

EPCOR Utilities Inc.

Interim Management's Discussion and Analysis

June 30, 2010

This management's discussion and analysis (MD&A), dated August 6, 2010, should be read in conjunction with the unaudited interim consolidated financial statements of EPCOR Utilities Inc. and its subsidiaries for the three and six months ended June 30, 2010 and 2009, the audited consolidated financial statements and MD&A for the year ended December 31, 2009 and the cautionary statement regarding forward-looking information on page 17. In this MD&A, any reference to "the Company", "EPCOR", "we", "our" or "us", except where otherwise noted or the context otherwise indicates, means EPCOR Utilities Inc., together with its subsidiaries. In this MD&A, Capital Power refers to Capital Power Corporation and its directly and indirectly owned subsidiaries including Capital Power L.P., except where otherwise noted or the context otherwise requires. Financial information in this MD&A is based on the unaudited interim consolidated financial statements, which were prepared in accordance with Canadian generally accepted accounting principles (GAAP), and is presented in Canadian dollars unless otherwise specified. In accordance with its terms of reference, the Audit Committee of the Company's Board of Directors reviews the contents of the MD&A and recommends its approval by the Board of Directors. The Board of Directors has approved this MD&A.

OVERVIEW

EPCOR is wholly owned by the City of Edmonton (the City). We build, own and operate electrical transmission and distribution networks as well as water and wastewater treatment facilities and infrastructure in Canada. We also provide energy and water services to residential and commercial customers. Our electricity, water and energy services businesses consist primarily of rate-regulated and long-term commercial operations. Our continuous improvement objective is to continue to seek out ways of maximizing the efficiency of our electricity and water operations. The long-term outlook for the North American electricity, water and wastewater treatment businesses remains relatively strong.

EPCOR's operations performed well in the second quarter without any significant issues or disruptions to customers. Results from operations for the quarter were on plan.

While EPCOR reported an \$8 million net loss and \$79 million in net income for the three and six month periods ended June 30, 2010, respectively, compared to \$50 million in net income and \$154 million in net income for the comparative periods in 2009, net income from EPCOR's current core operations was \$12 million and \$19 million higher this quarter and for the six months, respectively, than the corresponding periods in 2009, as explained in more detail below. The strong results from EPCOR operations for the quarter ended June 30, 2010 were more than offset by the Company's \$27 million equity share in the net loss of Capital Power.

Progress related to our 2010 capital expenditure plan continued on plan in the second quarter. This plan is aimed towards improving our infrastructure and increasing its capacity to meet the growing demands for treated water and electricity. Work on two significant projects for 2010, the construction of two additional digesters at the Gold Bar wastewater treatment plant and construction of the Summerside substation in southeast Edmonton, progressed as planned. In addition, work on a number of other significant capital projects for 2010 commenced this quarter.

On June 7, 2010, EPCOR signed an agreement for the acquisition of all outstanding shares of Chaparral City Water Company (Chaparral). Chaparral, a subsidiary of American States Water Company, is a public utility company engaged principally in the purchase, production, distribution, and sale of water to

approximately 13,000 customers in the Town of Fountain Hills, Arizona and a small portion of Scottsdale, Arizona. The US\$29 million acquisition, which is subject to regulatory approval by the Arizona Corporation Commission, is expected to close in 2011.

CONSOLIDATED RESULTS OF OPERATIONS

Note on Comparisons

For the first half of 2009, EPCOR owned or controlled all of the power generation assets and related operations, including Capital Power Income L.P. (formerly EPCOR Power L.P.) (CPILP), that were sold to Capital Power in July 2009. Accordingly, net income, results of operations and variances for the first half of 2009 include power generation net income, results of operations and variances presented on a consolidated basis. After the sale of the power generation business and related operations in July 2009, we no longer controlled those operations. Consequently, the second quarter and six months results of 2010 and the results going forward no longer present the power generation business and related operations on a consolidated basis. The related financial statement line items and variances are, in effect, replaced by EPCOR's interest in Capital Power reported on the equity basis. When making period-over-period comparisons, the results for the second quarter and six months of 2010 reflect the retained interest in the power generation business in the form of an equity investment in Capital Power while the second quarter and six months in 2009 reflect the power generation business on a consolidated basis. In this context, the results of operations are discussed below.

Net income

(Unaudited, \$ millions)	Three		Six	
	months		months	
Net income for the periods ended June 30, 2009	\$	50	\$	154
Net income related to the power generation business that was sold effective July 2009		(43)		(143)
Equity (loss) income from Capital Power in 2010		(27)		49
		(20)		60
Higher Energy Services margin		4		4
Higher Distribution and Transmission operating income		4		5
Higher income from commercial water operations		3		6
Higher Gold Bar operating income		-		7
Higher depreciation expenses, excluding amounts related to the power generation business		(1)		(4)
Other		2		1
Increase in net income from core operations		12		19
Net (loss) income for the periods ended June 30, 2010	\$	(8)	\$	79

Results for the three and six months ended June 30, 2010 were a net loss of \$8 million and net income of \$79 million respectively, compared with net income of \$50 million and \$154 million for the corresponding periods in 2009. Explanations of the primary period-over-period variances are as follows and should be read in conjunction with the Note on Comparisons above:

- Net income related to the power generation business reflects the net results of this business for the three and six month periods ended June 30, 2009. See Segment Results – Energy Services and Segment Results – Generation.
- Energy Services margin was higher in the three and six months ended June 30, 2010 compared to the corresponding periods in 2009 due to higher billed versus settled electricity prices as well as higher billing charges rates.

