



An **ATCO** Company

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

**FOR THE NINE MONTHS ENDED
SEPTEMBER 30, 2004**

CU INC.

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

The following discussion and analysis of financial condition and results of operations of CU Inc. (the "Corporation") should be read in conjunction with the Corporation's unaudited comparative interim financial statements for the three and nine months ended September 30, 2004, and the audited comparative financial statements and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2003 ("2003 MD&A"). Information contained in the 2003 MD&A that is not discussed in this document remains substantially unchanged. Additional information relating to the Corporation, including the Corporation's Annual Information Form, is available on SEDAR at www.sedar.com.

The common share capital of the Corporation consists of Class A non-voting shares ("Class A shares") and Class B common shares ("Class B shares").

FORWARD-LOOKING INFORMATION

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

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

CORPORATE REORGANIZATION

In August 2004, the Corporation renamed its Natural Gas and Electric segment as **Utilities**. Its composition has remained unchanged.

BUSINESS OF THE CORPORATION

The Corporation's financial statements are consolidated from two segments: utilities and power generation (see Note 7 to the comparative financial statements). Transactions between segments are eliminated in all reporting of the Corporation's consolidated financial information.

Transfer of the Retail Energy Supply Businesses

On May 4, 2004, ATCO Gas and ATCO Electric closed the transfer of their retail energy supply businesses to Direct Energy Marketing Limited and one of its affiliates (collectively "DEML"), a subsidiary of Centrica plc ("Transfer of the Retail Energy Supply Businesses"). Proceeds of the transfer were \$90 million, of which \$45 million was paid at closing, with the remainder to be paid 12 months following closing. Net proceeds, after adjustments related to legal, transition and other deferred costs pertaining to the transfer of the retail energy supply businesses, resulted in a gain of \$63.3 million before income taxes of \$8.2 million. This transfer increased earnings for the nine months ended September 30, 2004, by \$55.1 million.

The Corporation's revenues and natural gas supply and purchased power costs after May 4, 2004, will be reduced accordingly. Subsequent to May 4, 2004, ATCO Gas continued to purchase natural gas on behalf of DEML, pending the transfer of the relevant ATCO Gas natural gas purchase contracts to DEML. This transfer of contracts was completed by September 30, 2004. There will be no impact on earnings resulting from the transfer of these

businesses as natural gas and electricity have historically been sold to customers on a “no-margin” basis. ATCO Gas and ATCO Electric continue to own and operate the natural gas and electricity distribution systems used to deliver energy.

Under the various transaction agreements, ATCO Gas and ATCO Electric have transferred to DEML certain retail functions, including the supply of natural gas and electricity to customers and billing and customer care functions (the “transferred functions”).

On May 4, 2004, DEML commenced supplying natural gas and electricity at regulated rates to residential, farm and small business customers in the ATCO Gas and ATCO Electric service areas and billing customers for their natural gas and electricity service.

If DEML fails to perform all or part of the transferred functions, ATCO Gas and ATCO Electric will be required under existing legislation to perform such functions in the interim until DEML is able to perform such functions. In certain events (including where DEML fails to supply natural gas and/or electricity and ATCO Gas and/or ATCO Electric are ordered by the AEUB to do so), the agreements will terminate and the functions will revert to ATCO Gas and/or ATCO Electric with no refund of the purchase price to DEML by ATCO Gas and/or ATCO Electric. In certain circumstances, if DEML is restrained or prohibited from carrying out the transferred functions, all functions will revert to ATCO Gas and ATCO Electric and a portion of the purchase price will be refunded to DEML, depending upon the timing of any such reversion.

Centrica plc, DEML’s parent, has provided a \$300 million guarantee supported by a \$235 million letter of credit in respect of DEML’s obligations to ATCO Gas, ATCO Electric and ATCO I-Tek Business Services, an affiliate corporation, in respect of the ongoing relationships contemplated under the transaction agreements. The Centrica guarantee and letter of credit include limits for certain categories of claims, which limits cease to apply if the agreements are terminated. If the amount available to be drawn under the letter of credit at any time falls below \$200 million, the agreements with DEML will terminate and the functions will revert to ATCO Gas and ATCO Electric with no refund of the purchase price to DEML by ATCO Gas and ATCO Electric.

Canadian Utilities Limited has provided a guarantee of ATCO Gas’, ATCO Electric’s and ATCO I-Tek Business Services’ payment and indemnity obligations in respect of the ongoing relationships contemplated under the transaction agreements.

ATCO Gas and ATCO Electric have also agreed not to compete in the regulated and unregulated retail energy business in Alberta for a period of ten years.

In December 2003, the Alberta Energy and Utilities Board (“AEUB”) issued a decision approving the transfer of the retail operations of ATCO Gas and ATCO Electric to DEML. The City of Calgary filed for leave to appeal the AEUB decision, including the allocation of proceeds to ATCO Gas and ATCO Electric. On June 30, 2004, the Alberta Court of Appeal dismissed the City of Calgary’s application for leave to appeal.

