the Three Months Ended September 30			For the Nine Months Ended September 30		
	2009	2008	Change to 2009 (2009-2008)	2009	2008	Change to 2009 (2009-2008)
Earnings attributable to Class A and Class B Shares	56.5	30.9	83%	196.5	142.1	38%
H.R. Milner Income Tax Reassessment ⁽¹⁾	(16.8)	-	-	(16.8)	-	-
Federal Court of Appeal Decision- Mining Assets ⁽²⁾	-	(3.0)	-	-	(3.0)	-
Adjusted Earnings	39.7	27.9	42%	179.7	139.1	29%

SIGNIFICANT NON-OPERATING FINANCIAL ITEMS

(1) H.R. Milner Income Tax Reassessment

In 2006, Canada Revenue Agency (CRA) issued an income tax reassessment for Alberta Power (2000)'s 2001 taxation year which treated the proceeds received from the sale of the H.R. Milner generating plant to the Balancing Pool as income rather than as a sale of an asset. The Company disagreed with CRA's position and appealed the reassessment to the Tax Court of Canada. Due to the uncertainty as to whether the reassessment would ultimately be resolved in the Company's favour, the Company made a \$28.8 million payment and reduced earnings by \$12.4 million in 2006.

On August 21, 2009, Alberta Power (2000) received a judgment from the Tax Court of Canada ordering CRA to reverse its 2006 reassessment of Alberta Power (2000)'s 2001 tax return. On September 30, 2009, the appeal period for the judgment elapsed without an appeal from CRA.

The impact of the judgment is a \$13.7 million recovery of income tax and related interest expense reassessed by CRA in 2006. In addition, Alberta Power (2000) will receive interest income of approximately \$3.1 million earned on such amounts paid to CRA. These adjustments have resulted in a \$16.8 million increase in earnings for the three and nine months ended September 30, 2009. CRA will be required to refund to Alberta Power (2000) approximately \$28.0 million including interest and net of consequential adjustments to other taxation years arising from the judgment.

(2) Federal Court of Appeal Decision – Mining Assets

On May 22, 2008, the Federal Court of Appeal issued a decision overturning previous CRA reassessments pertaining to the computation of resource allowances and corresponding capital cost allowances for mining assets related to the Company's coal-fired power generation business. On July 8, 2008, the CRA advised that it would not seek leave to appeal to the Supreme Court of Canada in respect of this matter. This appeal and subsequent court decision applies to the 1997 to 1998 taxation years and

allows ATCO Electric, and Alberta Power (2000) (as successor to ATCO Electric in the coal-fired generating plants), to claim additional resource allowance and capital cost allowance. ATCO Electric and Alberta Power (2000) have recorded a reduction in current income tax expense and a decrease in interest expense which resulted in increases to the Company's earnings of \$3.0 million for the three and nine months ended September 30, 2008.

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

(\$ millions)	Total
	<i>(unaudited)</i>
Utilities	2.2
Energy	0.8
Total	3.0

CONSOLIDATED REVENUES AND EARNINGS

Revenues for the three months ended September 30, 2009, **increased** by \$16.3 million (5%) over the same period in 2008. This increase was primarily attributable to a \$17.4 million (6%) increase in revenues in the Utilities Business Group, partially offset by a \$1.0 million (1%) decrease in revenues in the Energy Business Group.

The **increase in revenues** was primarily attributable to the impact of the removal of the Carbon Facility from regulation and the suspension of the Carbon Rate Riders (refer to Regulatory Developments – ATCO Gas – Carbon Natural Gas Storage Facility), the impact of the ATCO Electric 2009/2010 general tariff application decision (ATCO Electric GTA) and higher AUC approved customer rates resulting from the ATCO Pipelines' negotiated settlement decision for 2008 and 2009 (ATCO Pipelines Negotiated Settlement). These increases in revenues were partially offset by the impact of applying new accounting standards in the Utilities Business Group relating to the recognition of revenues for rate regulated assets (refer to Changes in Accounting Policies – Rate Regulated Operations section) and lower franchise fees collected on behalf of cities and municipalities in ATCO Gas.

Revenues for the nine months ended September 30, 2009, **increased** by \$73.1 million (6%) over the same period in 2008. This increase was primarily attributable to a \$69.1 million (7%) increase in revenues in the Utilities Business Group and a \$4.1 million (2%) increase in revenues in the Energy Business Group.

The **increase in revenues** was primarily attributable to the impact of the ATCO Electric GTA, the impact of the ATCO Gas 2008/2009 general rate application decision (ATCO Gas GRA), higher AUC approved customer rates resulting from the ATCO Pipelines' Negotiated Settlement and the suspension of the Carbon Rate Riders in ATCO Gas (refer to Regulatory Developments – ATCO Gas – Carbon Natural Gas Storage Facility). These increases in revenues were partially offset by the impact of applying new accounting standards in the Utilities Business Group relating to the recognition of revenues for rate regulated assets (refer to Changes in Accounting Policies – Rate Regulated Operations section).

Earnings for the three months ended September 30, 2009, were \$56.5 million, an **increase** of \$25.6 million (83%), over the same period of 2008, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

For the three months ended September 30, 2009, **Adjusted Earnings** were \$39.7 million, an **increase** of \$11.8 million (42%), over the same period of 2008. The primary reasons for the increased Adjusted Earnings were the impact of the removal of the Carbon Facility from regulation and the suspension of the Carbon Rate Riders (refer to Regulatory Developments – ATCO Gas – Carbon Natural Gas Storage

Facility), the impact of the ATCO Electric GTA, lower operating and maintenance costs in ATCO Electric compared to amounts included in customer rates and the impact of the ATCO Pipelines' Negotiated Settlement. These increases in Adjusted Earnings were partially offset by higher financing costs in ATCO Electric compared to the amounts included in customer rates.

Earnings for the nine months ended September 30, 2009, were \$196.5 million, an **increase** of \$54.4 million (38%), over the same period of 2008, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

For the nine months ended September 30, 2009, **Adjusted Earnings** were \$179.7 million, an **increase** of \$40.6 million (29%), over the same period of 2008. The primary reasons for the increased Adjusted Earnings were due to the impact of the ATCO Pipelines' Negotiated Settlement, the impact of the ATCO Electric GTA, lower operating and maintenance costs in ATCO Electric compared to amounts included in customer rates and the impact of the removal of the Carbon Facility from regulation and the suspension of the Carbon Rate Riders (refer to Regulatory Developments – ATCO Gas – Carbon Natural Gas Storage Facility). These increases in Adjusted Earnings were partially offset by lower Excess Energy Charges in Alberta Power (2000).

Interest and other income for the three and nine months ended September 30, 2009, **increased** by \$10.0 million to \$17.3 million and by \$9.7 million to \$28.1 million, respectively, over the corresponding periods in 2008 mainly due to interest income recognized on the H.R. Milner Income Tax Reassessment in Alberta Power (2000) (recovery of \$7.5 million paid on the original 2006 income tax assessment and \$5.0 million of interest income pertaining to subsequent years) (refer to Results of Operations – Significant Non-Operating Financial Items – H.R. Milner Income Tax Reassessment) partially offset by lower rates of interest earned on cash balances.

CONSOLIDATED EXPENSES

(\$ millions)	For the Three Months Ended September 30			For the Nine Months Ended September 30		
	2009	2008	Change to 2009 (2009-2008)	2009	2008	Change to 2009 (2009-2008)
Operating expenses:						
Natural gas supply	0.1	0.7	(86%)	0.7	2.1	(67%)
Purchased power	11.8	11.9	(1%)	39.8	39.2	2%
Operation and maintenance	102.8	104.3	(1%)	324.5	299.0	9%
Selling and administrative	65.9	55.3	19%	193.5	165.5	17%
Franchise fees	24.2	26.7	(9%)	119.6	132.7	(10%)
	204.8	198.9	3%	678.1	638.5	6%
Depreciation and amortization	61.6	82.5	(25%)	183.3	222.9	(18%)
Interest	52.0	45.3	15%	149.4	134.1	11%
Income taxes	5.8	(0.5)	1260%	39.8	32.2	24%
Dividends on equity preferred shares	5.5	2.8	96%	14.0	8.5	65%

Operating expenses for the three months ended September 30, 2009, **increased** by \$5.9 million (3%), over the same period in 2008. Selling and administrative expenses increased in the Utilities Business Group primarily as a result of higher employment costs due to growth and higher costs relating to regulatory applications. Decreased franchise fees, recovered on a flow through basis, were paid in ATCO Gas.