- Distribution and Transmission operating income, before administration and depreciation expenses, was higher in the three and six months ended June 30, 2010 compared to the corresponding periods in 2009 due to customer refunds in 2009 related to property tax flow-through costs.
- Income from commercial water operations was higher due to the additional water and wastewater treatment plant operations in the Alberta oil sands energy sector which commenced in the fourth quarter of 2009.
- Gold Bar operating income, was higher in the six months ended June 30, 2010 compared with the corresponding period in 2009 as a result of the transfer of the Gold Bar operation to EPCOR from the City on March 31, 2009.
- Depreciation expense, excluding amounts related to the power generation business, was higher in the three and six months ended June 30, 2010 compared with the corresponding period in 2009 primarily due to Gold Bar and rate-regulated Water asset additions.

Revenues

(Unaudited, \$ millions)	Three months	Six months
Revenues for the periods ended June 30, 2009	\$ 735	\$ 1,631
Decreases related to the power generation business that was sold July 2009	(439)	(976)
	296	655
Interest revenue in 2010 on long-term loans receivable from Capital Power	15	30
Higher Gold Bar revenues in 2010	1	14
Higher revenue from commercial water operations	9	7
Higher (lower) regulated rate tariff electricity revenues	21	(29)
Higher Distribution and Transmission revenues	21	24
Increase in revenues from remaining operations	67	46
Revenues for the periods ended June 30, 2010	\$ 363	\$ 701

Consolidated revenues were lower for the three and six months ended June 30, 2010 compared with the corresponding periods in 2009 primarily due to the net impact of the following and should be read in conjunction with the Note on Comparisons above:

- The most significant factor contributing to the decrease relates to revenues reflected in the three and six months ended June 30, 2009 of the power generation business that was sold in July 2009.
- Interest revenue was earned in relation to the long-term loans receivable from Capital Power in connection with the sale of the power generation business in July 2009.
- Gold Bar revenues were higher in the three and six months ended June 30, 2010 compared with the corresponding periods in 2009 primarily due to higher rates and the transfer of the Gold Bar operation to EPCOR from the City on March 31, 2009.
- Higher commercial water revenues were primarily as a result of additional water and wastewater treatment operations in the Alberta oil sands energy sector in 2010.
- The increase in regulated rate tariff electricity revenues in the three months ended June 30, 2010 compared with the corresponding period in 2009 was mainly due to higher distribution and transmission system flow-through charges as well as higher electricity prices. The decrease in regulated rate tariff electricity revenues in the six months ended June 30, 2010 compared with the corresponding period in 2009 was primarily due to lower electricity prices in the first quarter of 2010 compared with the first quarter of 2009.

- Higher Distribution and Transmission revenues for three months and six months ended June 30, 2010 were primarily due to the rate increases associated with higher system access costs.

Capital Spending and Investment

(Unaudited, \$ millions)			
Six months ended June 30	2010	2009	
Distribution and Transmission	\$ 47	\$ 36	
Water Services	32	26	
Energy Services	-	7	
Corporate	2	7	
	81	76	
Generation	-	228	
	\$ 81	\$ 304	

Capital expenditures for property, plant and equipment were lower for the six months ended June 30, 2010 compared with the corresponding period in 2009 primarily due to the sale of the power generation business in July 2009. Capital spending in Distribution and Transmission was higher primarily due to the Summerside substation project and higher power pole and line upgrade capital expenditures. Higher capital spending in the Water Services segment was primarily due to construction on the new digesters at Gold Bar.

Segment Results

Distribution and Transmission

(Unaudited, \$millions)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Distribution and Transmission results (including intersegment transactions)				
Revenues	\$ 74	\$ 52	\$143	\$ 118
Expenses	64	46	121	100
Operating income	\$ 10	\$ 6	\$ 22	\$ 18

Distribution and Transmission operating income increased \$4 million respectively for both the three and six months ended June 30, 2010. The increase in operating income for both periods was due primarily to customer refunds recorded in 2009 related to Distribution and Transmission's flow-through property taxes.