SELECTED QUARTERLY INFORMATION

	For the Three Months Ended			
	Mar. 31	Jun. 30	Sep. 30	Dec. 31
	(\$ Millions)			
	(unaudited)			
2004				
Revenues (1)	960.0	480.7	266.3	.....
Earnings attributable to Class A and Class B shares (2) (4) (5)	63.8	80.3	24.0	.....
2003				
Revenues	1,099.2	588.7	430.2	728.1
Earnings attributable to Class A and Class B shares (3) (4) (5)	62.7	32.5	25.2	54.4
2002				
Revenues .....	.....	.....	.....	721.5
Earnings attributable to Class A and Class B shares (3) (4) (5) .....	.....	.....	.....	48.8

Notes:

- (1) Includes the reduction in revenues from the Transfer of the Retail Energy Supply Businesses for the three months ended June 30, 2004, and September 30, 2004.
- (2) Includes the impact of the Transfer of the Retail Energy Supply Businesses for the three months ended June 30, 2004.
- (3) 2003 and 2002 earnings attributable to Class A shares and Class B shares have been restated for retroactive changes in the methods of accounting for asset retirement obligations.
- (4) There were no discontinued operations or extraordinary items during these periods.
- (5) Due to the seasonal nature of the Corporation's operations and the timing of rate decisions, earnings for any quarter are not necessarily indicative of operations on an annual basis.
- (6) As all Class A and Class B shares of the Corporation are owned by Canadian Utilities Limited, the disclosure of earnings per share is not provided as it is not considered to be meaningful.
- (7) The above data has been prepared in accordance with Canadian generally accepted accounting principles and the reporting currency is the Canadian dollar.

RESULTS OF OPERATIONS

The principal factors that caused variations in revenues for the three and nine months ended September 30, 2004, were:

- lower sales of electricity and natural gas purchased for customers on a “no-margin” basis by ATCO Electric and ATCO Gas due to the Transfer of the Retail Energy Supply Businesses (refer to the Transfer of the Retail Energy Supply Businesses section), and lower prices of electricity and natural gas purchased for customers on a “no-margin” basis prior to May 4, 2004 (refer to the Utilities section);
- fluctuations in temperatures (refer to the Utilities section); and
- timing of rate decisions (refer to the Utilities and Regulatory Matters sections).

The principal factors that caused variations in earnings for the three and nine months ended September 30, 2004 were:

- the Transfer of the Retail Energy Supply Businesses (refer to the Transfer of the Retail Energy Supply Businesses and the Utilities sections);
- fluctuations in temperatures (refer to the Utilities section);
- timing of rate decisions (refer to the Utilities and Regulatory Matters sections); and
- timing of plant outages in Alberta Power (2000) (refer to the Power Generation section).

Consolidated Operations

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

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2004	2003	2004	2003
	(\$ Millions) (unaudited)			
Revenues (1).....	266.3	430.2	1,707.0	2,118.1
Earnings attributable to Class A shares and Class B shares (2) (3) (4) (5).....	24.0	25.2	168.1	120.4

Notes:

- (1) Includes the reduction in revenues from the Transfer of the Retail Energy Supply Businesses for the three and nine months ended September 30, 2004.
- (2) Includes the impact of the Transfer of the Retail Energy Supply Businesses for the nine months ended September 30, 2004.
- (3) 2003 earnings attributable to Class A shares and Class B shares have been restated for retroactive changes in the methods of accounting for asset retirement obligations.
- (4) There were no discontinued operations or extraordinary items during these periods.
- (5) Due to the seasonal nature of the Corporation's operations and the timing of rate decisions, earnings for any quarter are not necessarily indicative of operations on an annual basis.
- (6) As all Class A and Class B shares of the Corporation are owned by Canadian Utilities Limited, the disclosure of earnings per share is not provided as it is not considered to be meaningful.
- (7) The above data has been prepared in accordance with Canadian generally accepted accounting principles and the reporting currency is the Canadian dollar.

Revenues for the three months ended September 30, 2004, decreased by \$163.9 million to \$266.3 million, primarily due to:

- lower sales of electricity and natural gas purchased for customers on a “no-margin” basis by ATCO Electric and ATCO Gas due to the Transfer of the Retail Energy Supply Businesses;
- lower cost of service revenues in Alberta Power (2000) for the H.R. Milner generating plant which was sold by the Alberta Balancing Pool on January 29, 2004; and
- lower natural gas volumes purchased for ATCO Pipelines' customers as a result of customers moving from sales service (commodity and transportation revenues) to transportation service contracts (transportation revenue).

This decrease was partially offset by:

- colder temperatures in ATCO Gas for the three months ended September 30, 2004, which were 15.8% colder than normal, compared to 16.0% warmer than normal for the corresponding period in 2003; and
- customer additions in ATCO Gas.

Revenues for the nine months ended September 30, 2004, decreased by \$411.1 million to \$1,707.0 million, primarily due to:

- lower sales of electricity and natural gas purchased for customers on a “no-margin” basis by ATCO Electric and ATCO Gas due to the Transfer of the Retail Energy Supply Businesses, and lower prices of electricity and natural gas purchased for customers on a “no-margin” basis prior to May 4, 2004;
- warmer temperatures in ATCO Gas for the nine months ended September 30, 2004, which were 1.3% colder than normal, compared to 7.5% colder than normal for the corresponding period in 2003;
- lower cost of service revenues in Alberta Power (2000) from the H.R. Milner generating plant which was sold by the Alberta Balancing Pool on January 29, 2004; and
- lower natural gas volumes purchased for ATCO Pipelines' customers as a result of customers moving from sales service (commodity and transportation revenues) to transportation service contracts (transportation revenue).