Operating expenses for the nine months ended September 30, 2009, **increased** by \$39.6 million (6%) over the same period in 2008. Operation and maintenance expenses were higher primarily due to the impact of applying new accounting standards in the Utilities Business Group relating to the treatment of future removal and site restoration costs for rate regulated assets (refer to Changes in Accounting Policies – Rate Regulated Operations section). Selling and administrative expenses increased in the Utilities Business Group primarily as a result of higher employment costs due to growth and higher costs relating to regulatory applications. Decreased franchise fees, recovered on a flow through basis, were paid in ATCO Gas.

For the three months and nine months ended September 30, 2009, **depreciation and amortization expenses decreased** by \$20.9 million (25%), and by \$39.6 million (18%), respectively, compared to the same periods in 2008, primarily due to the impact of applying new accounting standards in the Utilities Business Group relating to the treatment of future removal and site restoration costs for rate regulated assets (refer to Changes in Accounting Policies – Rate Regulated Operations section). These decreases were partially offset by capital additions in 2008 and 2009 in the Utilities Business Group.

Interest expense for the three and nine months ended September 30, 2009, **increased** by \$6.7 million (15%), and by \$15.3 million (11%), respectively, over the same periods in 2008, primarily due to increased amounts of debt outstanding (net of redemptions) resulting from new financings issued in 2008 and 2009 to fund capital expenditures in the Utilities Business Group.

For the three and nine months ended September 30, 2009, **income taxes increased** by \$6.3 million (1260%) and by \$7.6 million (24%), respectively, over the same periods in 2008, primarily due to higher earnings before income taxes and a \$6.1 million income tax adjustment in ATCO Gas as a result of the removal of the Carbon Facility from regulation (refer to Regulatory Developments – ATCO Gas – Carbon Natural Gas Storage Facility), partially offset by a \$7.8 million tax adjustment as a result of the H.R. Milner Income Tax Reassessment in Alberta Power (2000) (refer to Results of Operations – Significant Non-Operating Financial Items – H.R. Milner Income Tax Reassessment) and higher income tax deductions in Utilities operations resulting from the flow-through method of income tax accounting.

Dividends on equity preferred shares for the three and nine months ended September 30, 2009, **increased** by \$2.7 million (96%), and by \$5.5 million (65%), respectively, over the same periods in 2008, as a result of the issue of \$160.0 million of 6.70% Cumulative Redeemable Preferred Shares Series 2 on March 27, 2009.

SEGMENTED INFORMATION

For the Three Months Ended September 30

(\$ millions)	Utilities	Energy	Corporate & Other	Intersegment Eliminations	Total
2009					
Revenues	290.5	78.5	-	(0.1)	368.9
Earnings attributable to Class A and Class B					
Shares	23.3	33.2	-	-	56.5
H.R. Milner Income Tax Reassessment ⁽¹⁾	-	(16.8)	-	-	(16.8)
Adjusted Earnings	23.3	16.4	-	-	39.7
2008					
Revenues	273.1	79.5	-	-	352.6
Earnings attributable to Class A and Class B					
Shares and Adjusted Earnings ⁽¹⁾	14.4	16.4	0.1	-	30.9
Federal Court of Appeal Decision – Mining Assets ⁽²⁾	(2.2)	(0.8)	-	-	(3.0)
Adjusted Earnings	12.2	15.6	0.1	-	27.9

Notes:

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

For the Nine Months Ended September 30

(\$ millions)	Utilities	Energy	Corporate & Other	Intersegment Eliminations	Total
2009					
Revenues	999.6	233.5	-	(0.1)	1,233.0
Earnings attributable to Class A and Class B					
Shares	142.6	53.9	-	-	196.5
H.R. Milner Income Tax Reassessment ⁽¹⁾	-	(16.8)	-	-	(16.8)
Adjusted Earnings	142.6	37.1	-	-	179.7
2008					
Revenues	930.5	229.4	-	-	1,159.9
Earnings attributable to Class A and Class B					
Shares	103.3	38.7	0.1	-	142.1
Federal Court of Appeal Decision – Mining Assets ⁽²⁾	(2.2)	(0.8)	-	-	(3.0)
Adjusted Earnings	101.1	37.9	0.1	-	139.1

Notes:

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

Utilities

ATCO Electric, ATCO Gas and ATCO Pipelines are regulated primarily by the AUC, which administers acts and regulations covering such matters as rates, financing, accounting, construction, operation and service area. These utilities are subject to a cost of service regulatory mechanism under which the AUC establishes the revenues required (i) to recover the forecast operating costs, including depreciation and

amortization and income taxes, of providing the regulated service, and (ii) to provide a fair and reasonable return on utility investment, or rate base. Rate base for each utility is the aggregate of the AUC approved investment in property, plant and equipment, less accumulated depreciation, and contributions by utility customers for extensions to plant, plus an allowance for working capital. The utilities earn a return on rate base intended to meet the cost of the debt and preferred share components of rate base and to provide share owners with a fair return on the common equity component of rate base.

Utilities **revenues** for the three months ended September 30, 2009, **increased** by \$17.4 million (6%) over the same period in 2008. The increase was primarily due to the impact of the removal of the Carbon Facility from regulation and the suspension of the Carbon Rate Riders (refer to Regulatory Developments – ATCO Gas – Carbon Natural Gas Storage Facility), the impact of the ATCO Electric GTA and higher AUC approved customer rates resulting from the ATCO Pipelines’ Negotiated Settlement. These increases in revenues were partially offset by the impact of applying new accounting standards in ATCO Electric, ATCO Gas and ATCO Pipelines relating to the recognition of revenues for rate regulated assets (refer to Changes in Accounting Policies – Rate Regulated Operations section) and lower franchise fees collected on behalf of cities and municipalities in ATCO Gas.

Utilities **revenues** for the nine months ended September 30, 2009, **increased** by \$69.1 million (7%) over the same period in 2008. The increase was primarily due to the impact of the ATCO Electric GTA, the impact of the ATCO Gas GRA, higher AUC approved customer rates resulting from the ATCO Pipelines’ Negotiated Settlement and the impact of the removal of the Carbon Facility from regulation and the suspension of the Carbon Rate Riders (refer to Regulatory Developments – ATCO Gas – Carbon Natural Gas Storage Facility). These increases in revenues were partially offset by the impact of applying new accounting standards in ATCO Electric, ATCO Gas and ATCO Pipelines relating to the recognition of revenues for rate regulated assets (refer to Changes in Accounting Policies – Rate Regulated Operations section) and lower franchise fees collected on behalf of cities and municipalities in ATCO Gas.

Earnings for the three and nine months ended September 30, 2009, were \$23.3 million, an **increase** of \$8.9 million (62%), and \$142.6 million, an **increase** of \$39.3 million (38%), respectively, over the corresponding periods in 2008, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

For the three months ended September 30, 2009, **Adjusted Earnings** were \$23.3 million, an **increase** of \$11.1 million (91%) over the corresponding period of 2008. The primary reasons for higher earnings were the impact of the removal of the Carbon Facility from regulation and the suspension of the Carbon Rate Riders (refer to Regulatory Developments – ATCO Gas – Carbon Natural Gas Storage Facility), the impact of the ATCO Electric GTA, lower operating and maintenance costs in ATCO Electric compared to the amounts included in customer rates and the impact of the ATCO Pipelines’ Negotiated Settlement. These increases in Adjusted Earnings were partially offset by higher financing costs in ATCO Electric compared to the amounts included in customer rates.