Energy Services

(Unaudited, \$millions)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Energy Services results (including intersegment transactions)				
Revenues	\$ 205	\$ 381	\$ 412	\$ 970
Expenses	200	360	402	878
Operating income before sale of energy trading operations	5	21	10	92
Operating income in the first quarter of 2009 related to energy trading operations sold in July 2009	-	(23)	-	(88)
Operating income	\$ 5	\$ (2)	\$ 10	\$ 4

Energy Services' operating income decreased \$16 million and \$82 million for the three and six months ended June 30, 2010 respectively from the corresponding periods in 2009. Of the total decreases, \$23

million and \$88 million for the three and six months ended June 30, 2010 respectively, were due to the sale of the energy trading operations sold with the power generation business in July 2009. These decreases were partially offset by increases of \$7 million and \$6 million respectively for the three and six months ended June 30, 2010, primarily due to higher Energy Services margin as a result of higher billed versus settled electricity prices and higher billing charges rates.

Water Services

(Unaudited, \$millions)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Water Services results (including intersegment transactions)				
Revenues	\$ 102	\$ 92	\$ 181	\$ 159
Expenses	79	76	143	133
Operating income	\$ 23	\$ 16	\$ 38	\$ 26

Water Services' operating income increased \$7 million and \$12 million for the three and six months ended June 30, 2010 compared with the corresponding periods in 2009 due primarily due to the additional water and wastewater treatment operations in the Alberta oil sands energy sector which commenced in the fourth quarter of 2009, and Gold Bar operations which were transferred to EPCOR from the City on March 31, 2009.

Generation

(Unaudited, \$millions)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Generation results (including intersegment transactions) (Unaudited, \$ millions)				
Revenues	\$ -	\$ 277	\$ -	\$ 517
Expenses	-	195	-	428
Operating income	\$ -	\$ 82	\$ -	\$ 89

The generation business and related operations were sold in July 2009. As a result, there are no comparative values to last year's three and six months results. The discussion regarding this segment should be read in conjunction with the Note on Comparisons above.

CONSOLIDATED BALANCE SHEETS

(\$ millions)	June 30, 2010	December 31, 2009	Increase (decrease)	Explanation
Cash and cash equivalents	\$ 27	\$ 11	\$ 16	Refer to liquidity and capital resources section
Accounts receivable (including income taxes recoverable)	234	247	(13)	Decrease primarily due to seasonal decrease in electricity consumption and lower electricity prices
Other current assets	15	13	2	
Property, plant and equipment	1,815	1,778	37	Capital expenditures partly offset by depreciation
Contract and customer rights and other intangible assets	104	110	(6)	Amortization of contract and customer rights
Future income tax assets (current and non-current)	42	41	1	
Long-term receivables (including current portion)	655	897	(242)	Reflects the scheduled repayments received in the quarter
Investment in Capital Power	1,488	1,481	7	Reflects equity income partly offset by the limited partnership distributions received
Other assets	167	163	4	
Short-term debt	59	-	59	Reflects increase in short-term debt primarily to fund working capital requirements and capital expenditures
Accounts payable and accrued liabilities	215	241	(26)	Decrease primarily due to seasonal decrease in electricity volume and lower prices for energy purchases
Income taxes payable	1	-	1	
Other current liabilities	34	32	2	
Long-term debt (including current portion)	1,696	1,917	(221)	Reflects the scheduled repayments in the current quarter
Other non-current liabilities	66	81	(15)	Reflects payment of transfer fee installment to the City for Gold Bar asset transfer
Future income tax liabilities	1	-	1	
Shareholder's equity	2,475	2,470	5	Reflects net income and other comprehensive income, partly offset by common share dividends

LIQUIDITY AND CAPITAL RESOURCES

Cash inflows (outflows)				
(\$ millions)	Three months ended June 30		Increase (decrease)	Explanation
	2010	2009		
Operating	\$ 14	\$ 104	\$ (90)	Primarily reflects lower cash flows due to the sale of the power generation business in July 2009
Investing	224	(158)	382	Reflects limited partnership distributions from Capital Power and payment received on long-term notes receivable from Capital Power in the second quarter of 2010, partly offset by lower capital spending due to the sale of power generation business and by proceeds from the sale of the Castleton facility in 2009
Financing	(228)	13	(241)	Decrease primarily relates to scheduled debt repayments in the second quarter of 2010 and no distributions to non-controlling interests in 2010 (as those were transferred with the sale of the power generation business in 2009)

Cash inflows (outflows)				
(\$ millions)	Six months ended June 30		Increase (decrease)	Explanation
	2010	2009		
Operating	\$ 68	\$ 251	\$ (183)	Primarily reflects lower cash flows due to the sale of the power generation business in July 2009
Investing	178	(286)	464	Reflects limited partnership distributions from Capital Power and payment received on long-term notes receivable from Capital Power in the second quarter of 2010, partly offset by lower capital spending due to the sale of power generation business and by proceeds from the sale of the Castleton facility in 2009
Financing	(230)	2	(232)	Reflects lower net proceeds from the issuance of short-term and long-term debt in 2010 and no distributions to non-controlling interests in 2010 (as those were transferred with the sale of the power generation business in 2009)

The Company's cash flow from operating activities decreased \$90 million and \$183 million in the three and six months ended June 30, 2010 compared with the corresponding periods in 2009 due primarily to the sale of the power generation business in July 2009. We expect cash flow from operating activities to be lower in 2010 than 2009 for the same reason but sufficient for current operations. We expect cash flow from operating activities to be somewhat higher in the third quarter of 2010 compared with the corresponding period in 2009 primarily due to the contribution to cash flows from the additional water and wastewater treatment operations in the Alberta oil sands energy sector which commenced in the fourth quarter of 2009.