This decrease was partially offset by:

- customer additions in ATCO Gas.

Earnings attributable to Class A shares and Class B shares for the three months ended September 30, 2004, decreased by \$1.2 million to \$24.0 million, primarily due to:

- negative impact of recent AEUB decisions for ATCO Electric.

For 2002, ATCO Electric's rate of return on common equity was 10.5% and the common equity ratio was 37% for transmission operations and 43% for distribution operations.

The October 2, 2003, AEUB decision respecting the 2003/2004 general tariff application decreased ATCO Electric's rate of return on common equity to 9.4% and the common equity ratio to 32% for transmission operations and 35% for distribution operations. These reductions in the common equity ratios reduced the common equity that ATCO Electric was allowed to earn a return on by \$83.0 million for 2003. The impact of this decision was recorded in the fourth quarter of 2003.

The July 2, 2004, generic cost of capital decision (refer to Regulatory Matters section) revised the rate of return on common equity to 9.6% and the common equity ratio to 33% for transmission operations and 37% for distribution operations beginning in 2004. These increases in the common equity ratios increased the common equity that ATCO Electric is allowed to earn a return on by \$22.3 million for 2004. The impact of this decision was recorded in the third quarter of 2004.

In summary, the negative impacts of the 2003/2004 general tariff decision and the generic cost of capital decision reduced the common equity that ATCO Electric is allowed to earn a return on by \$60.7 million over the two years, 2003 and 2004.

ATCO Electric's 2003/2004 general tariff decision as amended by the generic cost of capital decision is referred to in this MD&A as the "ATCO Electric Decision".

This decrease was partially offset by:

- moderately positive impact of the ATCO Gas AEUB decision respecting the 2003/2004 general rate application that increased ATCO Gas' rate of return on common equity to 9.5% ("ATCO Gas Decision");
- the impact of colder weather in ATCO Gas; and
- customer additions in ATCO Gas.

Earnings attributable to Class A shares and Class B shares for the nine months ended September 30, 2004, **including** the \$55.1 million after tax gain on the Transfer of the Retail Energy Supply Businesses, increased by \$47.7 million to \$168.1 million.

Earnings attributable to Class A shares and Class B shares for the nine months ended September 30, 2004, **excluding** the \$55.1 million after tax gain on the Transfer of the Retail Energy Supply Businesses, decreased by \$7.4 million to \$113.0 million, primarily due to:

- negative impact of the ATCO Electric Decision; and
- warmer temperatures in ATCO Gas.

This decrease was partially offset by

- moderately positive impact of the ATCO Gas Decision; and
- customer additions in ATCO Gas.

Operating expenses (consisting of natural gas supply, purchased power, operation and maintenance, selling and administrative and franchise fee costs) for the three months ended September 30, 2004, decreased by \$154.8 million to \$144.6 million, primarily due to:

- lower costs of electricity and natural gas purchased for customers on a "no-margin" basis by ATCO Electric and ATCO Gas due to the Transfer of the Retail Energy Supply Businesses;

- lower natural gas volumes purchased for ATCO Pipelines' customers as a result of customers moving from sales service (commodity and transportation costs) to transportation service contracts (transportation costs); and
- reduced operating and maintenance costs in Alberta Power (2000) from the H.R. Milner generating plant which was sold by the Alberta Balancing Pool on January 29, 2004.

This decrease was partially offset by:

- higher selling and administrative expenses associated with the impact of the ATCO Gas Decision.

Operating expenses for the nine months ended September 30, 2004, decreased by \$396.1 million to \$1,252.6 million, primarily due to:

- lower costs of electricity and natural gas purchased for customers on a "no-margin" basis by ATCO Electric and ATCO Gas due to the Transfer of the Retail Energy Supply Businesses, and lower costs of electricity and natural gas purchased for customers on a "no-margin" basis prior to May 4, 2004;
- lower natural gas volumes purchased for ATCO Pipelines' customers as a result of customers moving from sales service (commodity and transportation costs) to transportation service contracts (transportation costs); and
- reduced operating and maintenance costs in Alberta Power (2000) from the H.R. Milner generating plant which was sold by the Alberta Balancing Pool on January 29, 2004.

This decrease was partially offset by:

- higher selling and administrative expenses associated with the impact of the ATCO Gas Decision.

Depreciation and amortization expenses for the three months ended September 30, 2004, increased by \$1.2 million to \$48.2 million, primarily due to:

- capital additions in 2004 and 2003.

Depreciation and amortization expenses for the nine months ended September 30, 2004, increased by \$8.3 million to \$158.9 million, primarily due to:

- capital additions in 2004 and 2003.

Interest expense for the three months ended September 30, 2004, decreased by \$1.2 million to \$34.9 million, primarily due to:

- reduced interest expense associated with the \$100.0 million of 8.73% Debentures 1994 Series redeemed June 1, 2004, and the \$60.0 million of 7.25% Debentures redeemed September 24, 2003.

