EPCOR Utilities Inc.
Management's Discussion and Analysis
December 31, 2012

This management's discussion and analysis (MD&A) dated March 5, 2013 should be read in conjunction with the audited consolidated financial statements of EPCOR Utilities Inc. and its subsidiaries for the years ended December 31, 2012 and 2011 and the cautionary statement regarding forward-looking information on pages 38 and 39 of this MD&A. In this MD&A, any reference to "the Company", "EPCOR", "it", "its", "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 indicates. Financial information in this MD&A is based on the audited consolidated financial statements, which were prepared in accordance with International Financial Reporting Standards (IFRS), 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). EPCOR builds, owns and operates electrical transmission and distribution networks in Canada as well as water and wastewater treatment facilities and infrastructure in Canada and the United States (U.S.). EPCOR also provides electricity and water services and products to residential and commercial customers. EPCOR's electricity (collectively the Distribution and Transmission and Energy Services segments) and water (including wastewater treatment) businesses consist primarily of rate-regulated and long-term commercial contracted operations. EPCOR's continuous improvement objective is to seek out ways of maximizing the efficiency of its electricity and water operations.

Net income for the year ended December 31, 2012 was $18 million compared with net income of $144 million for 2011.

EPCOR's core operations performed well in the year without any significant issues or disruptions to customers and reported $48 million higher net income from core operations in 2012 than in 2011. Net income from core operations is a non-IFRS financial measure; see Non-IFRS Financial Measure on page 34 of this MD&A. EPCOR's equity share of income of Capital Power, net of income taxes, was $38 million lower for the year ended December 31, 2012, than in 2011.

Significant events for 2012 were as follows:

- The Company completed its acquisition of Arizona-American Water Company and New Mexico-American Water Company, Inc.
- The Company's investment in Capital Power was further reduced and an impairment charge of $124 million on the investment was recorded in the fourth quarter.
- The Company closed its Calgary contact center at the end of May 2012.
- The Company received the regulator's decision with respect to its 2013 – 2017 performance based regulation (PBR) plan for its Distribution and Transmission segment.
- The Company received the regulator's decision with respect to its 2012 cost of service rate application for its Distribution and Transmission segment.

Each of these transactions noted above are discussed further under Significant Events below.

STRATEGY

EPCOR's vision is to become a premier essential services utility in North America. To achieve this vision, EPCOR must excel at its electricity and water operations and be successful in its pursuit of new business growth opportunities. EPCOR's electricity strategy includes: (i) developing electricity transmission projects; (ii) acquiring rate-regulated electricity transmission and distribution assets; and (iii) providing new services and products to customers. EPCOR's water strategy is to focus on: (i) developing municipal infrastructure; (ii) providing design, build, finance and operating services for water and wastewater treatment and water distribution infrastructure; (iii) providing potable and process water and wastewater treatment for industrial customers; and (iv) acquiring rate-regulated water and wastewater assets and operations. Subject to acceptable business risk and the availability of financing, EPCOR intends to increase net income and shareholder value by growing its portfolio of electricity and water assets in rate-regulated and competitive contracted businesses.

We believe the long-term outlook for the North American electricity and water and wastewater treatment businesses remains relatively strong. While the recent recession and slow recovery has constrained electricity demand in the short-term, economic recovery will require new electricity transmission and distribution capacity in Alberta and other jurisdictions. In addition, the Alberta Electric System Operator (AESO) has outlined in its 2012 Long-term Transmission System plan a significant growth strategy for Alberta's transmission infrastructure over the upcoming 10 years which may provide the Company with an opportunity to further expand our investment in electricity transmission infrastructure. Similarly, the demand for water and wastewater infrastructure in North America is also expected to increase due to population growth, aging infrastructure, reduced water supply and increased consumer expectations for high quality and safe water.

Over the next five years, we will focus on investment opportunities in essential infrastructure in the water, wastewater and electricity sectors, including commercially contracted and rate-regulated facilities. We expect our rate-regulated business investment opportunities to be in water and wastewater infrastructure upgrades, acquisition of water and wastewater infrastructure businesses outside of Alberta, electricity transmission infrastructure development, and electricity distribution system upgrades. We will only invest in electricity or water and wastewater treatment assets where appropriate returns are expected, cost effective financing is available and the environmental footprint is acceptable. We plan to continue to increase our operating efficiency. We will also be monitoring our investment in Capital Power and will seek opportunities or transactions to reduce the investment, depending on our demand for capital and the prevailing market conditions.

As a utility with rate-regulated and contracted operations, an investment grade credit rating and access to capital through new and existing credit facilities and public debt financing, EPCOR believes it is able to adapt to changes in economic conditions. We also recognize that we are not immune to recessionary trends and will remain vigilant to minimize the risk of taking on projects that would result in growth beyond our financial means.

KEY PERFORMANCE INDICATORS

Our performance in meeting the goals of our strategy is measured through financial and non-financial measures that are approved by the Board of Directors. The measures fall under four broad categories comprised of people, growth (financial), operational excellence and the environment, and are applied across the Company.

There are specific measures established for each business unit and corporate shared service unit in alignment with the Company's strategy. For example, under the people category, safety performance is measured based on the number of incidents or reportable injury frequency. Business unit measures under the operational excellence category are focused on customer related measures relevant to the particular business unit, such as customer satisfaction or reputation survey results. Environmental measures for business units typically include reportable incident frequency.

In 2012, EPCOR's financial results from core operations were ahead of our plan primarily due to better than anticipated results from EPCOR's recently acquired operations in the U.S., which were purchased in the first quarter of 2012. Health and safety performance in 2012 saw a marked improvement over 2011 across all business areas and as a result, we met our aggregate 2012 safety targets. The primary reasons for this shift were a continuation of the development and implementation of EPCOR's integrated Health, Safety and Environment Management System, and an increased focus on leading indicators such as near miss reporting, workplace observation and worksite inspections. We continued to strive towards a zero injury and occupational illness culture in which we believe all incidents are preventable. Segment performance measures are discussed under Segment Results of this MD&A.

SIGNIFICANT EVENTS

Acquisition of Water Arizona and Water New Mexico

On January 31, 2012, the Company completed the acquisition of 100% of the stock of Arizona-American Water Company and New Mexico-American Water Company, Inc. from American Water Works Company, Inc. for cash consideration of $460 million (US$459 million) and the assumption of $9 million (US$9 million) in long-term debt. The acquired companies were renamed EPCOR Water Arizona Inc. (Water Arizona) and EPCOR Water New Mexico Inc. (Water New Mexico), respectively. Water Arizona and Water New Mexico are public utility companies engaged principally in the purchase, production, distribution and sale of water to approximately 126,000 customers in ten water utility districts and wastewater treatment and related services to approximately 52,000 customers in five wastewater utility districts. This investment provides the Company with a strong hub in the U.S. Southwest, consistent with the Company's strategic plan for expansion.

Investment in Capital Power

The Company's economic interest in Capital Power was reduced to 29% (2011 – 39%) as a result of the Company's sale of a portion of its investment in Capital Power in April 2012. The Company incurred a net non-cash loss of $36 million in 2012 as a result. The proceeds from the sell down were used by EPCOR to support ongoing capital expenditure programs and for general corporate purposes.

The Company concluded that objective evidence of impairment existed at December 31, 2012 and as a result, recorded a $124 million impairment charge on its investment in Capital Power in the fourth quarter.

Contact Center Consolidation

EPCOR closed its Calgary contact center at the end of May 2012 as the result of a review that determined efficiencies could be gained by consolidating the Company's customer contact centers. Employees in Calgary who chose to relocate to Edmonton to continue their careers with EPCOR had their relocation costs paid by the Company. Those employees not remaining with EPCOR received severance and outplacement services.

2013 – 2017 Performance Based Regulation Decision

In September 2012, the Alberta Utilities Commission (AUC) published its decision on Distribution and Transmission's 2013 – 2017 PBR plan. The decision was primarily a generic decision with most of the approved PBR elements applying to all electricity and natural gas distribution utility companies in Alberta. The unique aspects that each company applied for were mostly denied, including Distribution and Transmission's proposal to include its transmission operations with the PBR plan and exclude capital costs from its PBR plan. Under the approved PBR framework, rates will change annually based on a formula comprised of the following factors: inflation factor, productivity factor, capital trackers, flow-through items and exogenous adjustments. Capital trackers are used to allow a regulated utility to track and begin to recover the costs associated with certain approved capital projects that would otherwise be outside of the PBR framework. The productivity factor approved in the PBR plan decision was higher than what the Company included in its plan and will challenge the Company's ability to meet its approved target return on equity. The Company's PBR plan contemplated the capital component of customer rates continuing to be set under cost of service. However, the AUC's PBR plan decision approved the use of a capital tracker factor. While further clarification of the capital tracker factor is required, the Company believes that it could restrict the amount of necessary capital investment permitted to be recovered through customer rates, further challenging the Company's ability to meet its approved target return on equity. The PBR plan decision relative to the other factors in the PBR formula more closely aligned with the Company's expectations. In October 2012, a number of Alberta electricity and natural gas distribution utilities, including EPCOR, filed notices of leave to appeal the AUC's PBR plan decision with the Alberta Court of Appeal. In November 2012, the Company filed a request for review and variance of the AUC's PBR plan decision as it relates to the capital tracker factor, among other things. The complete impact of the PBR plan decision on the Company will not be known until further clarity is provided relative to the capital tracker factor.

2012 General Tariff Application Decision

In October 2012, the AUC issued a decision in respect of Distribution and Transmission's 2012 general tariff application, including common matters also relating to Energy Services' 2012 – 2013 regulated rate tariff (RRT) application. Among other things, the decision significantly reduced the amount of corporate costs permitted to be recovered through customer rates compared to what was applied for in Distribution and Transmission's 2012 cost of service rate application and Energy Services' 2012 – 2013 regulated rate tariff application. The amount of corporate costs not permitted to be recovered through customer rates is $8 million per year, subject to approval by the AUC. Most of the other elements of the decision were consistent with Distribution and Transmission's 2012 rate application. While Distribution and Transmission's cost of service rate application was for 2012, the decision will also impact future years since the 2012 approved customer rates form the basis for rate determinations under Distributions and Transmission's 2013 – 2017 PBR plan. Management will take the appropriate action necessary to mitigate the financial impact of the decision on the Company of reduced allocated corporate costs recovered through customer rates.