At June 30, 2010, the Company had undrawn amounts available of \$441 million under three credit facilities including a \$500 million syndicated bank credit facility. The syndicated bank credit facility has two tranches of \$250 million each committed until 2013. Committed and demand bank lines of credit facilities are also used to provide letters of credit. At June 30, 2010, the Company had letters of credit outstanding of \$100 million (December 31, 2009 - \$99 million) to meet the credit requirements of energy market participants and conditions of certain service agreements. The committed bank lines also indirectly back the Company's commercial paper program which has an authorized capacity of \$500 million and an issuance limit of \$225 million, of which \$59 million was outstanding at June 30, 2010 (December 31, 2009 - nil).

The Company's working capital requirements and contractual obligations for the balance of 2010 will be funded from operating cash flows, limited partnership distributions from Capital Power, interest received in relation to the long-term receivable from Capital Power, and/or the Company's credit facilities. In addition, the Company may issue medium-term notes to fund its long-term obligations.

The Company has a Canadian shelf prospectus which expires in January 2012 under which it may raise up to \$1 billion of debt with maturities of not less than one year. At June 30, 2010, the available amount remaining under this shelf prospectus was \$1 billion.

Floating-rate Notes

On January 21, 2009, the restructuring of non-bank asset-backed commercial paper (ABCP) was implemented. Under the restructuring, the affected ABCP was exchanged for floating-rate notes, maturing no earlier than the scheduled termination dates of the underlying assets. The exchange was recorded at the estimated fair value of the ABCP on January 21, 2009. Since the original purchase of ABCP in 2007 for \$71 million, \$2 million in principal repayments have been received. The face value of the notes received in exchange for ABCP was \$69 million at June 30, 2010.

As the notes are classified as held-for-trading financial assets, they are subject to ongoing fair value adjustments at each reporting date. At June 30, 2010, the fair value of the notes was estimated at \$39 million compared with a fair value of \$37 million at December 31, 2009. The \$1 million and \$2 million increases respectively for the three and six months ended June 30, 2010 were primarily due to narrower indicative corporate credit spreads relative to the Government of Canada yield curve and higher short-term interest rates. In the three and six months ended June 30, 2009, we recognized a \$3 million increase and a \$1 million decrease respectively in the fair values of the notes.

The estimate of fair value is subject to significant risks and uncertainties including the timing and amount of future cash payments, market liquidity, the quality and tenor of the assets and instruments underlying the notes, including the possibility of margin calls, and the future market for the notes. Accordingly, the fair value estimate of the notes may change materially. Financial reform legislation has been introduced in the United States which may alter the operation of the notes but until the actual rules are established, it is not possible to estimate the financial impact, if any, on the notes.

For the three and six months ended June 30, 2010, EPCOR received nil interest on the notes (2009 - \$2 million and \$4 million respectively) due to the interest earned for the period being insignificantly higher than the administration costs permitted to offset interest earned under the terms of the notes.

Effects of Economic and Market Uncertainty

Canadian and U.S. financial markets have improved over the previous year but there is still some uncertainty regarding a full recovery in light of both positive and negative economic news. The Company secured financing to fund its capital expenditures and working capital requirements at a weighted average interest rate of 0.46% per annum through the issue of commercial paper and bankers' acceptances in the quarter. The Company plans to continue using commercial paper, existing credit facilities or medium-term notes for its financing requirements for the balance of the year. Should instability in the credit and economic environments worsen, it may adversely affect the interest rates at which we are able to borrow.

If the economy were to deteriorate in the longer term, particularly in Canada and the U.S., the Company's ability to renew credit facilities, arrange long-term financing for its capital expenditure programs and acquisitions, or refinance outstanding indebtedness when it matures could be adversely impacted. If market conditions worsen, the Company may suffer a credit rating downgrade and be unable to renew its credit facilities or access the public debt markets. We continue to believe that these circumstances have a low probability of occurring. However, we continue to monitor EPCOR's capital programs and operating costs to minimize the risk that the Company becomes short of cash or unable to honour its obligations. If required, we would look to reduce capital expenditures and operating costs and / or sell our exchangeable limited partnership units of Capital Power pursuant to our agreements with Capital Power and as market conditions permit.

CONTRACTUAL OBLIGATIONS

Prior to the sale of its power generation business to Capital Power, the Company issued parental guarantees on behalf of subsidiaries to meet the credit requirements of energy market participants and to meet conditions of certain service agreements. During the second quarter of 2010, the Company transferred \$1,150 million of outstanding parental guarantees to Capital Power and at June 30, 2010, continued to have outstanding parental guarantees on behalf of Capital Power totaling \$19 million (December 31, 2009 - \$1,295 million). The Company and Capital Power expect to finalize transfer of the remaining parental guarantees to Capital Power by the end of 2010. Capital Power has indemnified EPCOR for any demand for payments under these guarantees. The expected liability associated with these guarantees is not material and has not been recorded in these financial statements.