This decrease was partially offset by:

- interest expense associated with the issue in January 2004 of \$180.0 million of 5.432% Debentures.

Interest expense for the nine months ended September 30, 2004, decreased by \$0.3 million to \$107.8 million, primarily due to:

- reduced interest expense associated with the \$100.0 million of 8.73% Debentures 1994 Series redeemed June 1, 2004, and the \$60.0 million of 7.25% Debentures redeemed September 24, 2003.

This decrease was partially offset by:

- interest expense associated with the issue in January 2004 of \$180.0 million of 5.432% Debentures.

Interest and other income for the three months ended September 30, 2004, increased by \$0.3 million to \$1.8 million, primarily due to:

- increased interest income on higher cash balances.

This increase was partially offset by:

- lower rates of interest earned on cash balances.

Interest and other income for the nine months ended September 30, 2004, increased by \$0.9 million to \$5.0 million, primarily due to:

- increased interest income on higher cash balances.

This increase was partially offset by:

- lower rates of interest earned on cash balances.

Income taxes for the three months ended September 30, 2004, decreased by \$7.6 million to \$12.9 million, primarily due to:

- lower earnings; and
- lower Alberta income tax rates.

Income taxes for the nine months ended September 30, 2004, **including** the \$8.2 million of income taxes resulting from the Transfer of the Retail Energy Supply Businesses, decreased by \$6.5 million to \$77.4 million.

Income taxes for the nine months ended September 30, 2004, **excluding** the \$8.2 million of income taxes resulting from the Transfer of the Retail Energy Supply Businesses, decreased by \$14.7 million to \$69.2 million, primarily due to:

- lower earnings; and
- lower Alberta income tax rates.

Segmented revenues for the three and nine months ended September 30, 2004, were as follows:

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2004	2003	2004	2003
	(\$ Millions) (unaudited)			
Utilities (1).....	193.7	351.2	1,491.1	1,885.8
Power Generation	72.6	80.9	218.2	237.1
Corporate and Other	-	-	-	-
Intersegment eliminations.....	-	(1.9)	(2.3)	(4.8)
Total.....	266.3	430.2	1,707.0	2,118.1

Note:

(1) Includes the reduction in revenues from the Transfer of the Retail Energy Supply Businesses for the three and nine months ended September 30, 2004.

Segmented earnings attributable to Class A and Class B shares for the three and nine months ended September 30, 2004, were as follows:

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2004	2003	2004	2003
	(\$ Millions) (unaudited)			
Utilities (1).....	10.1	11.8	130.0	79.6
Power Generation (2).....	13.5	13.4	37.1	40.8
Corporate and Other	0.4	-	1.0	-
Intersegment eliminations.....	-	-	-	-
Total.....	24.0	25.2	168.1	120.4

Notes:

(1) The earnings for the nine months ended September 30, 2004, include earnings of \$55.1 million from the Transfer of the Retail Energy Supply Businesses.

(2) 2003 earnings have been restated for a retroactive change in the method of accounting for asset retirement obligations.

Utilities

Revenues from Utilities operations for the three months ended September 30, 2004, decreased by \$157.5 million to \$193.7 million, primarily due to:

- lower sales of electricity and natural gas purchased for customers on a “no-margin” basis by ATCO Electric and ATCO Gas due to the Transfer of the Retail Energy Supply Businesses; and
- lower natural gas volumes purchased for ATCO Pipelines’ customers as a result of customers moving from sales service (commodity and transportation revenues) to transportation service contracts (transportation revenue).

This decrease was partially offset by:

- colder temperatures in ATCO Gas for the three months ended September 30, 2004, which were 15.8% colder than normal, compared to 16.0% warmer than normal for the corresponding period in 2003; and
- customer additions in ATCO Gas.

Revenues for the nine months ended September 30, 2004, decreased by \$394.7 million to \$1,491.1 million, primarily due to:

- lower sales of electricity and natural gas purchased for customers on a “no-margin” basis by ATCO Electric and ATCO Gas due to the Transfer of the Retail Energy Supply Businesses, and lower prices of electricity and natural gas purchased for customers on a “no-margin” basis prior to May 4, 2004;
- warmer temperatures in ATCO Gas for the nine months ended September 30, 2004, which were 1.3% colder than normal, compared to 7.5% colder than normal for the corresponding period in 2003; and
- lower natural gas volumes purchased for ATCO Pipelines’ customers as a result of customers moving from sales service (commodity and transportation revenues) to transportation service contracts (transportation revenue).

This decrease was partially offset by:

- customer additions in ATCO Gas.

Earnings for the three months ended September 30, 2004, decreased by \$1.7 million to \$10.1 million, primarily due to:

- negative impact of the ATCO Electric Decision.

This decrease was partially offset by:

- moderately positive impact of the ATCO Gas Decision;
- colder temperatures in ATCO Gas; and
- increased earnings related to ATCO Gas’ customer additions.

Earnings for the nine months ended September 30, 2004, **including** the \$55.1 million after tax gain on the Transfer of the Retail Energy Supply Businesses, increased by \$50.4 million to \$130.0 million.