For the nine months ended September 30, 2009, **Adjusted Earnings** were \$142.6 million, an **increase** of \$41.5 million (41%) over the corresponding period of 2008. The primary reasons for higher Adjusted Earnings were the impact of the ATCO Pipelines’ Negotiated Settlement, the impact of the ATCO Electric GTA, lower operating and maintenance costs in ATCO Electric compared to amounts included in customer rates and the impact of the removal of the Carbon Facility from regulation and the suspension of the Carbon Rate Riders (refer to Regulatory Developments – ATCO Gas – Carbon Natural Gas Storage Facility). These increases in Adjusted Earnings were partially offset by higher financing costs in ATCO Electric compared to the amounts included in customer rates.

Regulatory Developments

Generic Cost of Capital

In February 2008, the AUC initiated a generic proceeding to determine whether the standardized rate of return methodology and the utility capital structures should be reviewed. A regulatory process was established by the AUC and a hearing was held in May and June 2009 to review the generic return on equity formula as well as to review the capital structure for each of the Alberta utilities. An AUC decision is expected in the fourth quarter of 2009. The AUC also indicated that any changes which result from this proceeding would be applied beginning in 2009 for Alberta utilities except for ATCO Pipelines.

While ATCO Gas' rate of return for 2008 would remain unchanged as a result of this proceeding, a separate module within the generic proceeding will address ATCO Gas' 2008 capital structure, as inclusion of this issue was removed from its 2008/2009 general rate application.

The changes for 2009 will not apply to ATCO Pipelines since capital structure and rate of return were included in the ATCO Pipelines' Negotiated Settlement.

Pension Hearing

In July 2009, the ATCO Utilities submitted an application to the AUC requesting an increase in rates to recover company contributions to the Canadian Utilities pension plan which are expected to occur starting in 2010. A tentative hearing date has been reserved for January 2010 and with normal process a decision from the AUC would be expected in the second quarter of 2010.

Benchmarking

ATCO Electric, ATCO Gas, and ATCO Pipelines (the ATCO Utilities) purchase information technology services from ATCO I-Tek. ATCO Electric and ATCO Gas also purchase customer care and billing services from ATCO I-Tek. The recovery of these costs in customer rates is subject to AUC approval. Since 2003, the costs have been approved on a Placeholder basis, and are subject to final AUC approval after completion of a collaborative benchmarking process.

The benchmarking report, dealing with the period of 2003-2007, was received on January 23, 2008. In February 2008, the benchmarking report along with an application to adjust the Placeholder rates was filed with the AUC. In April 2008, a negotiated settlement was reached with interested parties concerning the adjustment to Placeholders and was submitted to the AUC for approval.

The status of the negotiated settlement is in question as interested parties have since applied to the AUC for further adjustments relating to the Placeholders contained in the settlement. In response, the ATCO Utilities took the position that the evidence filed by interested parties in this proceeding was inconsistent with the requirement to support the earlier negotiated settlement and, hence, the agreement is no longer in place. The AUC, on August 14, 2009, directed that the negotiated settlement is no longer in place and that the 2003-2007 Placeholders must now proceed on the basis that no agreement has been reached. A hearing has been scheduled for the fourth quarter of 2009.

All parties continue to support the calculation of fair market value provided in the benchmarking report. The issue in the regulatory proceeding is whether fair market value or some other basis should be used to finalize the Placeholders. If fair market value is used as the basis to finalize the Placeholders for the period 2003-2007 then there will not be a material impact on consolidated earnings.

For the 2008 and 2009 period, a separate regulatory process will occur to approve rates for information technology and customer care and billing services provided by ATCO I-Tek that can be included in customer rates. The 2008-2009 proceeding will commence after the completion of the 2003-2007 process. In 2009, the ATCO Utilities will continue to utilize Placeholders for information technology and customer care and billing services until final rates are determined by the AUC.

A further regulatory process to deal with rates for information technology and customer care and billing services provided by ATCO I-Tek for 2010 and beyond has been established and the AUC is expected to set a schedule for this regulatory process in the fourth quarter of 2009.

ATCO Electric

2009 and 2010 General Tariff Application

In July 2008, ATCO Electric filed a general tariff application with the AUC for 2009 and 2010 requesting, among other things, increased revenues to recover increased financing, depreciation and operating costs associated with increased rate base in Alberta. In December 2008, ATCO Electric received a decision from the AUC approving interim refundable rate increases amounting to 50% of the requested increase for transmission operations and 25% of the requested increase for distribution operations.

On March 11, 2009, ATCO Electric filed an application requesting an increase to its approved interim refundable rates for its distribution operations. A decision from the AUC was received on April 22, 2009, which resulted in an increase to the interim refundable rates to 67% of the requested rate increase.

On July 2, 2009, the AUC issued a decision on ATCO Electric's 2009 and 2010 general tariff application. The decision resulted in an increase to ATCO Electric's 2009 annual earnings of approximately \$10.0 million compared to customer rates in effect in 2008 mainly as a result of an increase in rate base. In the decision, the AUC used Placeholders for common equity of 33% for transmission operations and 37% for distribution operations, preferred share capitalization ratios of approximately 10%, return on common equity of 8.75%, 2009 and 2010 information technology and customer care and billing rates, pension costs and income tax amounts. The final amounts of these Placeholders will be determined by the AUC in subsequent proceedings.

Transmission Infrastructure Projects

Northwest Alberta Transmission 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 four distinct transmission line projects that is expected to result in 725 kilometres of new transmission lines to be constructed by 2012.

To date, all four transmission line projects have been assigned to ATCO Electric by the AESO with final approval having been received from the AUC for three of these projects relating to the construction of 622 kilometres of transmission line with an estimated cost of \$470.0 million and an anticipated completion by March 31, 2011. ATCO Electric is currently constructing two of these major transmission lines in northwest Alberta totaling approximately 516 kilometres. In addition to the three transmission line projects, seven additional infrastructure projects in the northwest with an estimated cost of \$58.0 million are anticipated to be complete by the end of 2010.

The total cost estimate and timing of the remaining transmission line project to be approved by the AUC in northwest Alberta is dependent on changing economic conditions as well as receiving all regulatory approvals on a timely basis. As a result of these variables, ATCO Electric is unable at this time to determine the completion dates or the cost of the entire project.

AESO Long-Term Transmission System Plan

In June 2009, the AESO announced its long-term transmission system plan which is in addition to the increased transmission infrastructure in northwest Alberta. This plan identifies \$8.1 billion of critical transmission infrastructure projects that are needed between 2010 and 2017 to meet current and future electricity needs in Alberta and a further \$6.4 billion in projects that are at a less advanced stage of planning. The Alberta government has already introduced amendments to the Alberta Utilities Commission Act, the Electric Utilities Act, and the Hydro and Electric Energy Act to expedite the determination of these critical transmission infrastructure projects. The amendments to the Electric Utilities Act allow the government to direct assign projects, utilize service territory assignments or put major projects out for bid.

On August 25, 2009, ATCO Electric was authorized by the Alberta Minister of Energy to prepare a facilities application to build and operate a new high-voltage transmission line along a corridor on the east side of the province between Edmonton and Calgary. Following approval of the facilities application by the AUC, ATCO Electric will construct and operate the new line. The AESO, in its recently released long-term transmission system plan, estimates the project will cost \$1.65 billion, in 2008 dollars, and it is anticipated that the majority of these costs will be incurred after 2011.

In addition to the increased transmission infrastructure in northwestern Alberta, ATCO Electric anticipates that 500 - 1,000 kilometres of transmission line projects will be required in its service area over the next five years. The increase in kilometers is mainly as a result of projects identified in the AESO's long-term transmission plan.