During the first half of 2010, there have been no material changes to the Company's purchase obligations, including payments for the next five years and thereafter. For further information on the Company's contractual obligations, refer to the 2009 annual MD&A.

CHANGES IN ACCOUNTING STANDARDS

Future Accounting Changes

Consolidated Financial Statements and Non-controlling Interests

In January 2009, the Canadian Institute of Chartered Accountants (CICA) issued Handbook Section 1601 – Consolidated Financial Statements and Section 1602 – Non-controlling Interests, which replace Section 1600 – Consolidated Financial Statements. Section 1601 establishes the standards for the preparation of consolidated financial statements while Section 1602 establishes the standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. Section 1602 is equivalent to the corresponding provisions of International Accounting Standard 27 – Consolidated and Separate Financial Statements.

Sections 1601 and 1602 will apply to EPCOR's interim and annual consolidated financial statements relating to periods commencing on or after January 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year provided Section 1582 – Business Combinations is also adopted at the same time. The impact of the new standards and the option to adopt them early will be assessed as part of our International Financial Reporting Standards (IFRS) conversion project.

Business Combinations

In January 2009, the CICA issued Handbook Section 1582 – Business Combinations, which replaces Section 1581 – Business Combinations and provides the Canadian equivalent to IFRS 3 – Business Combinations. The section will apply on a prospective basis to EPCOR's business combinations for which the acquisition date is on or after January 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year provided Sections 1601 – Consolidated Financial Statements and 1602 – Non-controlling Interests are also adopted at the same time. The impact of the new standard and the option to adopt it early will be assessed as part of our IFRS project.

IFRS

In February 2008, the CICA confirmed that Canadian reporting issuers will be required to report under IFRS effective January 1, 2011, including comparative figures for the prior year.

In January 2008, we established a core team to develop a plan which will result in the Company's first interim report for 2011 being in compliance with IFRS.

The diagnostic phase of the project was completed in April 2008. For each international standard, we identified the primary differences from Canadian GAAP and made an initial assessment of the impact of the required changes for the purpose of prioritizing and assigning resources. In making the assessment, the number of businesses impacted, the potential magnitude of the financial statement adjustment, the availability of policy choices, the impacts on systems and the impacts on internal controls were all considered.

The information obtained from the diagnostic phase was used to develop a detailed plan for convergence and implementation. The convergence and implementation work has five key sections: Financial Statement Adjustments, Financial Statements, Systems Updates, Policies and Internal Controls, and Training.

Financial Statement Adjustments

For each international standard, we will determine the quantitative impacts to the financial statements, system requirements, accounting policy decisions, and changes to internal controls and business policies. The initial accounting policy decisions will be brought forward to the Audit Committee for their information as each standard is addressed. However, final accounting policy decisions for all standards in effect at the end of 2009 will be made in the fourth quarter of 2010, as they should not be determined in isolation of other policy decisions. Policy decisions for any new standards or standards that are amended in 2010 will be made in conjunction with our analysis of those standards in 2010.

We have identified the following areas as having the most impact:

Property, Plant and Equipment (PP&E)

PP&E is primarily impacted by International Accounting Standard (IAS) 16 – Property, Plant and Equipment and IAS 23 – Borrowing Costs.

IFRS are different from Canadian GAAP in that certain costs such as overheads and borrowing costs in excess of the actual entity's cost of debt may not be capitalized, and IFRS do not have a rate-regulated provision allowing costs not specifically allowed under the standards, but allowed by the rate regulator, such as training costs, to be capitalized.

IFRS are also more specific with respect to the level at which component accounting is required, requiring each component of an asset for which different depreciation methods or rates are appropriate to be accounted for separately.

Under current accounting for rate-regulated operations, the method used to retire assets results in a deferral of any losses. IFRS do not allow this treatment.

The Company has substantially completed its assessment of the cumulative impact of the above changes and estimates that our current carrying amounts of PP&E include approximately \$60 million to \$65 million of costs which would not qualify for capital treatment under IFRS. The impact on annual depreciation would be a decrease of \$3 million to \$5 million.

Asset Retirement Obligations

The Company does not currently record asset retirement obligations as we do not believe they can be reasonably estimated for electricity distribution and transmission and water and wastewater infrastructure since such assets have long lives and are maintained continuously. IFRS suggest that it is only in extremely rare cases that an estimate of the obligation cannot be made.

IFRS require provisions for constructive as well as legal obligations. We have identified our obligations and will quantify the obligations in the third quarter but we do not expect them to be material.

Transfers of Assets from Customers

IFRS requires that assets received from customers that are used to connect a customer to the network or to provide ongoing access to a supply of goods or services should be treated as a revenue generating transaction, with the timing of revenue recognition dependent on the service or services provided. Under Canadian GAAP, contributions from customers are recorded as an offset against the cost of the associated asset, and amortized over the life of the asset.