Earnings for the nine months ended September 30, 2004, **excluding** the \$55.1 million after tax gain on the Transfer of the Retail Energy Supply Businesses, decreased by \$4.7 million to \$74.9 million, primarily due to:

- negative impact of the ATCO Electric Decision; and
- warmer temperatures in ATCO Gas.

This decrease was partially offset by:

- moderately positive impact of the ATCO Gas Decision; and
- increased earnings related to ATCO Gas’ customer additions.

On August 30, 2004, ATCO Electric completed construction of a \$99.0 million, 350 kilometre 240 kilovolt transmission line between Fort McMurray and Whitefish Lake. The project included three substations and the expansion of an existing substation. Construction was completed in 10 months. Typically, a project of this scale and complexity is constructed over two years.

Power Generation

Revenues from the power generation operations for the three months ended September 30, 2004, decreased by \$8.3 million to \$72.6 million, primarily as a result of:

- lower cost of service revenues in Alberta Power (2000) for the H.R. Milner generating plant which was sold by the Alberta Balancing Pool on January 29, 2004.

Revenues for the nine months ended September 30, 2004, decreased by \$18.9 million to \$218.2 million, primarily as a result of:

- lower cost of service revenues in Alberta Power (2000) for the H.R. Milner generating plant which was sold by the Alberta Balancing Pool on January 29, 2004; and
- lower energy charges due to the timing of plant outages.

Earnings for the three months ended September 30, 2004, increased by \$0.1 million to \$13.5 million, essentially unchanged.

Earnings for the nine months ended September 30, 2004, decreased by \$3.7 million to \$37.1 million, primarily due to:

- lower energy charges due to the timing of plant outages; and
- lower cost of service revenues in Alberta Power (2000) from the H.R. Milner generating plant which was sold by the Alberta Balancing Pool on January 29, 2004.

During the three months ended September 30, 2004, the deferred availability incentive account increased by \$15.8 million to \$38.0 million. The increase was primarily due to the receipt of \$10.4 million from the Battle River arbitration decision (refer to Business Risks – Alberta Power (2000) section) and additional availability incentive payments received for improved plant availability. During the three months ended September 30, 2004, the amortization of deferred availability incentives, recorded in revenues, increased by \$0.3 million to \$2.0 million.

During the nine months ended September 30, 2004, the deferred availability incentive account decreased by \$5.3 million to \$38.0 million. The decrease was primarily due to planned outages at the Sheerness generating plant, partially offset by \$10.4 million from the Battle River arbitration decision (refer to Business Risks-Alberta Power (2000) section). During the nine months ended September 30, 2004, the amortization of deferred availability incentives recorded in revenues was \$5.6 million.

REGULATORY MATTERS

Regulated operations are conducted by ATCO Electric, the ATCO Gas and ATCO Pipelines divisions of ATCO Gas and Pipelines Ltd., CU Water, and the generating plants of Alberta Power (2000), all of which are wholly owned subsidiaries of the Corporation.

In December 2003, the AEUB issued a decision approving the implementation of the “One Bill Model” no later than April 1, 2004. The One Bill Model is designed to ensure that customers who choose to purchase their natural gas requirements from a retailer will receive only one bill for natural gas service. Previously, customers would receive a bill from the retailer for the purchase of the commodity and a separate bill from ATCO Gas for the delivery service. ATCO Gas has now completed implementation of this process.

In July 2004, the AEUB issued its generic cost of capital decision. The decision established a standardized approach for each utility company regulated by the AEUB for determining the rate of return on common equity based upon a return of 9.60% on common equity. This rate of return will be adjusted annually by 75% of the change in long term Canada bond yield as forecast in the November Consensus Forecast, adjusted for the average difference between the 10 year and 30 year Canada bond yields for the month of October as reported in the National Post. This adjustment mechanism is the same as the National Energy Board uses in determining its formula based rate of return. The AEUB will undertake a review of this mechanism for the year 2009 or if the rate of return resulting from the formula is less than 7.6% or greater than 11.6%. The AEUB also noted that any party, at any time, could petition for a review of the adjustment formula if that party can demonstrate a material change in facts or circumstances.

The decision also established the appropriate capital structure for each utility regulated by the AEUB. The AEUB determined that any proposed changes to the approved capital structure which result from a material change in the investment risk of a utility will be addressed at utility specific rate applications.

ATCO Electric

For 2002, ATCO Electric's rate of return on common equity was 10.5% and the common equity ratio was 37% for transmission operations and 43% for distribution operations. In a decision dated October 2, 2003, the AEUB approved, among other things, a rate of return on common equity of 9.40% and a common equity ratio of 32% for ATCO Electric's transmission operations and 35% for its distribution operations for 2003. These reductions in the common equity ratios reduced the common equity that ATCO Electric is allowed to earn a return on by \$83.0 million for 2003. ATCO Electric, as directed by the AEUB, refiled the 2003 and 2004 revenue requirements, incorporating the findings in the decision. In a decision dated February 17, 2004, the AEUB issued its final determination of the revenue requirements for the 2003 and 2004 test years, accepting the refiling with no material changes. Certain matters relating to transactions with affiliates will be addressed in separate proceedings. In a decision dated July 2, 2004, the AEUB issued its generic cost of capital decision which approved, among other things, a return on common equity of 9.60% for 2004 and a common equity ratio of 33% for ATCO Electric's transmission operations and 37% for its distribution operations beginning in 2004. These increases in the common equity ratios increased the common equity that ATCO Electric is allowed to earn a return on by \$22.3 million for 2004.