ATCO Gas

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. On November 13, 2008, the AUC issued a decision on ATCO Gas' 2008 and 2009 general rate application. The decision resulted in an increase to ATCO Gas' 2009 annual earnings of approximately \$3.0 million compared to 2008 as a result of an increase in rate base. In the decision, the AUC used Placeholders for common equity ratios of 38%, preferred share capitalization ratios of approximately 6%, return on 2009 common equity of 8.75%, 2009 information technology and customer care and billing rates and income tax amounts. The final amounts of these Placeholders will be determined by the AUC in subsequent proceedings.

2005, 2006, and 2007 General Rate Application

In May 2006, the City of Calgary filed a review and variance application with the AUC, alleging that the AUC made errors in ATCO Gas' 2005-2007 general rate application decision related to the calculation of working capital needed by ATCO Gas to operate its Carbon natural gas storage facility. The AUC issued a decision on January 17, 2007, denying the City of Calgary's application. On February 15, 2007, the City

of Calgary filed for leave to appeal this decision with the Alberta Court of Appeal. On June 19, 2007, the appeal was heard with the court granting the City of Calgary leave to appeal on August 3, 2007. The court decided to postpone addressing the appeal, allowing the AUC time to address the Alberta Court of Appeal decision related to the removal of the Carbon assets from regulation. A hearing has now been set for March 11, 2010.

Deferred Gas Account

ATCO Gas filed an application with the AUC to address, among other things, corrections required to historical transportation imbalances (the process whereby third party natural gas supplies are reconciled to amounts actually shipped in the Company's pipelines) that have impacted ATCO Gas' deferred gas account. In April 2005, the AUC issued a decision resulting in a 15% decrease in the transportation imbalance adjustments sought by ATCO Gas. The decision resulted in ATCO Gas recovering \$9.2 million in natural gas supply costs from customers. The City of Calgary filed a leave to appeal the AUC's decision and ATCO Gas filed a cross appeal of the AUC's decision. On July 7, 2006, the Alberta Court of Appeal issued its decision granting the City of Calgary's leave to appeal on the question of whether the AUC erred in law or jurisdiction in assuming that it had the authority to allow recovery in 2005 of costs relating to prior years. At a hearing on April 13, 2007, the Alberta Court of Appeal declined to consider the City of Calgary's appeal and referred the jurisdictional question back to the AUC. On January 3, 2008, the AUC issued a decision confirming its jurisdiction to approve the prior period adjustment it had approved previously. In February 2008, the City of Calgary filed a leave to appeal the AUC's January 3, 2008, decision with the Alberta Court of Appeal. The hearing for this leave to appeal occurred on December 16, 2008 and on April 21, 2009, the Alberta Court of Appeal issued a decision granting the City of Calgary's leave to appeal. A hearing has been scheduled for January 13, 2010.

Carbon Natural Gas Storage Facility

Background

ATCO Gas owns a 43.5 petajoule natural gas storage facility located at Carbon, Alberta. ATCO Gas leases 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 to remove the Carbon Facility from regulation, 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 successfully appealed this decision with the Alberta Court of Appeal.

Utility versus Non-Utility Use of the Carbon Facility

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 November 3, 2008, the AUC denied the City of Calgary's request that it review and vary its decision, and the City of Calgary subsequently withdrew its leave to appeal.

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

On February 26, 2007, ATCO Gas filed for leave to appeal this decision with the Alberta Court of Appeal. The Alberta Court of Appeal granted ATCO Gas' leave to appeal on October 24, 2007. On May 9, 2008, the Alberta Court of Appeal heard the appeal and subsequently issued a decision on May 27, 2008 granting the appeal. The Court found that the AUC had erred in law or jurisdiction when it included the Carbon Facility in rate base for the purpose of generating revenues to offset customer rates. On August 22, 2008, the City of Calgary filed a leave to appeal this decision with the Supreme Court of Canada. On December 4, 2008, the Supreme Court of Canada dismissed the City of Calgary's application for leave to appeal, thus upholding the Alberta Court of Appeal's May 27, 2008 decision.

Customer Rate Riders and Removal from Regulation

As a result of the Alberta Court of Appeal's May 27, 2008 decision, ATCO Gas requested and received approval from the AUC to suspend rate riders to customer rates on an interim basis effective July 1, 2008. These riders were approved by the AUC in the past to distribute net revenues related to the facility to customers.

On July 11, 2008, ATCO Gas filed a compliance application with the AUC requesting removal of the Carbon Facility from regulation effective April 1, 2005. This request to remove the Carbon Facility is in alignment with the Alberta Court of Appeal's May 27, 2008 decision. Certain aspects of the application were updated on January 15, 2009. This application is seeking to recover from customers additional amounts that would result in an estimated increase to ATCO Gas' earnings of \$30.3 million, excluding interest, related to those amounts refunded to customers over the April 1, 2005, to June 30, 2008, period. On September 29, 2008, the AUC suspended ATCO Gas' compliance application. On October 15, 2008, ATCO Gas filed an application with the Alberta Court of Appeal to direct the AUC to comply with its May 27, 2008, decision. ATCO Gas has withdrawn its October 15, 2008, application to the Alberta Court of Appeal as a result of the AUC recommencing the Carbon proceeding.

A pre-hearing conference occurred on December 16, 2008, and on January 9, 2009, the AUC issued a decision establishing a final issues list to remove the Carbon Facility from regulation. The AUC set a proceeding schedule with a hearing scheduled to commence on March 16, 2009. On March 6, 2009, the AUC suspended the proceeding schedule as previously established due to unanticipated delays in the process. The AUC determined that it would instead consider written submissions on three preliminary questions related to the removal of the Carbon Facility from regulation.

On June 26, 2009, the AUC released its decision addressing the three preliminary questions as well as the remaining process related to the removal of the Carbon Facility from regulation. The AUC determined that the effective date of the removal of the Carbon Facility from regulation is to be October 10, 2006, in alignment with a previous AUC decision issued in 2006 which found that the Carbon Facility was not required to be used for load balancing ATCO Gas' distribution system.

As a result of that effective date, the remaining process is to focus on the effect of removing the Carbon Facility as of that date which includes a review of the lease rate for the facility leased by ATCO Midstream for the period April 1, 2005 – October 9, 2006. ATCO Gas has informed the AUC that it intends to seek guidance from the Alberta Court of Appeal with respect to whether the AUC's June 26, 2009 decision is in compliance with the Alberta Court of Appeals' May 27, 2008 decision. With respect to obtaining this guidance, ATCO Gas has filed a motion with the Alberta Court of Appeal which will be heard on January 21, 2010. An application for leave to appeal of the decision was also filed by ATCO

Gas on July 27, 2009 with the Alberta Court of Appeal. The application does not have to be addressed until February 2010 while other avenues are being pursued by ATCO Gas. In the second quarter of 2009, ATCO Gas had also requested permission from the AUC to enter into discussions with interested parties for the purpose of potentially reaching a negotiated settlement related to the Carbon Facility. The AUC granted ATCO Gas' request, however, it has now been determined that a negotiated settlement will not be achievable.

The AUC on its own initiative has also indicated its intention to commence a Review and Variance of the decision related to the October 10, 2006 effective date as determined in its June 26, 2009 preliminary questions decision. This proceeding commenced in October 2009 and an AUC decision is expected by January 2010.

In addition to the July 11, 2008 Carbon compliance application, ATCO Gas submitted a compliance application to the AUC on January 19, 2009 as part of its 2008-2009 general rate application. In this application, ATCO Gas reduced its rate increase applicable to its south customers by \$7.6 million related to the production and storage charge that was included in ATCO Gas' rates from January through June 2008. On July 28, 2009, the AUC issued a decision approving this reduction in rate increase. As a result of this decision and the June 26, 2009 preliminary questions decision in which the AUC confirmed that the Carbon Facility does not have an operational use for providing utility service, ATCO Gas has accordingly removed the Carbon Facility from regulation. ATCO Gas is seeking to recover from customers additional amounts that would result in an estimated increase to its earnings of \$20.5 million, excluding interest, related to the removal of the Carbon Facility from regulation for the period April 1, 2005 – December 31, 2007. The determination of these amounts is subject to the finalization of the effective date of removal from regulation.