IFRS 1, discussed below, provides transitional relief on implementation of these requirements. The Company does not plan on taking this exemption and plans to retrospectively restate its treatment of these contributions.

The Company has completed its review of contribution arrangements. Upon adoption, approximately \$500 million in contributions related to those arrangements which fall under the scope of IFRS are expected to be reclassified to deferred revenue from property, plant and equipment. There will be no impact on net assets. These contributions will be reflected in income through revenue rather than through decreased depreciation. There will be no net income impact.

Rate-regulated Accounting

On July 26, 2010, the Accounting Standards Board of the CICA announced that they will be issuing an exposure draft which will propose that qualifying rate-regulated entities be permitted, but not required, to defer adoption of IFRS until 2013. The Company will review the exposure draft when it is issued and make a decision at that time whether to defer adoption or not.

Under IFRS, there are currently no provisions for rate-regulated accounting. In addition to the changes noted above under PP&E, the lack of any provisions for rate-regulated accounting under IFRS would prohibit the recognition of certain regulatory assets and liabilities. Not recognizing these assets and liabilities would likely result in greater volatility in the reported amounts for net income and related financial statement items. Regulatory assets include accounts such as a transmission charge deferral account; regulatory liabilities include accounts such as a property tax deferral account. At December 31, 2009, we recognized \$28 million in regulatory assets, currently reported as accounts receivable, and \$10 million in regulatory liabilities, currently reported as accounts payable. On adoption of IFRS, we would not recognize these amounts. This change, holding all other factors constant, would result in a \$28 million decrease to accounts receivable, a \$10 million decrease in accounts payable and an \$18 million decrease to the January 1, 2010 opening retained earnings. See Rate-regulated Activities.

IFRS 1 – First Time Adoption of IFRS

IFRS 1 provides first time adopters with a number of elections, exempting them from retrospectively adopting certain IFRS. The following elections are relevant to EPCOR.

- Fair value or revaluation as deemed cost - An entity may choose to use fair value at the date of transition as deemed cost. This election is available on an asset by asset basis. We have initially concluded that we will not employ fair values on conversion and our estimate of the impact of IFRS on PP&E is based on management's current intent to not utilize this exemption.
- Employee benefits - An entity may elect to recognize all cumulative actuarial gains and losses associated with employee benefit plans at the date of transition to IFRS. We do not plan on taking this exemption and upon transition approximately \$1.8 million in previously unrecognized losses will be recognized through a decrease to opening retained earnings.
- Decommissioning liabilities – An entity may use a simplified calculation to calculate and restate the decommissioning liability and related property, plant and equipment and depreciation expense. A decision on whether to utilize this exemption will be made in the third quarter of 2010.
- Transfer of assets from customers - An entity does not have to reclassify customer contributions received prior to the transition date. As noted above, the Company does not plan to take this exemption.

Rate-regulated Activities

In February 2010, the staff of the IASB recommended to the IASB that the project on rate-regulated activities be revisited and, as a result, a decision is not expected until the third or fourth quarter of 2011. The IASB however will provide transitional relief to first time adopters.

The IASB has approved an exemption which would allow rate-regulated entities to use the current GAAP carrying amount on transition date to be the deemed cost for IFRS. The Company does not plan on taking this election and will record the adjustments noted in Rate-regulated Accounting above.

EPCOR anticipates completion of the quantification of the opening adjustments for all standards currently in effect by the end of the third quarter of 2010.

As the project progresses, the timing of completion of certain items may change as changes to standards and other external factors such as discussions with certain stakeholders may result in a change in priorities. However, we believe the project has sufficient resources to meet the overall project timeline.

Financial Statements

There are also a number of international standards which relate to financial statement presentation. Draft financial statements highlighting the disclosure and presentation requirements were reviewed by and discussed with the EPCOR Audit Committee in the first quarter of 2009. The development of the financial statement presentation will evolve throughout the project as the impacts of implementing the various standards are quantified. We plan to prepare an updated set of mock financial statements for review with the Audit Committee in the fourth quarter of 2010.

Systems Updates

Systems must be able to capture 2010 financial information under both the prevailing Canadian GAAP and IFRS to allow comparative reporting in 2011, the first year of reporting under IFRS. We completed our system updates in the third quarter of 2009 to capture both and have implemented operational procedures to capture the applicable accounting data through 2010. In effect, we have created a dual general ledger that captures the Canadian GAAP balances and a second ledger that captures the required financial adjustments to convert the Canadian GAAP balances to IFRS. As part of the final conversion to IFRS, we plan to adjust the general ledger primary accounts with the IFRS adjustment balances at the conversion date.

Policies and Internal Controls

In the determination of the financial statement adjustments, requirements for changes to Company policies and internal controls, including internal controls over financial reporting and disclosure controls and procedures, are being identified and documented. As there may be factors other than IFRS impacting policies and internal controls, the formal documentation and approval of revised policies and internal controls will not occur until the third quarter of 2010.