In March 2004, ATCO Electric filed an application to settle several deferral account balances and to revise the 2004 interim distribution tariff to incorporate the AEUB decision regarding the revenue requirements for the 2003 and 2004 test years. In the application, ATCO Electric requested that an interim net refund rider be implemented for the period May 1, 2004, to December 31, 2004, to refund a total of approximately \$43 million to customers. On April 22, 2004, the AEUB approved this application as filed. This refund has no impact on earnings. ATCO Electric submitted a Phase II application to finalize the interim distribution tariff on May 21, 2004. The hearing is scheduled to commence on November 9, 2004.

ATCO Gas

In December 2002, the AEUB issued a decision approving rates for ATCO Gas on an interim basis effective January 1, 2003. In a decision dated October 1, 2003, the AEUB approved for ATCO Gas, among other things, a rate of return on common equity of 9.50% for 2003 and 2004 and a common equity ratio of 37% for 2003 and 2004. ATCO Gas, as directed by the AEUB, refiled the 2003 and 2004 general rate application, incorporating the findings in the decision. In a decision dated June 15, 2004, the AEUB issued its final determination of the revenue requirements for the 2003 and 2004 test years, accepting the refiling with no material changes. Certain matters relating to transactions with affiliates will be addressed in separate proceedings. In a decision dated July 2, 2004, the AEUB issued its generic cost of capital decision which approved, among other things, ATCO Gas' common equity ratio of 38% beginning in 2005. As ATCO Gas' return on common equity for 2004 was already established, the standardized approach approved by the AEUB for determining the return on common equity (as described above) will be applied beginning in 2005.

In October 2001, the AEUB approved the sale by ATCO Gas of certain properties located in the City of Calgary, known as the Calgary Stores Block, for \$6.6 million (excluding costs of disposition) and subsequently issued a decision allocating \$4.1 million of the proceeds to customers, and \$1.8 million to ATCO Gas. Leave to appeal this decision was granted on July 12, 2002. On January 27, 2004, the Alberta Court of Appeal issued a decision which overturned the AEUB decision and directed the AEUB to allocate \$5.4 million of the proceeds to ATCO Gas. Subsequent to the receipt of this decision, the AEUB and the City of Calgary filed for leave to appeal the Alberta Court of Appeal decision to the Supreme Court of Canada. On October 7, 2004, the Supreme Court of Canada announced that the leave to appeal brought by the City of Calgary was granted with costs to the City of Calgary in any event of the cause. The application of ATCO Gas for leave to cross-appeal the Alberta Court of Appeal decision was also granted. In addition, the Supreme Court of Canada announced that the AEUB may participate as an intervenor and present arguments limited to the issue of its jurisdiction. Should the AEUB wish to pursue its application for leave to appeal, it will advise the Registrar accordingly within 10 days and an oral hearing will be ordered to address the question of the AEUB's standing to bring an application for leave to appeal. In the event the AEUB does not so advise, its leave application will be dismissed with no order as to costs. Accordingly, ATCO Gas has not yet recorded the impact of the Alberta Court of Appeal decision.

In March 2004, the AEUB issued a decision respecting the operation of ATCO Gas' Carbon storage facility for the 2004/2005 storage year. The decision, among other things, directed ATCO Gas to reserve 16.7 petajoules of storage capacity for utility customers and allowed ATCO Midstream to continue to utilize the remaining uncontracted capacity at a rate of \$0.45 per gigajoule, up from \$0.41 per gigajoule. On March 31, 2004, ATCO Gas filed for leave to appeal this decision to the Alberta Court of Appeal. A hearing to address the leave to appeal was held on September 14, 2004 with a decision from the Alberta Court of Appeal to follow. In July 2004, the AEUB initiated a written process, commencing August 16, 2004, to consider its role in regulating the operations of the Carbon storage facility.

ATCO Gas has filed an application with the AEUB to address, among other things, corrections required to historical transportation imbalances that have impacted ATCO Gas' deferred gas account. The application requests a recovery of approximately \$11.3 million from ATCO Gas' south customers, and a refund of approximately \$2.0 million to ATCO Gas' north customers. A decision from the AEUB is expected in 2004 or in the first quarter of 2005.

ATCO Pipelines

In a decision dated December 2, 2003, the AEUB approved for ATCO Pipelines, among other things, a rate of return on common equity of 9.50% and a common equity ratio of 43.5% for 2003. ATCO Pipelines, as directed by the AEUB, refiled the 2003 and 2004 general rate application, incorporating the findings in the decision. In a decision dated March 9, 2004, the AEUB approved interim rates to be effective from March 1, 2004 to October 31, 2004. In a decision dated April 30, 2004, the AEUB accepted the refiled of the revenue requirements for the 2003 and 2004 test years with no material changes. In a decision dated July 13, 2004, the AEUB awarded additional revenue with respect to the revenue forecasts of certain industrial customers. Certain matters relating to transactions with affiliates will be addressed in separate proceedings. In a decision dated July 2, 2004, the AEUB issued its generic cost of capital decision which approved, among other things, ATCO Pipelines' return on common equity of 9.60% for 2004 and a common equity ratio of 43% beginning in 2004.