2009 Financial Impact of Decisions

As a result of the AUC's June 26, 2009 preliminary question decision and also the July 28, 2009 decision on ATCO Gas' 2008-2009 GRA compliance application, ATCO Gas recognized increased revenues of \$13.8 million in the third quarter of 2009 for the impact of the Carbon rate rider revenue for the period January 1, 2008 to June 30, 2008 which was previously refunded to customers and decreased revenues of \$7.6 million as a result of excluding any costs for the Carbon Facility in its 2008-2009 general rate application. These items increased revenues by \$6.2 million and increased ATCO Gas' earnings by \$4.5 million in the third quarter of 2009. ATCO Gas is seeking to recover from customers additional amounts that would result in an estimated increase to its earnings of \$20.5 million, excluding interest, related to the removal of the Carbon Facility from regulation for the period April 1, 2005 – December 31, 2007. The determination of these amounts is subject to the finalization of the effective date of removal from regulation. As a result, these additional amounts have not yet been recognized by ATCO Gas.

Also, in the third quarter of 2009, as a result of the preliminary questions decision received on June 26, 2009, ATCO Gas has derecognized all previously recorded regulatory assets and liabilities relating to the Carbon Facility as these amounts are no longer recoverable from or payable to ATCO Gas' customers. The one-time impact of this discontinuation of regulatory accounting for the Carbon Facility was to increase ATCO Gas' earnings by \$1.9 million for the three and nine months ended September 30, 2009.

ATCO Pipelines

2008 and 2009 General Rate Application

In November 2008, ATCO Pipelines filed an application requesting the AUC approve a negotiated settlement with its customers of ATCO Pipelines' 2008 and 2009 revenue requirements. On March 18, 2009, the AUC issued a decision approving the negotiated settlement, including, among other things, a

rate of return on common equity of 8.75% and a common equity ratio of 43% for each of 2008 and 2009. As a result of the decision, ATCO Pipelines recognized additional earnings over existing interim rates of \$4.5 million in the first quarter of 2009, of which \$3.7 million related to 2008.

2010, 2011 and 2012 Negotiated Settlement

On January 29, 2009, ATCO Pipelines filed a request with the AUC to negotiate with customers the settlement of the revenue requirements for the years 2010, 2011 and 2012. On April 29, 2009, the AUC approved ATCO Pipelines' request to negotiate. Negotiations are expected to be completed in the fourth quarter of 2009.

Alberta System Integration

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

On June 26, 2009, ATCO Pipelines filed an application with the AUC for the integration of ATCO Pipelines' and NOVA's gas transmission systems in Alberta. The integration application requests the AUC to approve that (i) integration is in the public interest, (ii) ATCO Pipelines approved revenue requirements be charged to NOVA, (iii) ATCO Pipelines customers be transitioned to NOVA, with NOVA as the customer point of contact, and (iv) ATCO Pipelines and NOVA swap assets in order to set operating areas. A negotiated settlement on ATCO Pipelines 2010, 2011 and 2012 revenue requirements is a condition precedent of the integration application. ATCO Pipelines expects to receive an AUC decision on the integration in the first half of 2010.

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.

Energy

Energy **revenues** for the three months ended September 30, 2009, **decreased** by \$1.0 million (1%) compared to the corresponding period in 2008, primarily as a result of lower Excess Energy Charges, partially offset by increased Capacity Charges due to adjustments to indices for prior periods.

Energy **revenues** for the nine months ended September 30, 2009, **increased** by \$4.1 million (2%) over the corresponding period in 2008, primarily as a result of higher revenues due to increased Capacity Charges due to adjustments to indices for prior periods, higher GHG recoveries and increased amortization of deferred availability incentives (refer to Segmented Information – Energy – Alberta Power (2000) section). These increases were partially offset by lower Excess Energy Charges.

Earnings for the three and nine months ended September 30, 2009, were \$33.2 million, an **increase** of \$16.8 million (102%), and \$53.9 million, an **increase** of \$15.2 million (39%), respectively, over the corresponding periods in 2008, including the impact of the adjustments identified in the Significant Non-Operating Financial Items section.

Adjusted Earnings for the three months ended September 30, 2009, were \$16.4 million, an **increase** of \$0.8 million (5%), over the same period of 2008. The primary reasons for the increase were higher Capacity Charges due to adjustments to indices for prior periods and increased amortization of deferred availability incentives. These increases in Adjusted Earnings were partially offset by lower Excess Energy Charges at the Battle River and Sheerness generating plants.

Adjusted Earnings for the nine months ended September 30, 2009, were \$37.1 million, a **decrease** of \$0.8 million (2%), compared to the same period of 2008. The primary reason for the decrease was lower Excess Energy Charges, partially offset by higher Capacity Charges due to adjustments to indices for prior periods at the Battle River and Sheerness generating plants and increased amortization of deferred availability incentives.

Availability of the generating plants by geographic region is set forth below:

	For the Three Months Ended September 30			For the Nine Months Ended September 30		
	2009	2008	Change to 2009 (2009-2008)	2009	2008	Change to 2009 (2009-2008)
Alberta Power (2000) ⁽¹⁾						
Canada	92.7%	96.0%	(3.3%)	91.3%	90.3%	1.0%

Note:

⁽¹⁾ Generating plant availability will fluctuate due to the timing and duration of outages.

Alberta Power (2000)

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. These amounts are amortized based on estimates of future generating unit availability and future electricity prices over the term of the PPAs.

During the three and nine months ended September 30, 2009, the **deferred availability incentive** account increased by \$3.9 million and \$2.2 million, respectively, to \$63.5 million, mainly due to high availability offset by normal amortization. During the three and nine months ended September 30, 2009, the amortization of deferred availability incentives, recorded in revenues, increased by \$0.8 million to \$3.9 million and by \$3.5 million to \$12.6 million, respectively, primarily as a result of changes in assumptions related to the terms of the PPAs. Previous assumptions were based on a single term for the PPAs at the Battle River generating plant. These assumptions have been revised to coincide with the term of the Battle River individual unit PPAs. The change associated with the updated assumptions is expected to increase 2009 revenues by approximately \$3.8 million.

Liquidity and Capital Resources

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

SUMMARY OF CASH FLOW

(\$ millions)	For the Three Months Ended September 30			For the Nine Months Ended September 30		
	2009	2008	Change to 2009 (2009-2008)	2009	2008	Change to 2009 (2009-2008)
Cash position, beginning of period	271.9	265.3	2%	(9.0)	0.3	(3100%)
Cash provided by (used in) Operating activities:						
Funds generated by operations	129.9	105.0	24%	386.1	331.4	17%
Changes in non-cash working capital	6.4	(0.6)	1167%	(1.0)	54.5	(102%)
Cash flow from operations	136.3	104.4	31%	385.1	385.9	0%
Investing activities	(141.1)	(192.5)	(27%)	(533.4)	(417.0)	28%
Financing activities	-	(0.1)	100%	424.4	207.9	104%
Cash position, end of period	267.1	177.1	51%	267.1	177.1	51%

OPERATING ACTIVITIES

For the three months ended September 30, 2009, **funds generated by operations** were \$129.9 million, an **increase** of \$24.9 million (24%) over the same period in 2008. This increase was primarily due to higher cash earnings partially offset by decreased deferred availability incentives in Alberta Power (2000). For the three months ended September 30, 2009, **cash flow from operations** was \$136.3 million, an **increase** of \$31.9 million (31%) over the same period in 2008. This increase was primarily due to higher funds generated by operations and changes in non-cash working capital.

For the nine months ended September 30, 2009, **funds generated by operations** were \$386.1 million, an **increase** of \$54.7 million (17%) over the same period in 2008. This increase was primarily due to higher cash earnings. For the nine months ended September 30, 2009, **cash flow from operations** was \$385.1 million, a **decrease** of \$0.8 million (0%) compared to the same period in 2008. This decrease was primarily due to changes in non-cash working capital, partially offset by higher funds generated by operations.