CONSOLIDATED FINANCIAL INFORMATION

($ millions) **Years ended December 31,**		**2012**		**2011**		**2010**
Revenues	$	1,931	$	1,794	$	1,437
Net income		18		144		105
Total assets		5,424		5,032		4,932
Loans and borrowings (including current portion)		1,970		1,699		1,672
Provisions (including current portion)		99		52		51
Financial liabilities (including current portion)		37		50		63
Common share dividends		141		138		136

Analysis of Net Income

($ millions)		
Net income for the year ended December 31, 2011	**$**	**144**
Lower equity share of income from Capital Power		(38)
Higher loss on sale of a portion of investment in Capital Power (net of income tax recovery)		(12)
Impairment of investment in Capital Power		(124)
		(30)
Higher Water Services segment operating income		55
Higher Distribution and Transmission segment operating income		15
Higher Energy Services segment operating income		13
No unrealized gain on foreign exchange derivative instruments in 2012		(11)
Higher net financing expense		(15)
Floating-rate notes		(6)
Other		(3)
Increase in income from core operations		48
Net income for the year ended December 31, 2012	**$**	**18**

Explanations of the primary year-over-year variances in net income are as follows:

- EPCOR's equity share of income of Capital Power was lower in 2012 compared with 2011. The change reflects the Company's equity share of a decrease in Capital Power's net income and the impact of EPCOR's reduced economic interest in Capital Power.
- The Company sold portions of its investment in Capital Power in 2012 and in 2011, incurring losses on each sale. In addition, the Company incurred losses on dilutions of its investment in Capital Power by virtue of common share issuances by Capital Power during 2011 with no corresponding losses in 2012. Losses on sale resulted because the carrying amount of the portion of the Company's investment in Capital Power sold was greater than the proceeds received less direct expenses and realized accumulated other comprehensive loss. The loss on sale incurred in 2012 was higher than the loss on sale incurred in 2011 primarily due to a greater difference between the carrying amount of the investment on a per-share basis and share price at the time of sale in 2012 than in 2011 in addition to a higher number of shares sold in 2012 than in 2011. The dilution losses in 2011 resulted because the carrying amount of the portion of our investment which was considered to be disposed of as a result of dilution was greater than the portion of proceeds on the issuance deemed to be attributed to the Company.
- We concluded that objective evidence of impairment of our investment in Capital Power existed at December 31, 2012 because the recoverable amount of our investment was lower than the carrying amount. As a result, we recorded a $124 million after-tax impairment charge on the investment in Capital Power in the fourth quarter based on fair value determined by reference to the trading value of Capital Power Corporation shares on the Toronto Stock Exchange at December 31, 2012.
- The changes in each business segment's operating results for the year ended December 31, 2012 compared with the corresponding period in 2011 are described under Segment Results below.
- In December 2011, the Company recognized an unrealized gain on foreign exchange contracts held at December 31, 2011, with corresponding adjustments in 2012. The foreign exchange forward contracts were entered into in April 2011 as cash flow hedges to manage the foreign exchange risk related to the January 2012 acquisition of Water Arizona and Water New Mexico. The forward contracts were effective in removing the foreign exchange risk associated with the acquisition. In the first quarter of 2012, the Company recorded a loss on the settlement of these contracts since their settlement was less than the fair value of the contracts as recorded at December 31, 2011.

- Net financing expense was higher in 2012 compared with 2011 primarily due to additional long-term debt issued in late 2011 to fund the acquisition of Water Arizona and Water New Mexico and long-term debt issued in February 2012 to be used for general corporate purposes.
- The Company recorded a gain on the sale of floating-rate notes in the second quarter of 2011 partially offset by a negative fair value adjustment on those notes in the first quarter of 2011. There was no corresponding gain or fair value adjustment in 2012.

Revenues

($ millions)		
Revenues for the year ended December 31, 2011	**$**	**1,794**
Higher Water Services operating revenues		153
Higher electricity distribution and transmission revenues		22
Lower Energy Services revenues		(38)
Increase in revenues from core operations		137
Revenues for the year ended December 31, 2012	**$**	**1,931**

Consolidated revenues for the year ended December 31, 2012 increased $137 million compared with 2011 primarily due to the net impact of the following year-over-year changes:

- Water operating revenues were higher in 2012 compared with 2011 primarily due to the expansion of U.S. operations with the 2012 acquisition of Water Arizona and Water New Mexico and a full year of revenue from Chaparral City Water Company (Chaparral), compared with only seven months of revenue from Chaparral in 2011. Chaparral was acquired in May 2011. Also contributing to higher revenues were higher approved customer rates and a new commercial water contract in 2012, partially offset by lower commercial water construction activity in 2012 compared with 2011.
- Electricity distribution and transmission revenues were higher in 2012 compared with 2011 primarily due to higher approved customer rates, higher electricity sales volumes and higher contract service revenues.
- Energy Services revenues were lower in 2012 compared with 2011 primarily due to lower customer electricity volumes, partially offset by higher average rates.

Capital Spending and Investment

($ millions) **Years ended December 31,**		**2012**		**2011**		**2010**
Water Services	$	145	$	108	$	108
Distribution and Transmission		222		188		129
Energy Services		5		1		-
Corporate		7		41		8
		379		338		245
Business acquisition		460		29		1
	$	**839**	**$**	**367**	**$**	**246**

In 2012, we continued to enhance and increase the capacity of our infrastructure assets to improve reliability and meet increasing electricity and treated water and wastewater volumes. Capital expenditures for property, plant and equipment and other assets were higher for 2012 compared with 2011 primarily due to the acquisition of Water Arizona and Water New Mexico in 2012 and construction activity on the Heartland Transmission project, reflecting EPCOR's 50% joint venture share. This was partially offset by lower construction activity due to completion of the Company's corporate office leasehold improvements in 2011.

Work on a number of significant projects, including the Heartland Transmission project, will continue in 2013.

SEGMENT RESULTS

Water Services

Water Services earns income primarily from the treatment, distribution and sale of water and the treatment of wastewater while ensuring public health standards are met or exceeded. Water Services operates in both Canada and the U.S. The majority of Water Services' income in Canada is earned through a performance based regulation tariff charged to its Edmonton customers. The tariff is intended to allow Water Services to recover its costs and earn a fair rate of return while providing an incentive to manage costs below the inflationary adjustment built into the performance based rate. Water Services also operates in Arizona and New Mexico. Customer rates in these states are subject to approval by the Arizona Corporation Commission and the New Mexico Public Regulation Commission, respectively, and are intended to allow EPCOR to recover costs and earn a reasonable rate of return under a cost of service framework. The key to maintaining earnings on water sales is to provide sufficient quantities of high quality water while controlling costs. The key to maintaining earnings on wastewater treatment services is to ensure that quality wastewater operating practices are employed and that the associated infrastructure is maintained while controlling costs.

In addition, Water Services provides competitive contract-based water and wastewater services, including financing, in certain arrangements, to commercial, industrial and municipal customers. The key to earning satisfactory operating margins on these contracts is to satisfy the terms of the contracts while controlling or reducing operating costs.

Water Services Operating Income

(including intersegment transactions, $ millions) **Years ended December 31,**		**2012**	**2011**
Revenues	Water sales	$ 346	$ 215
	Provision of services	89	66
	Finance lease income	14	14
	Construction revenues	16	17
		465	312
Expenses	Other raw materials and operating charges	108	82
	Staff costs and employee benefits expenses	111	85
	Depreciation and amortization	65	41
	Franchise fees and property taxes	21	16
	Other administrative expenses	20	11
	Foreign exchange loss	-	1
		325	236
Operating income before corporate charges		140	76
Corporate charges		33	24
Operating income		**$ 107**	**$ 52**

($ millions)	
Operating income for the year ended December 31, 2011	**$ 52**
Higher U.S. water operating income	42
Higher Canadian water and wastewater operating income	10
Other	3
Increase in operating income	55
Operating income for the year ended December 31, 2012	**$ 107**

For the year ended December 31, 2012, Water Services' operating income increased by $55 million compared with 2011 due to the net impact of the following items:

- U.S. water operating income was higher in 2012 compared with 2011 due to the addition of Water Arizona and Water New Mexico operations in 2012 and a full year of Chaparral operations.
- Canadian water and wastewater operating income was higher in 2012 compared with 2011 due to higher approved customer rates, lower chemical costs and a lower provision recorded in 2012 related to a water rate complaint by an Edmonton regional water customer group compared with 2011, partially offset by higher salary and benefits costs, higher employee compensation costs and higher corporate charges. Chemical costs were higher in 2011 due to high snowpack and extended spring run-off as well as higher precipitation which resulted in higher levels of silt (turbidity) in the North Saskatchewan River, requiring more chemical treatment.

Years ended December 31,	**2012**	**2011**
Water volumes (megalitres)		
Water sales for Edmonton and surrounding region	121,185	121,700
Water sales for Arizona and New Mexico	81,059	4,263

Water Services owns eight, and operates 21 other water treatment and / or distribution facilities in Alberta and British Columbia. Additionally, Water Services owns five wastewater treatment and / or collection facilities and operates 23 other wastewater treatment and collection facilities in Alberta and British Columbia. In Arizona and New Mexico, EPCOR owns operations in 11 water utility districts, each containing one or more water treatment and / or distribution facilities, and five wastewater utility districts, each containing one or more wastewater treatment and / or collection facilities. In 2012, Water Services continued construction and upgrade work on its water and wastewater facilities located in the Alberta oil sands region. Water Services' core market is stable as Water Services is the sole supplier of water and provider of wastewater services within Edmonton. Operationally, the facilities Water Services owns or manages performed according to plan in 2012.

Water Services focused on two key areas in 2012: (i) the upgrade and enhancement of water distribution infrastructure and wastewater treatment facilities within Edmonton; and (ii) the pursuit of growth opportunities. Work on several significant upgrade projects within Edmonton continued in 2012. These include the annual water main renewal program to improve Edmonton's water distribution system, a project to replace the gaseous chlorine chemical system at the Rossdale water treatment plant with an on-site hypochlorite generation system and upgrades to a digester and pre-treatment and solids handling infrastructure project at the Gold Bar wastewater treatment facility (Gold Bar). Work on these projects will continue in 2013. Water Services completed the Water Arizona and Water New Mexico acquisition in the first quarter of 2012. During 2012, Water Services was successful in its bid for a project to design, build, finance and operate the expansion and upgrade of water and wastewater treatment facilities in Kananaskis, Alberta. Water Services has also been actively pursuing additional growth opportunities in the Alberta oil sands energy sector.