The impact of IFRS on certain agreements, such as debt, shareholder and compensation agreements, has also been included in the plan. Assessments of most agreements have been completed and will continue to be monitored as IFRS differences are quantified. We have not identified nor do we expect there to be any material issues with respect to these agreements arising from the conversion to IFRS.

Training

The Company recognizes that training at all levels is essential to a successful IFRS conversion and integration. Accounting staff have attended three training sessions with more planned to occur over the balance of the conversion process. The Board of Directors and Audit Committee have attended a training session and the Audit Committee receives regular updates on the conversion project including accounting policy determination. Further training for the Board of Directors and Audit Committee will occur in the fourth quarter of 2010.

CRITICAL ACCOUNTING ESTIMATES

In preparing the consolidated financial statements, management necessarily made estimates in determining transaction amounts and financial statement balances. The following are the items for which significant estimates were made in the interim consolidated financial statements: electricity revenues, costs and unbilled consumption, fair values, allowance for doubtful accounts, useful lives of assets and income taxes. Interim results will fluctuate due to the seasonal demands for electricity and water, changes in energy prices, and the timing and recognition of regulatory decisions. Consequently, interim results are not necessarily indicative of annual results.

For further information on the Company's critical accounting estimates, refer to the 2009 annual MD&A.

RISK MANAGEMENT

This section should be read in conjunction with the Risk Management section of the most recent annual MD&A. EPCOR faces a number of risks including risks related to its investment in Capital Power, operational risks, political, legislative and regulatory risk, financial liquidity risk, weather risk, project risk, availability of people risk, credit risk, health and safety risk, environment risk, conflicts of interest risk, and general economic conditions and business environment risks. The Company employs active programs to manage these risks.

As part of ongoing risk management practices, the Company reviews current and proposed transactions to consider their impact on the risk profile of the Company. There have been no material changes to the risk profile or risk management strategies of EPCOR as described in the annual MD&A for 2009 that have affected the financial statements for June 30, 2010.

OUTLOOK

In December 2009, Energy Services and Distribution and Transmission filed their 2010-2011 General Tariff Applications with the Alberta Utilities Commission (AUC). Hearings related to the Distribution and Transmission application took place during June 2010. Energy Services, on the other hand, requested from the AUC, and received approval, to negotiate its non-energy tariff with the interveners except for matters that are common to the Distribution and Transmission and Energy Services applications. Results of the negotiation are expected to be known by the end of the third quarter of 2010. A decision by the AUC on common matters with respect to the Energy Services and Distribution and Transmission tariff applications is expected by the end of 2010.

On February 26, 2010, the AUC announced a rate regulation initiative proposing a Performance Based Regulation (PBR) type framework under which rates would be adjusted annually by a formula recognizing expected inflation and achievable productivity improvements. A roundtable discussion was held on March 26, 2010, with all the interested or affected parties including EPCOR and a PBR framework document was issued in July 2010. The first PBR application is scheduled to be submitted in 2011, effective for 2012. As development of the PBR framework is still in the early stages, it is not possible to estimate the impact that this regulatory change might have on EPCOR.

Subject to receiving the Arizona Corporation Commission's approval of the Company's acquisition of Chaparral, discussed above under Overview, the Company will perform final close procedures and commence transition and integration of the public utility into EPCOR. This is expected to occur some time in 2011.

FORWARD-LOOKING INFORMATION

Certain information in this MD&A is forward-looking within the meaning of Canadian securities laws as it relates to anticipated financial performance, events or strategies. When used in this context, words such as "will", "anticipate", "believe", "plan", "intend", "target", and "expect" or similar words suggest future outcomes.

Forward-looking information in this MD&A includes: (i) the Company expects to close its acquisition of Chaparral in 2011, subject to regulatory approval; (ii) 2010 cash flow from operating activities will be lower than in 2009 due to the sale of the power generation business; (iii) cash flow from operating activities for the third quarter of 2010 will be higher than the corresponding period in 2009; (iv) the Company will fund its 2010 working capital requirements and contractual obligations from operating cash flows, limited partnership distributions from Capital Power, interest received in relation to the long-term

receivable from Capital Power, and the Company's credit facilities; (v) expectations regarding the impact on the Company of the capital and credit market instability and expected risk mitigation plans; (vi) the timing of decisions related to and expected impacts of the transition to IFRS; (vii) decisions from the AUC on Energy Services' and Distribution and Transmission's General Tariff Applications are expected by the end of 2010; (viii) results of the negotiation of the Energy Services non-energy tariff are expected in the third quarter of 2010; and (ix) the Company expects to file its first PBR applications with the AUC in 2011.