INVESTING ACTIVITIES

For the three months ended September 30, 2009, **cash used in investing activities decreased** by 27% compared to the same period in 2008. This decrease was primarily due to lower capital expenditures and higher contributions by utility customers for extensions to plant. **Capital expenditures** for the three months ended September 30, 2009 **decreased** by \$20.7 million, compared to the same period in 2008. This decrease was primarily due to decreased investment in natural gas distribution projects in ATCO Gas and transmission and distribution projects in ATCO Electric.

For the nine months ended September 30, 2009, **cash used in investing activities increased** by 28% over the same period in 2008. This increase was primarily due to changes in non-cash working capital and lower contributions by utility customers for extensions to plant. **Capital expenditures** for the nine months ended September 30, 2009 **increased** by \$0.5 million, over the same period in 2008. This increase was primarily due to increased investment in natural gas transportation projects in ATCO Pipelines and increased transmission and distribution projects in ATCO Electric. These increases in capital expenditures were partially offset by lower capital expenditures on natural gas distribution projects in ATCO Gas.

Capital expenditures to maintain capacity, meet planned growth, and fund future development activities are expected to be approximately \$0.9 billion in 2009, unchanged from 2008. The majority of these expenditures relate to the Utilities Business Group. For the 2009 to 2011 period, capital expenditures in the Utilities Business Group are expected to be \$2.0 billion and, depending on infrastructure spending, could be as much as \$4.0 billion (refer to Regulatory Matters – ATCO Electric – Transmission Infrastructure Projects section).

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

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

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

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

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

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

On September 9, 2008, ATCO Electric announced it had entered into an agreement with UK-based Balfour Beatty and Australia-based United Group Limited for engineering, construction, procurement and project management services to provide these services for required capital projects in the extremely tight labour market for such services available in Alberta. Individual projects assigned pursuant to this agreement will be jointly estimated and a target project cost agreed to before construction commences. The agreement provides ATCO Electric full discretion to assign or remove projects on an individual basis. Projects will be undertaken with a full disclosure to the AUC of actual costs, with any savings or overruns relative to target project costs shared equally.

FINANCING ACTIVITIES

For the three months ended September 30, 2009, the Company had no change in the **net debt**.

For the nine months ended September 30, 2009, the Company had **net debt increases** of \$270.0 million. Issuance of debt included \$150.0 million of 6.50% Debentures due March 7, 2039 and \$120.0 million of 6.215% Debentures due March 6, 2024.

On March 27, 2009 the Company **issued** \$160.0 million of 6.70% Cumulative Redeemable Preferred Shares Series 2 (for additional details on these shares, refer to Note 7 to the unaudited interim consolidated financial statements for the nine months ended September 30, 2009). The Company had no issues or redemptions of equity preferred shares in the three and nine months ended September 30, 2008.

Total **dividends** for the nine months ended September 30, 2009, **decreased** by \$15.0 million to nil, compared to the same period in 2008. The payment of any dividend is at the discretion of the Board of Directors and depends on the financial condition of the Company and other factors.

SHORT TERM INVESTMENT POLICY

The Company has a long-standing policy not to invest any of its cash balances in asset-backed securities; consequently, the turmoil in the 2007 asset-backed commercial paper market has had no impact on the Company. Cash and short term investment credit risk is reduced by investing 100% in short term money market instruments of Canadian financial institutions and Government of Canada treasury bills as at September 30, 2009.

LINES OF CREDIT

At September 30, 2009, the Company had the following credit lines that enable it to obtain funding for general corporate purposes.

	Total	Used	Available
(\$ millions)			
Short term committed	300.0	21.5	278.5
Uncommitted	28.7	2.1	26.6
Total	328.7	23.6	305.1

The short term committed credit facility of \$300.0 million was renewed in July 2009 by the Company. Unless extended at the option of the lender, this credit facility will now expire in July 2010.

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

CONTRACTUAL OBLIGATIONS

Contractual obligations disclosed in the 2008 MD&A remain substantially unchanged as at September 30, 2009.

NET CURRENT AND LONG TERM FUTURE INCOME TAXES

Net current and long term future income taxes at September 30, 2009, were \$304.8 million, an increase of \$278.8 million (1072%) over the same period of 2008. This increase was primarily due to

changes in accounting policies relating to rate regulated operations (refer to Changes in Accounting Policies – Rate Regulated Operations section).

Future income taxes are attributable to differences between the financial statement carrying amounts of assets and liabilities and their tax bases. These differences result primarily from recognizing revenue and expenses in different years for financial and tax reporting purposes. Future income taxes will become payable when such differences are reversed through the settlement of liabilities and realization of assets.

BASE SHELF PROSPECTUS

On May 16, 2008, CU Inc. filed a **base shelf prospectus** that permits CU Inc. to issue up to an aggregate of \$1,500.0 million of debentures over the twenty-five month life of the prospectus. During the nine months ended September 30, 2009, the following debentures were issued:

- on March 6, 2009, CU Inc. issued \$150.0 million of 6.50% Debentures due March 7, 2039, and
- on March 6, 2009, CU Inc. issued \$120.0 million of 6.215% Debentures due March 6, 2024.

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

Under its base shelf prospectus, the Company has issued \$0.6 billion of debentures to date, leaving \$0.9 billion remaining.

Share Capital

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

At October 29, 2009, the Company had outstanding 3,286,124 Class A Shares and 2,014,076 Class B Shares, all of which are owned by Canadian Utilities.

Business Risks

Information contained in the 2008 MD&A related to Business Risks which is not discussed in this section remains substantially unchanged.

FINANCIAL MARKETS

Over the last year, significant challenges have been experienced in domestic and international financial markets. These challenges have an impact on the ability of certain borrowers to finance existing operations and capital expenditure programs.

As discussed elsewhere in this MD&A, the Utilities Business Group has a capital expenditure program of \$2.0 billion that, depending on infrastructure spending, could be as much as \$4.0 billion over the next three years. While the current financial situation has not directly impacted the Company's ability to fund this capital expenditure program and ongoing operations, future borrowing may be impacted by these financial markets through increased carrying costs and the ability to raise debt and equity capital.

In March 2009, the Company completed a \$270 million debenture issue and a \$160 million preferred share issue to fund the 2009 portion of the Utilities Business Group's capital expenditure program and to fund scheduled maturities of previous debenture issues.

In addition, as at September 30, 2009, the Company has cash balances of approximately \$0.3 billion and available committed and uncommitted lines of credit of approximately \$0.3 billion which can be utilized for general corporate purposes.

The Company is unable to determine what future changes in the financial markets could occur and how these changes could affect the Company. Deterioration in domestic and international economic activity may impact the operations of the Company.

PENSION PLANS

Employees are required to contribute a percentage of their salary to registered pension plans. The Company is required to contribute its share of contributions on behalf of the defined contribution members of the pension plans and to provide the balance of the funding necessary to ensure that benefits will be fully provided for at retirement for the members of the defined benefit pension plans.

Declines in stock and bond markets have resulted in a reduction in the value of the defined benefit pension plans' assets, creating funding deficits. The Company has not made material contributions since April 1, 1996, as a result of the defined benefit plans' surplus positions which have been used to fund the employer's contributions to the defined contribution component of the pension plans. Based on the most recent actuarial valuations for funding purposes dated December 31, 2006, and December 31, 2007, and recent changes in government regulations resulting from the white paper issued by the government of Alberta in 2008, the Company does not anticipate that it will be required to make material contributions to its pension plans in 2009. However, the Company may be required to make contributions in 2009 if a decrease in market values warrants additional funding.