Distribution and Transmission

Distribution and Transmission earns income principally by transmitting high-voltage electricity from power generation plants across the Alberta Interconnected Electrical System to points of distribution and, from there, distributing low-voltage electricity to end-use customers on behalf of electricity retailers such as Energy Services and competitive retailers. These transmission services are provided to the AESO. Distribution and Transmission's assets are located in and around Edmonton and are regulated by the AUC. Distribution and Transmission charges regulated distribution and transmission tariffs intended to allow recovery of prudent costs and earn a fair rate of return on the electricity distribution and transmission infrastructure. Distribution and Transmission is also responsible for providing meter reading and load settlement services for all retail electricity suppliers within the

Edmonton service area. This segment also provides competitive contract-based commercial services related to installation, maintenance and repair of street lighting, traffic signals and light rail transit, primarily to the City.

Distribution and Transmission Operating Income

(including intersegment transactions, $ millions) **Years ended December 31,**			**2012**		**2011**
Revenues	Distribution	$	349	$	322
	Transmission		60		62
	Commercial and other		106		98
			515		482
Expenses	Electricity purchases and system access fees		134		143
	Other raw materials and operating charges		45		40
	Staff costs and employee benefits expenses		92		84
	Depreciation and amortization		46		41
	Franchise fees and property taxes		63		61
	Other administrative expenses		12		12
			392		381
Operating income before corporate charges			123		101
Corporate charges			39		32
Operating income		**$**	**84**	**$**	**69**

($ millions)		
Operating income for the year ended December 31, 2011	**$**	**69**
Higher distribution approved customer rates and volumes, net of expenses		18
Lower transmission rates		(3)
Increase in operating income		15
Operating income for the year ended December 31, 2012	**$**	**84**

For the year ended December 31, 2012, Distribution and Transmission's operating income increased $15 million compared with 2011 primarily due to increased revenue from higher approved electricity distribution customer rates and electricity sales volumes. Operating income also increased due to improved timing of approvals to bill customers for electricity transmission flow-through costs in 2012 compared to 2011. These increases were partially offset by lower approved transmission customer rates, higher salary and benefits costs, higher employee compensation costs and higher corporate charges.

Years ended December 31,	**2012**	**2011**
Distribution reliability and volumes		
Reliability (system average interruption duration index in hours)	0.64	0.83
Electricity distribution (gigawatt-hours)	7,523	7,347

The vision of Distribution and Transmission is to be a trusted provider of electricity, known for a focus on safety, operational excellence and innovative and practical solutions. Distribution and Transmission's primary measure of distribution system reliability is the System Average Interruption Duration Index (SAIDI), which it focuses on minimizing. This measure captures the annual average number of hours of interruption experienced by Distribution and Transmission's customers, including scheduled and unscheduled interruptions to its primary distribution circuits. In 2012, the SAIDI was 0.64 hours compared with 0.83 in 2011. Distribution and Transmission's SAIDI for 2012 was targeted at 0.86 (2011 – 0.88). The key system reliability improvement efforts undertaken were the rejuvenation or replacement of underground distribution cables to mitigate cable failures, the installation of automated switches on selected circuits to isolate faults and restore service to customers faster and the construction of new circuits to strengthen the electrical system. These reliability improvement efforts contributed significantly to the improved SAIDI performance. Distribution and Transmission will continue with its reliability improvement programs to further address controllable factors and help improve overall system reliability in the future. Electricity distribution volumes in 2012 were consistent with 2011.

The AESO has outlined a significant growth strategy for Alberta's electricity transmission infrastructure and has indicated that certain proposed electricity transmission projects will be open to a competitive bid process, as opposed to the historic process whereby each transmission facility operator performs approved work within their designated service area. Distribution and Transmission will have the opportunity to bid on the projects and increase its rate base if successful in its bids.

The AUC has directed all electricity distribution companies to transition from the traditional cost of service rate model to a PBR model effective in 2013. The PBR model is intended to allow a utility to recover its costs and earn a fair rate of return over a longer regulatory test period while providing an incentive to manage costs below an inflationary adjustment built into the performance based rates. In its decision on Distribution and Transmission's 2013 – 2017 PBR plan, the AUC denied Distribution and Transmission's proposal to include its transmission operations and capital costs within the PBR plan. Consequently, Transmission rates will continue to be set using the cost of service rate model.

Energy Services

Energy Services earns income from the supply of electricity to RRT customers. These are residential and small commercial customers who are not under a competitive contract and receive their electricity under the regulated rate option (RRO). Energy Services also earns income from default rate customers (customers with higher electricity volumes that are not under a competitive contract with an electricity provider) in the EPCOR Distribution and Transmission Inc. and FortisAlberta Inc. service areas and several Rural Electrification Association service territories. Energy Services also provides billing, collection, and contact center services to certain Water Services operations and the City Waste and Drainage Services departments. Energy Services focuses on providing excellent service experiences for its customers and measures call answer performance, billing performance and customer satisfaction and reports results to the AUC on a quarterly basis.

Energy Services operates under provincial cost of service rate regulations intended to allow it to recover its prudent costs and earn a fair rate of return.

Energy Services Operating Income

(including intersegment transactions, $ millions) **Years ended December 31,**		**2012**	**2011**
Revenues	Electricity sales	$ 1,099	$ 1,133
	Provision of services	26	30
		1,125	1,163
Expenses	Electricity purchases and system access fees	1,024	1,077
	Other raw materials and operating charges	1	1
	Staff costs and employee benefits	22	19
	Depreciation and amortization	8	9
	Other administrative expenses	26	26
		1,081	1,132
Operating income before corporate charges		44	31
Corporate charges		15	15
Operating income		**$ 29**	**$ 16**

Operating income for the year ended December 31, 2011	**$ 16**
Increase due to net positive fair value adjustments on financial electricity purchase contracts	25
Decrease due to lower commercial services margin	(4)
Decrease due to lower billing charges	(5)
Other	(3)
Increase in operation income	13
Operating income for the year ended December 31, 2012	**$ 29**

For the year ended December 31, 2012, Energy Services' operating income increased by $13 million. This increase was primarily due to the net impact of the positive fair value adjustments on financial electricity purchase contracts associated with the Energy Pricing Setting Plan (EPSP) compared to negative fair value adjustments in 2011, partially offset by lower billing charge income due to a lower number of customer sites billed, lower commercial services margin as a result a contract that expired at the end of 2011, higher rent costs, and higher employee compensation costs

Energy Services' retail sales volumes were as follows:

Years ended December 31,	**2012**	**2011**
Electricity (gigawatt-hours)		
RRT	5,370	5,734
Default	798	886
	6,168	6,620

A portion of the margin that Energy Services earns on RRT electricity sales is based on an EPSP approved by the AUC in March 2011. Under the EPSP, Energy Services manages its exposure to fluctuating wholesale electricity spot prices by entering into financial electricity purchase contracts up to 45 days in advance of the month of consumption in order to fix the price of electricity to be purchased under a well-defined purchase and risk management process set out in the EPSP. Energy Services expects slightly lower RRT sales volumes in 2013 primarily driven by the likelihood that customers will sign competitive contracts due to continuing RRT price volatility. Some of this volatility is expected to be reduced as changes to the RRT, announced and effective in January 2013, will permit EPCOR to purchase electricity contracts up to 120 days in advance of the month of consumption. This extension of the purchasing window should enhance price stability since it allows forward purchases to be spread over a longer period of time (120 days compared with 45 days) rather than being compressed into a 45 day period. EPCOR's current EPSP allows for a purchase window of 45 days, however, the Company has agreed in principle with its customer representatives to amend its EPSP to include this extension.

Consolidated Statements of Financial Position

($ millions) **December 31,**	**2012**	**2011**	**Increase (decrease)**	**Explanation**
Cash and cash equivalents	$ 232	$ 316	$ (84)	Refer to liquidity and capital resources section.
Trade and other receivables	359	372	(13)	Decrease primarily due to year-over-year decrease in electricity volumes and prices, a lower current portion of long-term receivable from Capital Power, partially offset by assumption of Water Arizona and Water New Mexico accounts receivable.
Inventories	13	12	1	
Derivative assets	-	11	(11)	Decrease primarily due to the settlement of foreign exchange forward contracts.
Finance lease receivables	125	127	(2)	Decrease due to scheduled lease payment received.
Other financial assets	383	402	(19)	Decrease primarily due to the collection of certain notes receivable.
Deferred tax assets	52	43	9	Increase primarily due to deferred partnership income from investment in Capital Power.
Investment in Capital Power	621	987	(366)	Decrease due to the impairment charge, sale of a portion of the investment in 2012 and limited partnership distributions, partially offset by equity share of income of Capital Power.
Intangible assets	222	104	118	Increase primarily due to the acquisition of Water Arizona and Water New Mexico goodwill and other intangible assets, partially offset by amortization of intangible assets with finite useful lives.
Property, plant and equipment	3,417	2,658	759	Increase primarily due to the acquisition of Water Arizona and Water New Mexico, partially offset by depreciation expense.
Trade and other payables	303	264	39	Increase primarily due to higher electricity purchases payable as a result of the timing of the payment to AESO.
Loans and borrowings (including current portion)	1,970	1,699	271	Increase primarily due to the issuance of long-term debt, partially offset by scheduled repayment of long-term debt.
Deferred revenues (including current portion)	762	602	160	Primarily reflects the assumption of Water Arizona and Water New Mexico deferred revenues.
Provisions (including current portion)	99	52	47	Increase primarily due to the assumption of Water Arizona and Water New Mexico provisions and higher employee benefit obligations, partially offset by settlement of the Rossdale power plant decommissioning liability.
Derivative liabilities	2	-	2	
Other liabilities (including current portion)	49	63	(14)	Decrease primarily due to the scheduled Gold Bar asset transfer fee payment to the City in the first quarter of 2012.
Deferred tax liabilities	5	1	4	Increase primarily due to new net taxable temporary differences resulting from the acquisition of Water Arizona and Water New Mexico.
Equity attributable to the Owner of the Company	2,234	2,351	(117)	Decrease due to dividends paid, partially offset by total comprehensive income.