In October 2003, ATCO Pipelines filed a 2004 Phase II general rate application for new rates. In a decision dated September 24, 2004, the AEUB substantially accepted ATCO Pipelines' rate design proposals. However, the AEUB deferred competitive issues between ATCO Pipelines and NOVA Gas Transmission Ltd. to a competitive proceeding to be held in 2005. In the decision, the AEUB confirmed that it intends to canvass interested parties, likely in the fall of 2004, to assist in developing the scope of the competitive proceeding.

LIQUIDITY AND CAPITAL RESOURCES

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

Cash flow from operations for the three months ended September 30, 2004, increased by \$16.2 million to \$87.5 million, primarily due to:

- increased availability incentives in Alberta Power (2000), primarily due to recovery of \$10.4 million of availability incentive payments (refer to Business Risks – Alberta Power (2000) section) and availability incentive payments received for improved plant availability.

This increase was partially offset by:

- lower earnings.

Cash flow from operations for the nine months ended September 30, 2004, decreased by \$5.1 million to \$270.7 million, primarily due to:

- payments made by Alberta Power (2000) with respect to availability incentive payments due to planned plant outages, partially offset by the recovery of \$10.4 million of availability incentive payments (refer to Business Risks – Alberta Power (2000) section); and
- lower earnings.

Investing for the three months ended September 30, 2004, increased by \$16.0 million to \$108.6 million, primarily due to:

- higher capital expenditures; and
- changes in non-cash working capital.

Capital expenditures for the three months ended September 30, 2004, increased by \$5.2 million to \$110.3 million, primarily due to:

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

Investing for the nine months ended September 30, 2004, increased by \$42.7 million to \$277.7 million, primarily due to:

- higher capital expenditures; and
- reduced recoveries of non-current deferred electricity costs.

This increase was partially offset by:

- proceeds from the Transfer of the Retail Energy Supply Businesses; and
- changes in non-cash working capital.

Capital expenditures for the nine months ended September 30, 2004, increased by \$79.7 million to \$322.2 million, primarily due to:

- increased investment in electric transmission projects.

During the three months ended September 30, 2004, the Corporation **issued**:

- \$96.0 million of notes payable, which resulted in a net debt increase of \$96.0 million.

During the nine months ended September 30, 2004, the Corporation **issued**:

- \$96.0 million of notes payable; and
- \$180.0 million of 5.432% Debentures due January 23, 2019.

During the nine months ended September 30, 2004, the Corporation **redeemed**:

- \$100.0 million of 8.73% Debentures 1994 Series due June 1, 2004.

These changes resulted in a **net debt increase** of \$176.0 million.

Contractual obligations for the next five years have been updated from disclosure provided in the 2003 MD&A. As at September 30, 2004, contractual obligations have been reduced by approximately \$1 billion from the amounts disclosed at December 31, 2003. This decrease is primarily due to reduced ATCO Gas natural gas purchase contracts deriving from the Transfer of the Retail Energy Supply Businesses (refer to Transfer of the Retail Energy Supply Businesses and Business Risks – Transfer of Retail Energy Supply Businesses sections). There will be no impact on future earnings resulting from this reduction in contractual obligations as natural gas has historically been sold to customers on a “no-margin” basis.

BUSINESS RISKS

Transfer of the Retail Energy Supply Businesses

Although ATCO Gas and ATCO Electric have transferred to DEML certain retail functions, including the supply of natural gas and electricity to customers and billing and customer care functions, ATCO Gas and ATCO Electric remain legally obligated to perform these functions if DEML fails to perform. If DEML fails to perform all or part of the transferred functions, ATCO Gas and ATCO Electric will be required under existing legislation to perform such functions in the interim until DEML is able to perform such functions. In certain events (including where DEML fails to supply natural gas and/or electricity and ATCO Gas and/or ATCO Electric are ordered by the AEUB to do so), the functions will revert to ATCO Gas and/or ATCO Electric with no refund of the purchase price to DEML by ATCO Gas and/or ATCO Electric. In certain circumstances, if DEML is restrained or prohibited from carrying out the transferred functions, all functions will revert to ATCO Gas and ATCO Electric and a portion of the purchase price will be refunded to DEML, depending upon the timing of any such reversion. In the event of a reversion of such functions, ATCO Gas and ATCO Electric could incur costs related to commodity procurement, transportation and delivery charges and various regulatory costs.

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

Canadian Utilities Limited has provided a guarantee of ATCO Gas', ATCO Electric's and ATCO I-Tek Business Services' payment and indemnity obligations in respect of the ongoing relationships contemplated under the transaction agreements.

As a result of the agreements with DEML, ATCO Gas and ATCO Electric are no longer involved in arranging for the supply and sale of natural gas and electricity to customers, but will continue to own the assets and provide transportation and distribution services under AEUB approved rates that provide for a recovery of costs of service and fair return.