Depending on the outcome of future actuarial valuations, material current service and deficit funding contributions will likely be required to resume in 2010. The amounts before recovery from utility customers are expected to be in the range of \$46.0 million to \$57.0 million in 2010. For purposes of any funding requirements pertaining to utility operations, the AUC has directed that the cash basis of accounting be used in customer rate applications. Accordingly, the Company includes the cost of funding in its rate applications to the AUC, thereby, with the consent of the AUC, recovering 100% of the costs of funding its pension plans pertaining to utility operations from utility customers (refer to Segmented Information – Utilities – Regulatory Developments – Pension Hearing section). Alberta Power (2000) contracts the operations of its power generating plants to ATCO Power, a wholly-owned subsidiary of CU Inc.'s parent company, Canadian Utilities. As a result, ATCO Power is responsible for funding the appropriate pension contributions for these employees. Costs relating to pensions are recovered by Alberta Power (2000) under the terms of the PPAs.

ENVIRONMENTAL MATTERS

The Company's operating subsidiaries and the industries in which they operate are subject to extensive federal, provincial and local environmental protection laws concerning emissions to the air, discharges to surface and subsurface waters, land use activities and the handling, manufacturing, processing, use, emission and disposal of materials and waste products.

Alberta legislation requires most large emitters to reduce GHG emission intensities by up to 12% annually. For cogeneration and combined cycle facilities, steam production GHG emissions are subjected to the same reduction target (up to 12%) and electricity production emissions are compared to a deemed emission baseline. Compliance reports with true-up amounts for any obligations must be submitted annually to Alberta Environment by March 31 for the previous calendar year. The compliance reports and obligation amounts for the 2008 reporting year have been submitted to Alberta Environment. Alberta Power (2000)'s compliance reporting obligation resulted in a true-up of 1.27 million tonnes including our

partners share of the output of the plants (approximately \$19.0 million when assessed at \$15/tonne) emissions. Of this total, approximately 0.90 million tonnes represented Alberta Power (2000)'s share (approximately \$13.6 million when assessed at \$15/tonne). This was achieved through a combination of approved compliance options including: improved unit performance, offset credits and technology fund credits. PPA counterparties have reimbursed Alberta Power (2000) for amounts paid for their GHG obligations.

Alberta regulation requires coal-fired generating plant operators, including Alberta Power (2000), to monitor mercury emissions and target a capture of at least 70% of the mercury in the coal commencing January 1, 2011. Proposals to monitor and install control equipment on the Battle River and Sheerness generating plants have been approved by Alberta Environment, and installation of control equipment is scheduled for 2009 to 2010.

The Clean Air Strategic Alliance is conducting a review of air emissions standards (sulphur dioxide, nitrogen oxides, mercury, and particulate matter) for the electricity sector in Alberta. The Energy Business Group participates in this process which will develop new air emissions standards for new units and units at the end of their design life (40 years or the end of their PPA term for coal-fired units and 30 years for natural gas-fired units). The new standards are expected to be adopted by Alberta Environment by 2010, and to be effective January 1, 2011.

Following the U.S. election and a heightened expectation that the U.S. will progress a national GHG Cap and Trade scheme, the federal government reopened discussions with industry early in 2009 aimed at implementing a Canadian GHG Cap and Trade scheme. It is proposed that the regulatory underpinnings of the scheme would be finalized in 2010, that 2011 would be used as a test year and that the program would be fully implemented by 2012. Under current proposals, all carbon emissions would require permits. Permits would be allocated to electricity sector emitters based on historical emissions and ongoing electricity production. The number of permits provided to the electricity sector would begin at 3% less than 2006 carbon emission levels in 2012 and decrease linearly to a targeted 25% reduction in carbon emission level by 2020. While not yet resolved, it is anticipated that a financial compliance mechanism will be available at the outset of the scheme. In addition to making physical reductions, compliance could also be accomplished via purchasing offsets or through permit trading.

Unlike the previously contemplated carbon emission intensity based schemes, the current proposals would expose producers to the costs of their GHG emissions.

It is anticipated that the PPAs will allow Alberta Power (2000) to recover all of the costs associated with complying with both the federal and Alberta regulations during the PPA term except for the emissions related to output in excess of the committed capacity in the PPA which is minimal.

In May 2008, the federal government and the Canadian Council of Environment Ministers sanctioned a tripartite group (federal, provincial and territorial governments, industry and non-government organizations) to develop a new air management system for sulphur dioxide, nitrogen oxides, particulate matter, volatile organic compounds, mercury, and ground level ozone. They propose to have regulations in place by 2010 with implementation by 2015 for new and existing facilities. The three key elements of this proposal are: national ambient air quality standards set by the federal government, base level equipment performance standards and geographically based air quality management zones. The Energy Business Group is represented on the Tripartite Steering Committee through the Canadian Electricity Association and is also participating in the working groups that have been set up to assist with the development of this air management system.

The Energy Business Group continues to monitor these developments and the impact of complying with any resulting regulations.

As a result of recent drought conditions, the water levels in the cooling pond used by the Battle River generating plant in its production of electricity have fallen to levels below normal. To date in 2009, these changes have not resulted in the need to curtail production of electricity beyond normal summer derates to ensure water temperatures remain within acceptable limits. However, continued drought conditions could result in future curtailments of production. Should the plant experience significant curtailments due to this issue the Battle River PPA provides for force majeure protection and, as a result, the plant's earnings will not be materially affected.

REGULATED OPERATIONS

Benchmarking

ATCO Electric, ATCO Gas, and ATCO Pipelines (the ATCO Utilities) purchase information technology services from ATCO I-Tek. ATCO Electric and ATCO Gas also purchase customer care and billing services from ATCO I-Tek. The recovery of these costs in customer rates is subject to AUC approval. Since 2003, the costs have been approved on a Placeholder basis, and are subject to final AUC approval after completion of a collaborative benchmarking process.

The benchmarking report, dealing with the period of 2003-2007, was received on January 23, 2008. In February 2008, the benchmarking report along with an application to adjust the Placeholder rates was filed with the AUC. In April 2008, a negotiated settlement was reached with interested parties concerning the adjustment to Placeholders and was submitted to the AUC for approval.

The status of the negotiated settlement is in question as interested parties have since applied to the AUC for further adjustments relating to the Placeholders contained in the settlement. In response, the ATCO Utilities took the position that the evidence filed by interested parties in this proceeding was inconsistent with the requirement to support the earlier negotiated settlement and, hence, the agreement is no longer in place. The AUC, on August 14, 2009, directed that the negotiated settlement is no longer in place and that the 2003-2007 Placeholders must now proceed on the basis that no agreement has been reached. A hearing has been scheduled for the fourth quarter of 2009.

All parties continue to support the calculation of fair market value provided in the benchmarking report. The issue in the regulatory proceeding is whether fair market value or some other basis should be used to finalize the Placeholders. If fair market value is used as the basis to finalize the Placeholders for the period 2003-2007 then there will not be a material impact on consolidated earnings.

For the 2008 and 2009 period, a separate regulatory process will occur to approve rates for information technology and customer care and billing services provided by ATCO I-Tek that can be included in customer rates. The 2008-2009 proceeding will commence after the completion of the 2003-2007 process. In 2009, the ATCO Utilities will continue to utilize Placeholders for information technology and customer care and billing services until final rates are determined by the AUC.

A further regulatory process to deal with rates for information technology and customer care and billing services provided by ATCO I-Tek for 2010 and beyond has been established and the AUC is expected to set a schedule for this regulatory process in the fourth quarter of 2009.

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 had been called into question. In July 2009, a settlement agreement was approved by the Court of Queens Bench of Alberta, resulting in the certification of a class action suit relating to late penalties charged by ATCO Gas. The settlement payment of \$1.5 million did not impact earnings of ATCO Gas as this payment was paid out of its reserve account for injuries and damages.

Changes in Accounting Policies

Rate Regulated Operations

Effective January 1, 2009, the Canadian Institute of Chartered Accountants (CICA) 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. Previously, the Company followed Canadian GAAP recommendations, which were similar to standards issued by the Financial Accounting Standards Board ("FASB") in the United States, which provide guidance on the recognition and measurement of assets and liabilities arising from rate regulation. As permitted by Canadian GAAP, the Company has applied standards issued by FASB as another source of Canadian GAAP. This change in accounting policy has been adopted prospectively with changes identified below.