CONSOLIDATED STATEMENTS OF CASH FLOWS

($ millions)
Cash inflows (outflows)

	Years ended December 31, 2012	2011	Increase (decrease)	Explanation
Operating	$ 368	$ 123	$ 245	Increase primarily reflects higher cash flow from operations and increased cash flow resulting from the year over year change in non-cash operating working capital.
Investing	(577)	205	(782)	Decrease primarily reflects the acquisition of Water Arizona and Water New Mexico, lower payments on long-term receivables from Capital Power, higher capital expenditures in 2012, decreased cash flow resulting from the year over year change in non-cash investing working capital and no similar cash proceeds in 2012 from the sale of floating-rate notes that occurred in 2011.
Financing	125	(116)	241	Increase primarily reflects higher issuance of long-term debt, net of repayments.
Opening cash and cash equivalents	316	104	212	
Closing cash and cash equivalents	$ 232	$ 316	$ (84)	

LIQUIDITY AND CAPITAL RESOURCES

($ millions) Years ended December 31,	2012	2011	2010
Long-term borrowings during the year	$ 300	$ 254	$ -
Cash and cash equivalents, at end of year	232	316	104

Operating Activities

Cash flow from operating activities, which includes changes in non-cash operating working capital, increased to $368 million in 2012 from $123 million in 2011. The increase was primarily due to a decrease in working capital requirements.

Working capital requirements in 2013 are expected to be lower than 2012. The Company expects to fund its 2013 working capital requirements with a combination of cash on hand, cash flow from operating activities, the issuance of commercial paper and drawings upon existing credit facilities. Cash flows from operating activities are generated through our regulated rates and contracted operations which are generally stable. Cash flows from operating activities would be impaired by storm events that cause severe damage to our facilities and would require unplanned cash outlays for repairs for system restoration. Under those circumstances, more reliance would be placed on our credit facilities for working capital requirements until a regulatory approved recovery mechanism or insurance proceeds were in place.

Financing

Generally, our external capital is raised at the corporate level and invested in the operating business units. Our external financing has consisted of commercial paper issuance, borrowings under committed credit facilities, debentures payable to the City, publicly issued medium-term notes, U.S. private debt notes and issuance of preferred shares.

The Company has credit facilities, which are used principally for the purpose of backing the Company's commercial paper program and providing letters of credit, as outlined below:

($ millions) **December 31, 2012**	**Expiry**	**Total facilities**	**Banking commercial paper issued**	**Letters of credit and other facility draws**	**Net amounts available**
Committed					
Syndicated bank credit facility Tranche A	November 2015	$ 250	$ -	$ -	$ 250
Syndicated bank credit facility[1]	November 2015	400	-	139	261
Syndicated bank credit facility Tranche B	November 2017	250	-	-	250
Total committed		900	-	139	761
Uncommitted					
Bank line of credit	No expiry	25	-	-	25
Bank line of credit	November 2013	20	-	-	20
Total uncommitted		45	-	-	45
		$ 945	$ -	$ 139	$ 806

($ millions) **December 31, 2011**	**Expiry**	**Total facilities**	**Banking commercial paper issued**	**Letters of credit and other facility draws**	**Net amounts available**
Committed					
Syndicated bank credit facility Tranche A	November 2014	$ 250	$ -	$ -	$ 250
Syndicated bank credit facility Tranche B	November 2016	250	-	203	47
Total committed		500	-	203	297
Uncommitted					
Bank lines of credit	No expiry	120	-	50	70
Bank line of credit	November 2012	20	-	19	1
Total uncommitted		140	-	69	71
		$ 640	$ -	$ 272	$ 368

1. Restricted to letters of credit.

Letters of credit are issued to meet the credit requirements of energy market participants and conditions of certain service agreements.

In addition to the Company's $500 million two tranche committed syndicated bank credit facility which was extended in November 2012, the Company established an additional $400 million committed syndicated bank credit facility in 2012 that is restricted to the issuance of letters of credit and reduced its uncommitted bank lines of credit. Under this bank credit facility, EPCOR consolidated its uncommitted bank lines of credit, thereby increasing the Company's sources of capital. Both tranches of the Company's other committed syndicated bank credit facility are available and primarily used for short-term borrowing and backstopping EPCOR's $500 million commercial paper program. The committed syndicated bank credit facility cannot be withdrawn by the lenders until expiry, provided that the Company operates within the related terms and covenants. On an annual basis, each committed bank credit facility provides the opportunity to request an extension of the maturity date. The Company regularly monitors market conditions and may elect to enter into negotiations to extend the maturity dates. The maturity dates were most recently extended by one year in 2012.

In the first half of 2012, the Company secured short-term financing to fund a portion of its capital expenditures and working capital requirements at a weighted average interest rate of 1.069% per annum through the issue of commercial paper. No commercial paper was issued and outstanding at December 31, 2012.

The Company has a Canadian base shelf prospectus under which it may raise up to $1 billion of debt with maturities of not less than one year. At December 31, 2012, the available amount remaining under this shelf prospectus was $700 million (2011 - $1 billion). The shelf prospectus expires in January 2014.

In February 2012, the Company issued $300 million, 4.55% medium-term notes due February 28, 2042, under its base shelf prospectus. The notes were priced to yield 4.565%, pay interest semi-annually and rank equally, except as to sinking fund and statutory preferred exceptions, with all other unsecured and unsubordinated indebtedness of the Company. As planned, the notes were used to pay down commercial paper indebtedness and for general corporate purposes.

In April 2012, EPCOR exchanged 9,775,000 limited partnership units for an equal number of shares of Capital Power which were immediately sold at an offering price of $23.55 per share for aggregate gross proceeds of $230 million. The proceeds from the offering were used, as planned, to support ongoing capital expenditure programs and for general corporate purposes.

The Company plans to continue to use commercial paper, existing credit facilities and publicly or privately issued medium-term notes for its financing requirements. Current and longer-term financing requirements could also be funded by a sale of a portion of the Company’s investment in Capital Power, pursuant to applicable agreements with Capital Power and as market conditions permit. Instability in the credit, equity and economic environments may adversely affect the interest rates at which the Company is able to borrow and may adversely affect the Company’s ability to sell a portion of its investment in Capital Power.

If the economy were to deteriorate in the longer term, particularly in Canada and the U.S., the Company’s ability to extend the maturity or revise the terms of 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 extend the maturity or revise the terms of 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 our capital programs and operating costs to minimize the risk that the Company becomes short of cash or unable to honor its obligations. If required, the Company would look to reduce capital expenditures and operating costs and/or sell a portion of its investment in Capital Power pursuant to applicable agreements with Capital Power and as market conditions permit.

As at March 5, 2013, there were three common shares of the Company outstanding, all of which are owned by the City. EPCOR’s dividend policy for these common shares, as set by the City, was modified in 2012. Effective for 2012, the annual dividend is set at $141 million, subject to annual review by EPCOR’s Board and recommendation to the City. The dividend will remain fixed at that level unless the Board recommends a change to the City. Under the prior policy, which was unchanged from 2000 through 2011, the annual dividend was set in the fall for the following year at the greater of: (i) the current year’s dividend adjusted for the forecast change in the consumer price index; and (ii) 60% of the following year’s forecast earnings available to the common shareholder. In accordance with the prior policy, the annual dividends for 2011 were $138 million.

Credit Ratings

Years ended December 31,	2012	2011	2010
Credit ratings			
Standard & Poor's			
Long-term debt	BBB+	BBB+	BBB+
DBRS Limited			
Short-term debt	R-1 (low)	R-1 (low)	R-1 (low)
Long-term debt	A (low)	A (low)	A (low)

These credit ratings reflect the Company's ability to meet its financial obligations given the stable cash flows generated from the regulated water and distribution and transmission businesses. The Company's sale of the power generation assets in 2009 served to improve certain creditworthiness measures. However, the Company continues to be exposed indirectly to the power generation related risks through its remaining 29% economic interest in Capital Power, as well as the long-term loans receivable from Capital Power. As both the equity interest and long-term loans receivable decrease and are replaced with rate-regulated distribution and transmission and water infrastructure assets, the Company's creditworthiness is expected to improve. A credit rating downgrade for EPCOR could result in higher interest costs on new borrowings and reduce the availability of sources and tenor of investment capital.

Financial Covenants

EPCOR is currently in compliance with all of its financial covenants as set out in its bank credit agreements and the financial covenants of its Canadian public medium-term notes and U.S. private-debt notes. Based on current financial covenant calculations, the Company has sufficient capacity to borrow to fund current and long-term requirements. Although the current risk of breaching these covenants is low, it could potentially result in a revocation of EPCOR's credit facility causing a significant loss of access to liquidity.

The Company's indebtedness is subject to a number of financial covenants which are monitored for compliance. No breach of covenants has occurred. The Company's indebtedness is subject to a number of financial covenants which are monitored for compliance. The Company continues to be in compliance with the financial covenants of its credit facilities and publicly and privately issued debt.

The key financial covenants and their thresholds, as defined in the respective agreements, and EPCOR's actual measures at December 31, 2012 and December 31, 2011 were as follows:

	Actual 2012	Financial Covenant 2012	Actual 2011	Financial Covenant 2011
Modified consolidated net tangible assets to consolidated net tangible assets[1]	100%	> or = 85%	100%	> or = 85%
Consolidated senior debt to consolidated capitalization ratio[2]	46%	< or = 70%	41%	< or = 70%
Interest coverage ratio[3]	4.12	> or = 1.75:1.00	3.90	> or = 1.75:1.00
Debt issued by subsidiaries to consolidated net tangible assets[4]	0%	< or = 12.5%	0%	< or = 12.5%

1. Modified consolidated net tangible assets to consolidated net tangible assets refers to the total assets of the material subsidiaries of the Company on a consolidated basis, less intangible assets, the Capital Power investment adjusted for cash distributions, and the back-to-back debt expressed as a percentage of the total assets of the Company on a consolidated basis, less intangible assets, the Capital Power investment adjusted for cash distributions and the back-to-back debt.
2. Consolidated senior debt to consolidated capitalization refers the Company's total unsubordinated long-term debt expressed as a percentage of total unsubordinated long-term debt plus and shareholder's equity. This excludes subordinated debt which has a lower ranking for repayment.
3. Interest coverage ratio refers to the Company's ability to pay the interest that arises on outstanding debt. It is calculated by dividing the Company's operating income before interest income and, depreciation and amortization expense plus cash distributions received from Capital Power by the Company's interest expense on loans and borrowings less interest income. The interest coverage ratio is not applicable if the Company has an investment grade credit rating.
4. Limitation of debt issued by subsidiaries refers to the total debt held by the Company's subsidiaries that is not guaranteed by the Company plus total debt held by material subsidiaries which is secured by the subsidiaries' assets expressed as a percentage of the Company's total assets less any intangible assets.