These statements are based on certain assumptions and analyses made by the Company in light of its experience and perception of historical trends, current conditions and expected future developments and other factors it believes are appropriate. The material factors and assumptions underlying this forward-looking information include, but are not limited to: (i) the operation of the Company's facilities; (ii) the Company's assessment of the markets and regulatory environments in which it operates; (iii) weather; (iv) availability and cost of labour and management resources; (v) performance of contractors and suppliers; (vi) availability and cost of financing; (vii) foreign exchange rates; (viii) management's analysis of applicable tax legislation; (ix) the currently applicable and proposed tax laws will not change and will be implemented; (x) counterparties will perform their obligations; (xi) expected interest rates, related credit spreads and mortality rates for floating-rate notes; (xii) ability to implement strategic initiatives which will yield the expected benefits; (xiii) the Company's assessment of capital markets; and (xiv) factors and assumptions in addition to the above related to the Company's 72.2% equity interest in Capital Power.

Whether actual results, performance or achievements will conform to the Company's expectations and predictions is subject to a number of known and unknown risks and uncertainties which could cause actual results and experience to differ materially from EPCOR's expectations. The primary risks and uncertainties relate to: (i) operation of the Company's facilities; (ii) unanticipated maintenance and other expenditures; (iii) electricity load settlement; (iv) regulatory and government decisions including changes to environmental, financial reporting and tax legislation; (v) weather and economic conditions; (vi) competitive pressures; (vii) construction; (viii) availability and cost of financing; (ix) foreign exchange; (x) availability of labour and management resources; (xi) performance of counterparties, partners, contractors and suppliers in fulfilling their obligations to the Company; and (xii) risks in addition to the above related to the Company's 72.2% equity interest in Capital Power, including power plant availability and performance.

Readers are cautioned not to place undue reliance on forward-looking statements as actual results could differ materially from the plans, expectations, estimates or intentions expressed in the forward-looking statements. Except as required by law, EPCOR disclaims any intention and assumes no obligation to update any forward-looking statement even if new information becomes available, as a result of future events or for any other reason.

QUARTERLY RESULTS

Quarter ended	Revenues	Net income (loss)
	(Unaudited, \$ millions)	
June 30, 2010	\$ 363	\$ (8)
March 31, 2010	338	87
December 31, 2009	374	27
September 30, 2009	350	(56)
June 30, 2009	735	50
March 31, 2009	896	104
December 31, 2008	820	15
September 30, 2008	954	76

Events for 2010, 2009 and 2008 quarters that have significantly impacted net income and the comparability between quarters are:

- June 30, 2010 second quarter results included equity loss from Capital Power, lower revenues due to the sale of the power generation business in 2009, interest revenue on the long-term loans receivable from Capital Power, and positive operating income as a result of the transfer of Gold Bar on March 31, 2009 and the acquisition of water and wastewater treatment operations in the fourth quarter of 2009.
- March 31, 2010 first quarter results included equity income from Capital Power, lower revenues due to the sale of the power generation business in 2009, interest revenue on the long-term loans receivable from Capital Power, positive operating income as a result of the transfer of Gold Bar on March 31, 2009 and the acquisition of water and wastewater treatment operations in the fourth quarter of 2009.
- December 31, 2009 fourth quarter results included adjustments to the loss on sale of the power generation business, interest revenue on the long-term loans receivable from Capital Power and positive operating income as a result of the transfer of Gold Bar on March 31, 2009.
- September 30, 2009 third quarter results included a loss on the sale of the power generation business and the write-off of syndicated credit facility issue costs related to the sale of the power generation business partly offset by equity income from Capital Power, interest revenue on the long-term loans receivable from Capital Power and positive operating income as a result of the transfer of Gold Bar on March 31, 2009.
- June 30, 2009 second quarter results included unrealized fair value gains resulting from the impact of low Alberta power prices on derivative electricity contracts that were not designated as hedges for accounting purposes, unrealized fair value gains on CPILP's forward foreign exchange contracts used to economically hedge U.S. cash flows and positive operating income as a result of the transfer of Gold Bar on March 31, 2009.
- March 31, 2009 first quarter results included a \$26 million gain on the sale of a 10% interest in the Battle River Power Syndicate Agreement, and unrealized fair value gains resulting from the impact of low Alberta power prices on derivative electricity contracts that were not designated as hedges for accounting purposes. These gains were partly offset by unrealized fair value losses on CPILP's natural gas supply contracts, and forward foreign exchange contracts used to economically hedge U.S. cash flows.

- December 31, 2008 fourth quarter results reflected impairment charges on the goodwill associated with the investment in CPILP and on CPILP's investment in Primary Energy Recycling Holdings. CPILP also recognized unrealized fair value losses on its forward foreign exchange contracts used to economically hedge U.S. cash flows and on its natural gas supply contracts.
- September 30, 2008 third quarter results reflected gains on the sale of portfolio investments and unrealized fair value gains on derivative electricity contracts, Joffre contract-for-differences and forward foreign exchange contracts. These gains were partly offset by administration costs resulting from long-term incentive plan adjustments, and lower income from CPILP.

ADDITIONAL INFORMATION

Additional information relating to EPCOR, including EPCOR's annual information form, is available on SEDAR at www.sedar.com.