The reserves for future removal and site restoration costs for the utility operations, which were previously netted against property plant and equipment, have been reclassified to non-current regulatory liabilities, resulting in an increase to the Company's total assets and total liabilities. The Company reclassified \$376.2 million at January 1, 2009, corresponding to these reserves.

Previously, depreciation expense for property, plant and equipment included a provision for future removal and site restoration costs for the utility operations. An amount corresponding to this provision is incorporated into rates charged to customers and was previously recognized in revenues. Under the new method of accounting, the Company does not recognize this amount in depreciation and amortization expense and revenues. The Company now recognizes operation and maintenance expense and revenues as actual removal and site restoration costs are incurred. As a result of the change in accounting, for the three months ended September 30, 2009, depreciation and amortization expense was \$13.1 million lower, revenues were \$7.0 million lower, and operations and maintenance expense was \$6.1 million higher, resulting in no change in earnings. For the nine months ended September 30, 2009, depreciation and amortization expense was \$40.2 million lower, revenues were \$30.5 million lower, and operations and maintenance expense was \$9.7 million higher, resulting in no change in earnings.

Effective January 1, 2009, the Company also adopted the CICA recommendations requiring the recognition of future income tax assets and liabilities as well as a separate regulatory asset or liability for the amount of future income taxes expected to be included in future rates and recovered from or paid to future customers in the Company's utility operations. As a result of adopting these recommendations, the Company recorded future income tax liabilities and non-current regulatory assets of \$255.6 million at January 1, 2009.

Concurrent with the changes in accounting for rate regulated operations noted above, the Company changed its presentation of changes in regulatory accounts within the statement of cash flows. Certain items relating to changes in rate regulated assets and liabilities that were previously included in investing and financing activities are now reported in operating activities. The inclusion of changes in the non-

current regulatory assets and liabilities in operating activities provides more relevant information on the activities of the Company.

Goodwill and Intangible Assets

Effective January 1, 2009, the Company adopted the CICA recommendations for goodwill and intangible assets which established standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets (including internally developed intangible assets).

This change in accounting has been adopted retrospectively and had the following effect on the consolidated financial statements for the nine months ended September 30, 2009 and September 30, 2008:

- (a) Restatement of opening retained earnings at January 1, 2008, to recognize the prior years' earnings effect of amounts capitalized prior to 2008 that do not meet the definition of intangible assets as now defined by GAAP (refer to Note 2 to the unaudited interim consolidated financial statements for the nine months ended September 30, 2009).
- (b) Reclassification of \$183.2 million included in property, plant and equipment and other assets to intangible assets on the balance sheet at September 30, 2008.
- (c) Reclassification within investing activities of \$29.1 million from purchases of property, plant and equipment to purchases of intangibles for 2008.

Intangible assets mainly include computer software not directly attributable to the operation of property, plant and equipment and land rights and are recorded at cost less accumulated amortization and unamortized contributions by utility customers. The assets are amortized over their useful lives; which are not longer than 10 years for computer software and between 75 and 100 years for land rights.

Intangible assets with finite lives are tested for recoverability whenever events or changes in circumstances indicate a possible impairment. An impairment of intangible assets with finite lives is recognized in earnings when the asset's carrying value exceeds the total cash flows expected from its use and eventual disposition. The impairment loss is then calculated as the difference between the asset's carrying value and its fair value, which is determined using discounted future cash flows.

FUTURE ACCOUNTING CHANGES

International Financial Reporting Standards

The Canadian Accounting Standards Board confirmed in 2008 that the use of International Financial Reporting Standards (IFRS) by publicly accountable enterprises will be required in 2011. 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 Canadian GAAP, but there could be significant differences in recognition, measurement and disclosures that will need to be addressed.

The Company has established a Steering Committee, a project team, and working groups to review the adoption of IFRS. The project team and working groups provide position papers and regular updates to management, the Steering Committee and the Audit Committee. Education sessions have been, and will continue to be, provided for employees, senior management and the Audit Committee to increase knowledge and awareness of IFRS and its impacts.

The Company is participating in various industry groups, including the Canadian Energy Pipeline Association, the Canadian Gas Association and the Canadian Electricity Association. The Company participated in a collaborative process which culminated in the AUC issuing regulations that summarize the rate making accounting procedures and requirements to be used by utilities as a result of adopting IFRS. The direction provided in the AUC regulations will allow the Company to proceed with cost

efficient changes to its financial reporting computer systems. The AUC announced that it will periodically review and amend the material contained in the regulations as circumstances warrant.

The Company's IFRS Conversion Project consists of three phases:

- Assessment and Diagnostic – This phase involves high level assessment to identify the key areas impacted by the transition to IFRS and to identify the International Accounting Standards and Interpretations of those standards applicable to the Company. It also involves assessing each standard and interpretation to identify the changes required to existing accounting policies, information systems and business process. This phase is now complete.
- Design and Planning – This phase involves assessing alternative accounting policies and planning changes that need to be made to financial covenants and internal controls. Preliminary estimates are prepared to show the impact of the quantitative impact of the new standards. This phase is substantially complete.
- Implementation and Review – This phase involves making changes in accounting policies and procedures and financial information systems and training staff on the implementation of the new standards. Financial information in accordance with IFRS is collected in 2010 to allow for comparative reporting in 2011. This phase is in progress.

Position papers on issue-specific accounting differences between Canadian GAAP and IFRS and the impact on financial reporting computer systems are substantially complete and they have been discussed with the Company's auditor. The Company has also made most of the necessary changes to its financial reporting computer systems and has completed its review of the impact of IFRS on financial covenants. As a number of the IFRS standards are changing, the position papers and the impact of IFRS on financial covenants will be updated to reflect any changes resulting from the final standards. The Company is currently evaluating the impact of IFRS on internal controls over financial reporting. A detailed evaluation of the financial impact of the issues identified in the assessment and diagnostic phase will be completed in 2009.

The Company reviews discussion papers, exposure drafts and standards released by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee. On July 23, 2009, the IASB issued an exposure draft on Rate Regulated Activities which is similar in many respects to the current accounting treatment under Canadian GAAP. The impacts of the differences on the Company are currently being analyzed. A final standard is due in mid-2010. The Company will continue to assess the impact of the proposed standards on its financial statements and disclosure as additional information becomes available. Financial impacts cannot be reasonably determined at this time.

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

The Company is party to numerous joint arrangements which currently use proportionate consolidation as the appropriate accounting treatment. Under proportionate accounting, the Company records its proportionate share of the assets, liabilities, revenues and expenses of the joint arrangement. Under the recent IFRS exposure draft, the Company would switch to equity accounting including the net investment in joint venture on the balance sheet and net equity in earnings on the income statement.

The Company is currently party to a number of contracts with customers that will be deemed to be finance leases under IFRS. Under Canadian GAAP, the total revenue received from the customer is recorded on the income statement and the related property, plant and equipment is depreciated evenly over the life of the contract. Under IFRS, property, plant and equipment of a project which is deemed to be a finance lease will effectively be removed from the balance sheet and replaced with a present value

receivable for the lease payments to be received over the remaining life of the arrangement. Payments received from the customer are allocated between revenue and principal payment based on mortgage style calculation.

Employee benefits consist of pensions and other retirement benefits, including life insurance and medical care. IFRS allows an entity to recognize all experience and transitional gains and losses to retained earnings as at January 1, 2010. IFRS also allows an entity to subsequently recognize experience gains and losses in other comprehensive income. The amortization of the net pension gain that would be required under Canadian GAAP is not made under IFRS. The balance sheet also reflects the pension transition adjustment, which was initially recognized upon a change in Canadian GAAP in 2000, to retained earnings as at January 1, 2010.

Financial Instruments Disclosure

The CICA has issued revisions to the disclosures for financial instruments requiring classifications of fair value measurement of financial instruments using a three level fair value hierarchy reflecting the significance of the inputs used in making the measurements. These revisions are effective for the Company's annual reporting for the year ended December 31, 2009.