2013 Cash Requirements

EPCOR's projected cash requirements for 2013 includes $300 million to $450 million for capital expenditures and acquisitions (including $105 million for EPCOR's share of the Heartland Transmission project), $141 million for common share dividends, $118 million in interest payments, and $26 million for repayments of long-term loans and borrowings.

If total cash requirements for 2013 remain as planned, the sources of capital will be cash on hand, operating cash flows, partnership distributions from Capital Power and interest and principal payments related to the long-term loans receivable from Capital Power. Should these sources of capital be insufficient, the Company may rely on the issuance of commercial paper, existing credit facilities, public or private debt offerings or sell a portion of its remaining interest in Capital Power. When the Company sells a portion of its interest in Capital Power in order to generate capital, it results in lower future partnership distributions from Capital Power due the reduced economic interest. The Company is pursuing growth opportunities which may be funded by any of the sources of capital listed above.

The Company has an adequate contractual liquidity position. At December 31, 2012, the Company had $232 million (2011 - $316 million) in cash and cash equivalents, and credit available under various bank lines as described above under Financing.

The Company expects to have sufficient liquidity to finance its plans and fund its obligations in 2013.

Contractual Obligations

The following table represents the Company's contractual obligations by year:

($ millions)	2013	2014	2015	2016	2017	2018 and thereafter	Total
Heartland Transmission project	$ 105	$ -	$ -	$ -	$ -	$ -	$ 105
Other capital projects[1]	14	-	-	-	-	-	14
Contracted energy purchases	52	-	-	-	-	-	52
Gold Bar transfer fee	10	6	1	-	-	-	17
Water Arizona and Water New Mexico billing and customer care services agreement	5	5	4	4	3	10	31
Water Arizona purchase and transportation of water agreements	6	-	1	-	1	3	11
Loans and borrowings net of sinking fund payments received	18	14	15	145	15	1,777	1,984
Interest payments on loans and borrowings	122	117	117	112	107	1,379	1,954
Operating leases, net	10	8	9	8	8	109	152
Total contractual obligations	$ 342	$ 150	$ 147	$ 269	$ 134	$ 3,278	$ 4,320

1. EPCOR's obligations for capital projects include obligations for various distribution and transmission projects as directed by the AESO, the Suncor Voyageur project and the Customer Relationship Management Software project.

In the normal course of business, EPCOR provides financial support and performance assurances, including guarantees, letters of credit and surety bonds, to third parties in respect of its subsidiaries. The liabilities associated with these underlying subsidiary obligations are included in the consolidated balance sheet.

The Company's long-term lease agreement for commercial space in a downtown Edmonton office tower has an initial lease term of 20 years, expiring on December 31, 2031, and provides for three successive five-year renewal options. Under the terms of the lease, the Company has committed to make annual payments of $7 million for the period of January 1, 2013 through December 31, 2013, $6 million for the period of January 1, 2014 through December 31, 2022, $7 million for the period of January 1, 2023 through December 31, 2023 and $8 million for the period of January 1, 2024 through December 31, 2031, net of annual payments committed to be paid to the Company under two sublease agreements. The first is a sublease agreement with Capital Power under the same terms and conditions as the Company's lease with the landlord. The second sublease is to a third party for a term that commences on November 1, 2013 and expires on October 31, 2023 with two renewal options of four years each.

The Company has committed to various distribution and transmission projects through 2013, as directed by AESO. The total estimated project costs are $13 million (2011 - $40 million). The Company has incurred costs of $2 million to the end of 2012 (2011 - $23 million).

In March 2009, the Gold Bar wastewater assets and associated long-term debt were transferred to EPCOR from the City. EPCOR issued $112 million of long-term debt to the City and incurred a $75 million transfer fee payable to the City for the Gold Bar asset transfer. The remaining long-term debt bears interest at a weighted average interest rate of approximately 5.10% and remaining principal repayments are included in the table of contractual obligations above. The transfer fee is payable in annual installments over the period from 2009 to 2015 and is included in the table of contractual obligations above.

The Company has entered into an agreement for billing and customer care services for Water Arizona and Water New Mexico. The contract term is for ten years, expiring on August 31, 2021.

Water Arizona maintains agreements with the Central Arizona Water Conservation District for the purchase and transportation of water. These agreements are for terms of 100 years expiring at the end of 2107. Under the terms of these agreements, certain minimum payments of approximately $0.5 million are due each year in order to maintain the agreements until they expire. Additional payment obligations related to orders placed in the fall of each year for water to be purchased and transported the following year, commit the Company only for the amount of the water ordered. The obligations are $8 million total from 2013 through 2017 and $3 million thereafter.

OUTLOOK

In 2012, we focused on prudent and responsible business operations and growth in water and electricity infrastructure. In 2013, we intend to focus on continued growth in water and electricity rate-regulated infrastructure in conjunction with further expansion of commercial water operations.

Demand for water is expected to continue to increase and we anticipate increased requirements for better water management practices including watershed management and conservation. With municipal budgets under pressure, municipal governments are considering the opportunities presented by public-private partnerships. We will pursue expanding our portfolio of commercial water contracts, particularly in the Alberta oil sands.

The existing electricity transmission infrastructure in Alberta is inadequate to meet the growing demand for electricity in the province and we will continue to strongly support government and public approval for the construction of additional transmission capacity in the province.

Commencing in 2013, the Company's electricity distribution business will operate under a PBR framework rather than a cost of service model. Under the PBR framework, rates for electricity distribution services will be adjusted annually by a formula recognizing expected inflation and achievable productivity improvements. The stated objectives of PBR include promoting efficiency, allowing the opportunity for affected companies to earn a fair return and recover prudently incurred costs, reducing the regulatory burden, recognizing the uniqueness of affected companies and allowing customers to share in the benefits. A PBR framework differs substantially from the historic cost of service model whereby utilities are allowed to recover prudent costs and earn a set rate of return. The 2012 cost of service rates approved by the AUC in October 2012 for the Company's electricity distribution business will form the basis for 2013 rates under the PBR framework. The Company's electricity transmission business will continue to operate under a cost of service model. The Company expects to file its electricity transmission business cost of service rate application for the years 2013 - 2014, in the second quarter of 2013.

In May 2012, the Company filed its Energy Services cost of service rate application, for 2012 – 2013. A decision regarding the cost of service application is expected in the first half of 2013.

In February 2012, the Government of Alberta announced a number of initiatives including a rate freeze on electricity distribution, transmission, and administrative charges which remained in effect until January 2013, and an independent panel review of the retail electricity market in Alberta. As a result, the Retail Market Review Committee (RMRC) was established to review the regulated rate option to help address volatility and costs. The RMRC reported its findings to the Alberta government in September 2012. In January 2013, the Alberta government announced its actions in respect of the RMRC findings. The key decisions by the government affecting EPCOR are: (i) the Regulated Rate Option (RRO) will continue and not be phased out and affected Alberta customers will not be forced to sign a competitive contract (the RRO Regulation will be extended to June 30,2018); (ii) the RRO Regulation will be amended to extend the procurement window for electricity under the RRT from 45 days to 120 days effective immediately; and (iii) the AUC has been advised to lift the rate freeze to allow for recovery of amounts owed to utilities. These actions affect EPCOR's Energy Services and Distribution and Transmission segments. EPCOR has an agreement in principle with its customer representatives to amend its EPSP to include the new procurement purchasing window in a revised EPSP. We will also commence the monthly recovery of amounts earned but frozen during the rate freeze as early as possible in 2013.

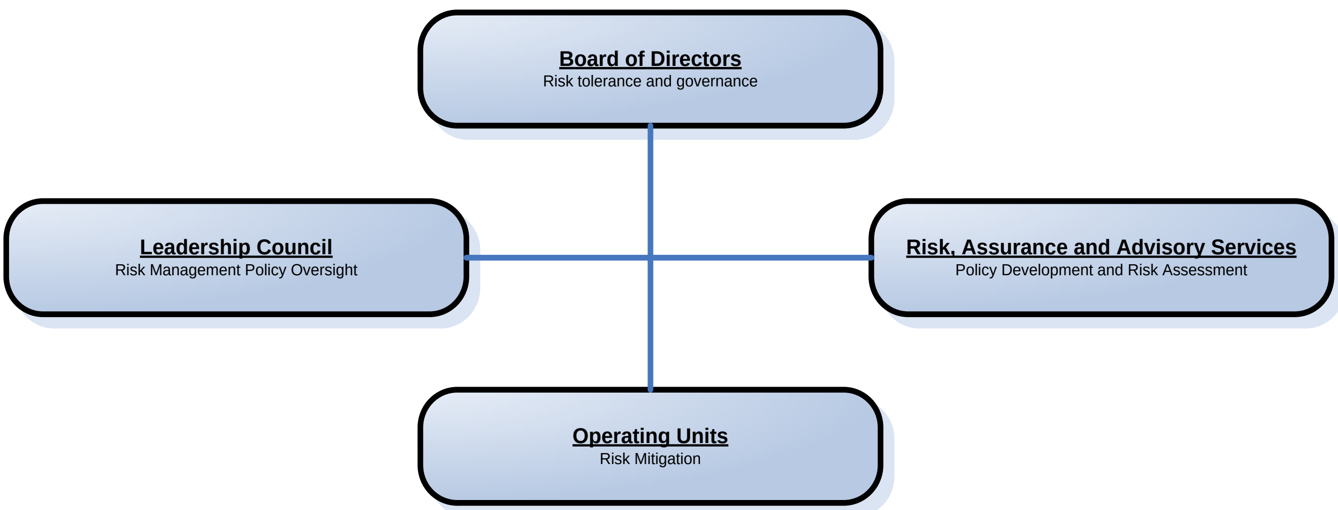
In May 2012, President & CEO Don Lowry announced his intention to retire from the Company by December 2013, after 14 years of service. The Company commenced an extensive local, national, and international search for a successor candidate. Mr. Lowry has agreed to remain with EPCOR as a resource as long as required to ensure a smooth transition for his successor.