In December 2003, the AEUB issued a decision approving the transfer of the retail operations of ATCO Gas and ATCO Electric to DEML. The City of Calgary filed for leave to appeal the AEUB decision, including the allocation of proceeds to ATCO Gas and ATCO Electric. On June 30, 2004, the Alberta Court of Appeal dismissed the City of Calgary's application for leave to appeal.

Late Payment Penalties on Utility Bills

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

Alberta Power (2000)

As a result of unprecedented drought conditions, the water level in the cooling pond used by the Battle River generating plant in its production of electricity had fallen to an all-time low in early 2003, and the Corporation made a force majeure claim in respect of short term curtailed plant production which was experienced during the first quarter of 2003. On August 11, 2004, an arbitration tribunal appointed under the Battle River Power Purchase Arrangement ("Battle River PPA") determined that Alberta Power (2000) is entitled to recovery of \$10.4 million of availability incentive payments, plus interest, from EPCOR Utilities Inc. ("EPCOR"), the counterparty to the Battle River PPA. The decision of the arbitration tribunal is final and binding. This decision will not impact Alberta Power (2000)'s 2004 earnings. The \$10.4 million of availability incentive payments plus interest, less costs associated with the arbitration proceedings, has been recorded in Alberta Power (2000)'s deferred availability incentive balance sheet account.

To date in 2004, the Battle River generating plant's water levels are below those of 2003 which has required the Corporation to limit generation to avoid exceeding the environmental license temperature limitations. The

Corporation has made force majeure claims for the period June 24, 2004, to July 4, 2004, and the period July 13, 2004 to July 26, 2004. The outcome of the 2004 force majeure claims is not known at this time.

Insurance Coverage

On October 14, 2004, the Attorney General of the State of New York filed suit against Marsh & McLennan. Certain insurance companies were also named in the suit, including American International Group and Ace Ltd. These insurers provide a portion of the Corporation's insurance coverage. The Corporation is unable at this time to determine what impact, if any, the suit may have on the ability of the insurers mentioned to pay any corporate insurance claims which may arise.

CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2004, the Corporation retroactively adopted the Canadian Institute of Chartered Accountants ("CICA") recommendations on accounting for asset retirement obligations as described below. The prior year's financial statements have been restated for the change in the method of accounting for asset retirement obligations.

The CICA recommendations on accounting for asset retirement obligations require the Corporation to identify legal obligations associated with the retirement of tangible long lived assets. To the extent that they can be quantified, these obligations are measured and recognized at fair value, which is determined using present value techniques. An asset retirement obligation is recorded as a liability, with a corresponding increase to property, plant and equipment. The liability is accreted over the estimated time period until settlement of the obligation, with the accretion expense included in depreciation and amortization. The asset is depreciated over its estimated useful life. Prior to January 1, 2004, site restoration and removal costs that are now accounted for as asset retirement obligations were accrued over the estimated remaining useful lives of the assets.

Asset retirement obligations for regulated natural gas and electric transmission and distribution assets were not recognized as the Corporation expects to use the assets in service for an indefinite period. As such, no final removal date can be determined and, consequently, a reasonable estimate of the related retirement obligations cannot be made at this time. Asset retirement obligations have been recorded for the regulated generating plants of Alberta Power (2000).

The effect of adopting these recommendations is presented as increases (decreases) below:

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2004	2003	2004	2003
	(\$ Millions) (unaudited)			
<i>Statement of earnings</i>				
Depreciation and amortization	(0.2)	(0.4)	(0.8)	(1.5)
Accretion expense, included in depreciation and amortization	0.3	0.4	1.1	1.1
Earnings attributable to Class A and Class B shares	(0.1)	-	(0.3)	0.4

	January 1 2003
	(\$ Millions) (unaudited)

Balance sheet

Retirement assets and site restoration and removal costs, included in property, plant and equipment	20.4
Asset retirement obligations, included in deferred credits	24.5
Retained earnings at beginning of period	(4.1)

Changes in asset retirement obligations are summarized below:

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2004	2003	2004	2003
	(\$ Millions) (unaudited)			
Obligations at beginning of period	26.7	25.2	25.9	24.5
Accretion expense.....	0.3	0.4	1.1	1.1
Obligations at end of period	27.0	25.6	27.0	25.6

The Corporation estimates the undiscounted amount of cash flow required to settle the asset retirement obligations is approximately \$63 million, which will be incurred between 2005 and 2026. A weighted average discount rate of 5.9% was used to calculate the fair value of the asset retirement obligations.

Effective January 1, 2004, the Corporation prospectively adopted the CICA recommendations on accounting for asset impairment. These recommendations require an impairment of property, plant and equipment, intangible assets with finite lives, deferred operating costs and long term prepaid expenses to be 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 present value techniques. This change in accounting had no effect on earnings for the three and nine months ended September 30, 2004.

Effective January 1, 2004, the Corporation prospectively adopted the CICA recommendations that define the primary sources of GAAP. While the recommendations encourage the application of the primary sources of GAAP to all operations, the recommendations do not require that assets and liabilities arising from rate regulation be recognized and measured in accordance with the primary sources of GAAP. The Corporation has chosen to retain its existing accounting policies for its regulated operations, which are permitted by GAAP.

October 27, 2004