In February 2013, the Board of Directors of EPCOR announced the appointment of David Stevens as the Company's new President & CEO. David Stevens will assume the responsibilities of President & CEO in March 2013. As President & CEO of EPCOR, David Stevens will assume responsibility for leading the executive management team and overseeing all strategic, operations, financial and brand-building facets of the Company's interests in Canada and the U.S. David Stevens is a 30-year veteran of the energy and utility industry with over 20 years of experience in executive leadership.

Earnings from core operations are expected to be higher in 2013 due to higher approved utility rates and new commercial water and wastewater treatment contracts expected in 2013.

RISK FACTORS AND RISK MANAGEMENT

Approach to risk management



Our approach to enterprise risk management (ERM) is to identify, monitor and manage the key controllable risks facing the Company and consider appropriate actions to respond to uncontrollable risks. ERM includes the controls and procedures implemented to reduce controllable risks to acceptable levels and the identification of the appropriate management actions in the case of events occurring outside of management's control. Acceptable levels of risk and risk appetite for EPCOR are established by the Board of Directors, representing the shareholder, and are embodied in the decisions and corporate policies associated with risk. ERM is generally carried out at three levels. Firstly, general ERM oversight framework reviews and recommendations, and reviews of risk compliance are provided by Leadership Council, EPCOR's senior executive group, based upon objectives, targets and policies approved by the Board of Directors. Secondly, the Director, Risk, Assurance and Advisory Services is responsible for developing the framework and assessing risk at an enterprise level and monitoring compliance with risk management policies. The Director, Risk, Assurance and Advisory Services provides the Board of Directors with an enterprise risk assessment quarterly. Thirdly, the business units and shared service units are responsible for carrying out the risk management and mitigation activities associated with the risks in their respective operations. These risk management activities are integral aspects of the business units' and shared service units' operations. EPCOR believes that risk management is a key component of the Company's culture and we have put into place cost-effective risk management practices. At the same time, EPCOR views risk management as an ongoing process and we continually review our risks and look for ways to enhance our risk management processes.

The Company's Ethics Policy includes procedures which provide for confidential disclosure of any wrong-doing relating to accounting, reporting and auditing matters. The policy prohibits any retaliation against any person making a complaint. During 2012, no significant substantiated complaints were received under the Ethics Policy.

Risks Related to Investment in Capital Power

Significant reliance is placed on the capacity of Capital Power to honor its back-to-back debt obligations with EPCOR. While EPCOR has a significant economic interest in Capital Power, EPCOR does not control Capital Power. Should Capital Power fail to satisfy these obligations, EPCOR's capacity to satisfy its debt obligations would be reduced and EPCOR would need to satisfy its own debt obligations by other means. The back-to-back debt obligations may be called by EPCOR for repayment once its ownership interest in Capital Power is below 20%. The repayment must occur within 180 days of notice if the principal balance outstanding is less than to $200 million or 365 days of notice if the principal balance outstanding is equal to or greater than $200 million.

In addition, EPCOR relies on the cash flow from Capital Power partnership distributions as one of the Company's funding sources. The Capital Power distributions are paid at the discretion of the general partner of Capital Power L.P., which EPCOR does not control. There can be no assurance that Capital Power L.P. will continue to pay distributions at current levels as the distributions may be reduced or eliminated entirely in the future. Reduced future distributions as a result of our expressed intent to sell down our interest in Capital Power over time are expected and have been factored into our plans.

Underlying these risks are the specific business risks of Capital Power. EPCOR has no ability to manage these risks directly. EPCOR, by virtue of its holdings of exchangeable limited partnership units in Capital Power L.P., currently has four elected directors on the Board of Capital Power. This does give EPCOR some input into certain of the operating and strategic decisions made by Capital Power, including risk management. EPCOR can indirectly reduce its exposure to these risks by reducing its interest in Capital Power.

Capital Power has indemnified EPCOR for any losses arising from its inability to discharge its liabilities, including any amounts owing to EPCOR in relation to the long-term loans receivable.

Operational Risks

The ability of the water treatment plants to maintain adequate treatment and testing of water on a continuous basis is essential in seeking to ensure that the prescribed requirements under regulation or conventional industry standards are met. Failure to properly maintain fully functioning treatment and measurement systems and provide a reliable source of water could result in regulatory fines, lost revenue or potential lawsuits.

Although distribution and transmission facilities have operated through their construction and periodic upgrades and have generally continued operations in accordance with expectations, there can be no assurance that they will continue to do so. To the extent that these networks experience outages due to equipment failure or suffer disruption for other reasons, delivery of power or water and associated revenues may be negatively affected.

Operational risk in Distribution and Transmission, and Water Services is managed through sound maintenance and safety practices. Water Services performs continuous and rigorous quality control testing of water purification consistent with government and industry standards. The ability of the water treatment plants to maintain adequate treatment requirements is dependent on continuous water testing in order that the prescribed requirements under regulation or conventional industry standards are met. Failure to properly maintain fully functioning treatment and measurement systems could result in regulatory fines, lost revenue or the occurrence of public health issues. Our maintenance practices are augmented by an inventory of strategic spare parts, which can reduce down-time considerably in the event of power or water system interruptions.

We use several key computer application systems to support our various operations such as electricity and water distribution network control systems, electricity and water plant control systems and electricity settlement and billing systems. These systems and the associated hardware are vulnerable to malfunction and unauthorized access, including cyber-attacks, which could divert Company assets or otherwise disrupt operations. We take measures to reduce the risk of malicious corruption or failure of these systems and the hardware and network infrastructure on which they operate, as well as theft of electronic data.

Political, Legislative and Regulatory Risk

EPCOR is subject to risks associated with changing political conditions and changes in federal, provincial, state, local or common law, regulations and permitting requirements in Canada and the U.S. It is not possible to predict changes in laws or regulations that could impact the Company's operations, income tax status or ability to renew permits as required.

EPCOR is subject to risks associated with the rate regulation processes that much of its operations are subject to. Such processes can result in significant lags between the time changes to customer rates or tariffs are applied for and the time that regulatory decisions are received. Furthermore, the regulator may deny or alter the applied for customer rates or tariffs.

Under the Settlement System Code of the *Electric Utilities Act* (Alberta), a retailer must rely on load settlement agents to provide customer consumption data to be used in computing its customers' bills. Under the *Alberta Regulated Rate Option Regulation*, regulated rate providers may not collect from customers an amount undercharged due to a billing error if the consumption occurred more than 12 months before the date of the revised billing.

The AUC sets rates intended to permit the regulated Distribution and Transmission and RRT customer services businesses to recover estimated costs of providing service plus a fair return on equity. The AUC has announced that effective January 1, 2013, it will be moving to a PBR structure for electricity distribution and natural gas distribution utilities in Alberta. Under the PBR, EPCOR's annual distribution rates will be set by a formula that is generally equal to last year's rate plus an inflation factor less a productivity factor plus a provision for limited additional capital additions (capital trackers). Our ability to recover the actual costs of providing service and to earn a fair return is dependent upon achieving the implicit underlying cost forecasts, achieving the productivity factor and not exceeding the underlying capital additions all as defined by the PBR formula. EPCOR, as well as other Alberta electric distribution companies, has appealed the 2012 PBR rate decision on the basis that the determination of capital trackers in the PBR formula is materially flawed and puts distribution utilities owners at greater risk for cost recovery and returns on unavoidable but required capital additions.

Electricity rates in Alberta for RRO eligible customers are based entirely on the index price of the next month's cost of electricity. As this electricity pricing model results in increasing volatility in prices to our customers, it may impact our volume of electricity sales, as well as electricity margins. In January 2013, the Alberta government announced that the procurement window for the purchase of electricity for RRO customers will be expanded from 45 days to 120 days, which is expected to reduce the volatility of electricity prices for RRO customers. In February 2013, EPCOR and its customer representatives agreed in principle to amend the EPSP. The amendments incorporate the 120 day procurement window, provide an increased return margin to EPCOR and establish an automatic quarterly risk adjustment mechanism that will adjust margins up or down if the electricity commodity risk has increased or decreased significantly over the relevant period. The EPSP amending agreement is expected to be filed in the first half of 2013 for approval by the AUC.

EPCOR's water treatment and distribution services to customers within Edmonton are rate-regulated by Edmonton City Council pursuant to a PBR Plan bylaw. Edmonton City Council approved a renewal of the PBR Plan bylaw in October 2011 for the five-year period commencing April 1, 2012. The renewal also incorporated the costs associated with the provision of wastewater treatment services supplied from Gold Bar to the residents of Edmonton. Rates approved under this bylaw are intended to allow the Company to recover its operating costs and earn a return on equity, as well as provide an incentive to manage cost increases below inflation. If the performance targets outlined in the bylaw are achieved, water and wastewater rates are increased by the change in the rate of inflation less an efficiency factor. Our ability to fully recover operating and capital costs and to earn a fair return is dependent upon achieving the performance targets prescribed in the bylaw, maintaining cost increases below inflation and managing operational risks.

Rates associated with wastewater treatment services provided to the residents of Edmonton at Gold Bar are regulated by Edmonton City Council. The master agreement related to the transfer of Gold Bar from the City to EPCOR in March 2009 contains provisions to address the allocation of Edmonton City Council-approved sanitary utility fees charged to Edmonton residents and businesses, to EPCOR and the City's Drainage Services department. EPCOR's allocation of the fees is for wastewater treatment, and the City's Drainage Services department's allocation of the fees is for collection and transmission of wastewater to Gold Bar. Up to March 31, 2012, EPCOR's net income was affected by the revenue allocation between EPCOR and the City's Drainage Services department, which was based on a relative cost of service between the collection and transmission and wastewater treatment functions, and our ability to obtain approval for sanitary utility rate increases from the regulator, Edmonton City Council, for the recovery of our costs and a fair return on equity. Effective April 1, 2012, EPCOR's Gold Bar wastewater treatment fees are incorporated under the PBR Plan as stated above, and as a result, no allocation of the fees is required.

Rates for water sales to regional water commissions that supply water to communities surrounding Edmonton are regulated by the AUC on a complaints-only basis, whereby such communities may apply to the AUC to resolve disputes related to rates, tolls or charges determined by the Company. EPCOR sets the rates it charges to these regional water commissions to recover related operating and capital costs plus a reasonable rate of return. Actual operating and capital costs associated with the provision of water to the commissions, and a fair return on rate-base, are recovered in accordance with a full cost-of-service method.

Water and wastewater services in the U.S. are provided by EPCOR's U.S. subsidiaries and are subject to state laws and regulation by the state regulatory commissions within Arizona and New Mexico. Rates and services in Arizona are in compliance with the laws of Arizona and are regulated by the Arizona Corporation Commission and the rates are determined using cost-of-service principles applied to a historical test year. Rates and service in New Mexico are in compliance with the laws of New Mexico and are regulated by the New Mexico Public Regulation Commission. The rates are also determined using cost-of-service principles applied to a historical test year. Rates approved by the regulatory commissions are intended to allow for a recovery of operating and capital costs and provide for a fair return on equity. Our ability to fully recover operating and capital costs and earn a fair return is dependent upon achieving our capital and operating cost targets built into the rates, and meeting the customer growth and water usage targets built into the rates. Since rates are established on a historical cost basis, any new capital additions for water or wastewater infrastructure must be carefully planned and evaluated before commencement since the addition of such costs to the regulatory rate base for subsequent recovery will only take place after the new infrastructure is built and the regulator approves the prudency of the rate base additions through the rate application process. Accordingly, there will be time lags for cost recovery and potential cost disallowances.

Strategy Execution Risk

Our growth strategy is dependent on the development, acquisition and operation of water and wastewater infrastructure for municipal, commercial and industrial customers primarily in the Alberta oil sands region and the Southwestern U.S. Both of these markets are defined as emerging and currently do not have clearly established protocols for third party participants such as EPCOR and are subject to a variety of external forces. For example, the oil sands market could be potentially delayed by postponement of capital projects and depressed oil prices. Should either of these markets not develop as quickly or as fully as envisioned, the Company's growth plans could be similarly delayed.

EPCOR's growth strategy is also dependent on the development or acquisition of new electricity distribution and transmission assets. Such growth is dependent on the availability of such assets in the marketplace which will be impacted by the willingness of parties to sell such assets, political and public sentiment regarding third party ownership and EPCOR's cost competitiveness. These risks could result in delays or curtailment of EPCOR's growth plans.

Business development projects, including acquisitions, can take a relatively long period of time to execute, exposing such projects to event and external factor risks that may emerge and thereby alter project economics or completion.

For each new business development project, EPCOR seeks to ensure project success by addressing project risks, including events and external factors, as part of its due diligence process.

Weather Risk

Weather can have a significant impact on our operations. Melting snow, freeze / thaw cycles and seasonal precipitation in the North Saskatchewan River watershed affect the quality of water entering our Edmonton water treatment plants and the resulting cost of purification. Weather variability and seasonality also impact the demand and supply of water and electricity in our respective businesses in both Canada and the U.S. Extreme weather can impact the physical operation of our facilities.

Extreme weather can cause damage to distribution and transmission equipment and wires, temporarily disrupting the reliable supply of power to customers and can cause unpredictability in the demand for power. Unseasonal temperature changes can cause water main breaks temporarily disrupting the reliable supply of water to customers.

Weather that varies significantly from historical norms can result in changes in quantity and shape of the provincial power load. EPCOR procures power to service its RRO customers in advance of the consumption month and the quantity procured is based on historical weather and usage patterns. Unseasonal temperatures can cause a mismatch between the power procured in advance of the consumption month and actual customer usage, resulting in unexpected variances in income from the RRO business.

Financial exposures associated with extreme weather are partly mitigated through our insurance programs.

Financial Liquidity Risk

EPCOR's internally generated cash flows from operating activities do not provide sufficient capital to undertake or complete ongoing or future development, enhancement opportunities or acquisition plans and accordingly, the Company requires additional financing from time to time. The ability of the Company to arrange such financing will depend in part upon prevailing market conditions at the time, the Company's business performance as well as the ability to sell additional interests in Capital Power. If the Company's revenues or cash flows decline, it may not have the capital necessary to undertake or complete the initiatives. There can be no assurance that debt or equity financing will be available or that cash generated by operations will be sufficient to meet these requirements or for other corporate purposes. Furthermore, if financing is available, there can be no assurance that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's business, prospects and financial condition. Further discussion is included in Liquidity and Capital Resources in this MD&A.

EPCOR's financial risks are governed by a Board-approved financial exposure management policy, which is administered by EPCOR's Treasurer.

Environment Risk

There are a variety of environmental risks associated with EPCOR's water and wastewater operations and its electricity distribution and transmission businesses. EPCOR's power and water operations are subject to laws, regulations, and operating approvals which are designed to reduce the impacts on the environment. Environmental risks associated with water and wastewater operations include water supply, wastewater discharge, biogas release, and residuals management. Risks associated with electricity distribution and transmission operations include the unintended environmental release of substances such as oil from its oil-filled pipe-type cable, hydraulic oil and polychlorinated biphenyl transformer fluid. A material environmental event could materially and adversely impact EPCOR's business, prospects, reputation, financial conditions, operations or cash flow. Furthermore such incidents could result in spills or emissions in excess of those permitted by law, regulations or operating approvals.

Compliance with future environmental legislation may require material capital and operating expenditures and failure to comply could result in fines and penalties or the regulator could force the curtailment of operations. There are uncertainties associated with current legislative proposals including implementation details, their impact on current licenses and permits, and how compliance costs might be recovered through prices or shared among customers and stakeholders. Further, there can be no assurances that compliance with or changes to environmental legislation will not materially and adversely impact EPCOR's business, prospects, financial conditions, operations or cash flow.

EPCOR's water operations are regulated with stringent water and wastewater treatment standards and controls covering quality of treated water and wastewater effluent, the number, frequency and form of water quality testing, as well as mandatory improvements to the water and wastewater treatment processes. Water and wastewater technologies and supporting processes are continuing to evolve and be influenced by more stringent regulation and environmental challenges. Failure to identify and deploy viable new technologies to meet these regulations and challenges could undermine the competitiveness of EPCOR's market position and exclude it from some market opportunities.

We seek to ensure that we comply, in all material respects, with the laws, regulations and operating approvals affecting our facilities, and minimize the potential for incidents by incorporating environmental management practices in our strategy, policies, processes and procedures. To achieve this, we require each facility to have an environmental management system (EMS) which is based on the ISO 14001 standard. These systems encompass the identification of the scope, objectives, training and stewardship of our environmental responsibility. Each plant and facility is also subject to environmental audits to help ensure compliance with the EMS and all regulations. The Edmonton waterworks system (including the Rossdale and E.L. Smith water treatment plants) achieved EnviroVista Champion status as of June 2011. Additionally, EPCOR Water Services is working towards formal implementation of an ISO 14001 Environmental Management System designation for the Gold Bar facility.

In Arizona, we obtain surface water primarily from the Central Arizona Project canal to treat and sell to customers. The Central Arizona Project conducts water quality testing upstream of the take-off points and has a formal notification process in place to notify our Arizona operations of any water quality issues that may arise. Process and compliance sampling results are stringently analyzed and trended for all groundwater and surface water systems in Arizona and New Mexico to ensure systems continue to meet all regulatory standards. Each system in Arizona and New Mexico has an Emergency Operations Plan which addresses environmental water quality issues and provides further risk mitigation.

Our strategy includes a commitment to environmental performance on existing and new facilities and EPCOR's environmental policy commits the Company and all of its employees to environmental compliance and stewardship. Our water and wastewater operations are controlled through stringent water treatment standards and controls covering the quality of treated water and the number, frequency and form of water quality testing, as well as mandatory improvements to the water treatment process. Water and wastewater technologies and supporting processes are continuing to evolve and be influenced by more stringent regulation and environmental challenges. The Company is actively involved in a watershed management program, which involves the protection and management of our Edmonton water source from impurities such as soil particles, excess nutrients, fertilizers, microbiological contaminants and organic materials. Activities include river water quality monitoring, forming stakeholder partnerships to work on watershed issues, and acting as a resource and leader on quality issues of the North Saskatchewan River Basin. Although there are no formal watershed protection groups in the Arizona and New Mexico service areas, all water systems in the two states underwent source water assessments to determine whether and to what degree the sources were vulnerable to contamination from adjacent land uses. These water assessments were conducted in Arizona and New Mexico between 2002 and 2005 by the Arizona Department of Environmental Quality and New Mexico Environment Department, respectively. Wells in Arizona and New Mexico are protected from contamination by proper well construction and system operation and management.

Electricity Price and Volume Risk

EPCOR sells electricity to RRO customers under a RRT. The amount of electricity to be procured, the procurement method and electricity selling prices to be charged to these customers is determined by the EPSP under which the Company directly manages procurement of the electricity for the RRO customers. All electricity for the RRO customers is purchased in real time from the AESO in the spot market. Under the EPSP, the Company uses financial contracts to hedge the RRO requirements and incorporate the price into customer rates for the applicable month. Fixed volumes of electricity are purchased at fixed prices using financial contracts-for-differences up to 45 days in advance of the month in which the electricity (load) is consumed by the RRO customers. The volume of electricity purchased in advance is based on load (usage) forecasts for the consumption month. When consumption varies from forecast consumption patterns, EPCOR is exposed to prevailing market prices because it must either buy electricity if its volumes procured are short of actual load requirements or sell the electricity if its volumes procured are greater than the actual load requirements (long). Exposure to variances in electricity volume can be exacerbated by other events such as unexpected generation plant outages and unusual weather patterns. In January 2013, the government of Alberta announced that the province will extend the purchasing window from 45 days to 120 days. In February 2013, EPCOR and its customer representatives agreed in principle to amend the EPSP, including the 120 day procurement window.

Under contracts-for-differences, the Company agrees to exchange, with a single creditworthy and adequately secured counterparty, the difference between the AESO electricity spot market price and the fixed contract price for a specified volume of electricity up to 45 days (120 days once the amended EPSP is approved by the AUC) in advance of the consumption date, all in accordance with the EPSP. The contracts-for-differences are referenced to the AESO electricity spot price and any movement in the AESO price results in changes in the contract settlement amount. If the risks of the EPSP were to become untenable, EPCOR could test the market and potentially re-contract the procurement risk under an outsourcing arrangement at a certain cost that would likely increase procurement costs and reduce margins.

Project Risk

Our construction and development of electricity transmission and distribution and water treatment facilities and acquisition activities are subject to various engineering, construction, stakeholder, government and environmental risks. These risks can translate into performance issues, delays and cost overruns. Project delays may delay expected revenues and project cost overruns could make projects uneconomic. Our ability to complete projects successfully depends upon numerous factors beyond our control such as unexpected cost increases, ability of third parties to access financing or credit facilities, accidents, availability of skilled labor, strikes and regulatory matters. Many of the water and wastewater growth projects currently pursued by the Company require design and construction capabilities that are not part of the services presently offered by EPCOR. In order to pursue these projects, strategic partnerships have been established with reputable firms that have an established track record of infrastructure design and construction. Should these partnerships dissolve or are not recognized by the market as a viable approach, the Company's growth plans will potentially be curtailed.

We attempt to mitigate project risks by performing detailed project analysis and due diligence prior to and during construction or acquisition, and by entering into favorable contracts for various services to be provided as required.

Availability of People

Our ability to continuously operate and grow the business is dependent upon retaining and developing sufficient labor and management resources. As with most organizations, the Company is facing the demographic shift where a large number of employees are expected to commence retirement over the next few years. Failure to secure sufficient qualified technical and leadership talent may impact EPCOR's operations or materially increase expenses.

We believe that we employ good human resource practices and have been named a top 60 employer in Alberta in 2013 by MediaCorp Canada Inc. Just a year after entering the metropolitan Phoenix market, EPCOR Water USA was officially selected as one of the "Best Places to Work" by The Phoenix Business Journal. We continue to monitor developments and review our human resource strategies so that we have an adequate supply of labor and management.

Credit Risk

Credit risk is the possible financial loss associated with the ability of counterparties to satisfy their contractual obligations to EPCOR, including payment and performance.

We manage credit risk and limit exposures through our credit policies and procedures. These include an established credit review, rating and monitoring process, specific terms and limits, appropriate allowance provisioning and use of credit mitigation strategies, including collateral arrangements.

RRO and Default Supply Credit Risk

Exposure to credit risk for residential and commercial customers under default electricity supply rates are generally limited to amounts due from the customers for electricity consumed but not yet paid for. As the electricity procurement for these customers has evolved and is conducted through a creditworthy exchange and the AESO, our potential exposure to losses for the purchase of electricity that is not consumed is relatively low.

This portfolio is reasonably well diversified with no significant credit concentrations. Historically, credit losses in these customer segments have not been significant and depend in large measure on the strength of the economy and the ability of the customers to effectively manage their financial affairs through economic cycles and competitive pressures. While electricity is considered an essential service and there has been some improvement in the economies in which the Company operates over the past two years, EPCOR may experience credit losses in the future should economic conditions deteriorate.

EPCOR's exposure to RRO and default customer credit risk, which is primarily the risk of non-payment for electricity consumed by these end-use customers, is summarized below. Exposures represent the accounts receivable value for this portfolio.

($ millions) **December 31,**	**2012**	**2011**
RRT and default supply customers[1, 2]	$ 176	$ 219

1. Under the *Alberta Electric and Utilities Act*, EPCOR provides electricity supply in its service area to RRO eligible customers and those commercial and industrial customers in its service areas who have not chosen a competitive offer and consume electricity under default supply arrangements.
2. EPCOR monitors credit risk for this portfolio at the gross exposure level rather than by individual customer account. RRT regulations allow for the recovery of forecasted credit losses relating to RRT and for the recovery of a percentage of unforecasted credit losses through a deferral account.

The year-over-year decrease in exposure relates to lower customer volumes and rates.

Water Credit Risk

Exposures to credit risk in our regulated and non-regulated water businesses are generally limited to amounts due from the customers for water consumed and wastewater discharged but not yet paid for, as well as amounts for water management services provided under contracts to municipal and industrial customers.

This portfolio is reasonably well diversified with no significant credit concentrations. Our operations expanded significantly in 2012 with the acquisition of Water Arizona and Water New Mexico. While water is considered an essential service and there has been some improvement in the economies in which the Company operates over the past two years, EPCOR may experience credit losses in the future should economic conditions deteriorate. EPCOR's exposure to regulated and non-regulated customer credit risk, which is primarily the risk of non-payment for water consumed by these end-use customers, is summarized below. Exposures represent a 60-day potential accounts receivable value for this portfolio.

($ millions) **December 31,**	**2012**	**2011**
Unrated customers	$ 61	$ 40
Rated customers[1]	$ 20	$ 15

1. Rated customers have investment grade credit ratings which are based on the Company's internal criteria and analyses, which take into account, among other factors, the investment grade ratings of external credit rating agencies when available.

Health and Safety Risk

Our operations have hazardous elements, like high voltage electricity and hazardous chemicals that could have adverse health and safety consequences to our employees, on-site suppliers and customers. Our operations are subject to the risks of a widespread influenza outbreak or other pandemic illness. We have developed plans in Canada to respond to a potential pandemic influenza to help maintain a sufficient healthy workforce and enable the Company to deliver reliable power and water to customers in such an event. We are developing similar protocols for our U.S. operations.

We manage health and safety risks through a company-wide health and safety management program and measure health and safety performance against recognized industry and internal performance measures. We conduct numerous external and internal compliance audits to verify that our health and safety management system meets or exceeds the regulatory requirements in which we operate our business. We are committed to working with industry partners to share and improve health and safety within the industry.

Conflicts of Interest

Certain conflicts of interest could arise as a result of EPCOR’s relationship with the City, EPCOR’s sole common shareholder and regulator for water and wastewater utility rates in Edmonton. The City has the authority to revise the dividend policy in respect of the common shares of the Corporation held by it.

Certain directors and a senior officer of EPCOR are directors of Capital Power. The Board of Directors of Capital Power currently has 12 members, four of whom are EPCOR nominated directors. The Chairman of the Board of Directors of Capital Power was the Chief Executive Officer of EPCOR until March 5, 2013.

Foreign Exchange Risk

The Company is exposed to foreign exchange risk on foreign currency denominated forecasted transactions, firm commitments, monetary assets and liabilities denominated in a foreign currency and on its net investments in foreign entities.

The Company’s financial exposure management policy attempts to minimize economic and material transactional exposures arising from movements in the Canadian dollar relative to the U.S. dollar or other foreign currencies. The Company’s direct exposure to foreign exchange risk arises on capital expenditure commitments denominated in U.S. dollars or other foreign currencies and U.S. operations. The Company coordinates and manages foreign exchange risk centrally, by identifying opportunities for naturally occurring opposite movements and then dealing with any material residual foreign exchange risks.

The Company may use foreign currency forward contracts to fix the functional currency of its non-functional currency cash flows thereby reducing its anticipated U.S. dollar denominated transactional exposure. The Company looks to limit foreign currency exposures as a percentage of estimated future cash flows.

General Economic Conditions, Business Environment and Other Risks

Fluctuations in interest rates, product supply and demand, market competition, risks associated with technology, general economic and business conditions, EPCOR’s ability to make capital investments and the amounts of capital investments, risks associated with existing and potential future lawsuits and other regulations, assessments and audits (including income tax) against EPCOR and its subsidiaries, political and economic conditions in the geographic regions in which EPCOR and its subsidiaries operate, difficulty in obtaining necessary regulatory approvals, a significant decline in EPCOR’s reputation and such other risks and uncertainties described from time to time in EPCOR’s reports and filings with the Canadian Securities authorities could materially adversely impact EPCOR’s business, prospects, financial condition, results of operations or cash flows. Transmission risk relates to blackouts or constraints on the system which result from curtailment of output at generation facilities or restrictions on the development of interconnections with new generation facilities. The following table outlines our estimated sensitivity to specific risk factors as at December 31, 2012. Each sensitivity factor provides a range of outcomes assuming all other factors are held constant and current risk management strategies are in place. Under normal circumstances, such sensitivity factors will not be held constant but rather, will change at the same time as other factors are changing. In addition, these sensitivities are presented at December 31, 2012 and the degree of sensitivity to each factor will change as the Company’s mix of assets and operations subject to these factors changes.

($ millions, except as otherwise noted) Factor	Change	Annual Cash Flow	Annual Net Income
Increase in RRO customers	+2.5%	+0.5	+0.5
Decrease in RRO customers	-5.0%	-1.0	-1.0
Increase in water consumption	+5.0%	+11.7	+11.7
Decrease in water consumption	-5.0%	-11.7	-11.7

Litigation Update

Following the AUC approval of the Heartland Transmission project facility application in November 2011, appeals were filed with the AUC and the Alberta Court of Appeal. Strathcona County and the citizens' group "Responsible Electricity Transmission for Albertans" (RETA) filed their appeals with the AUC, asking it to review and vary its original decision. The AUC denied those appeals. The Alberta Court of Appeal granted local residents leave to appeal to determine whether the AUC correctly interpreted legislation on critical transmission infrastructure. In December 2012, the Court dismissed this appeal.

In a separate action related to the Heartland Transmission project, the group RETA commenced an action in the Court of Queen's Bench of Alberta against the Minister of Infrastructure requesting a judicial review of the Minister's consent of construction of the 500 kilovolt transmission line through the East Transmission Utility Corridor between Edmonton and Sherwood Park. RETA is asking the Court to reverse the Minister's written consent to the project and suspend any further work. The judicial review application took place in January 2013. There is no prescribed time frame for the release of the decision, but it is expected to be released before mid-April 2013.

CONTROLS AND PROCEDURES

For purposes of certain Canadian securities regulations, EPCOR is a "Venture Issuer". As such, it is exempt from certain of the requirements of National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings. Accordingly, the Chief Executive Officer and Chief Financial Officer have reviewed the annual information form, annual financial statements and annual MD&A, for the year ended December 31, 2012. Based on their knowledge and exercise of reasonable diligence, they have concluded that these materials fairly present in all material respects the financial condition, results of operations and cash flows of the Company for the periods presented.

FUTURE ACCOUNTING STANDARD CHANGES

The following accounting standards and interpretations, which may be significant to the Company, were issued by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committees for application in future periods:

International Accounting Standards (IAS / IFRS)	Effective for annual periods beginning on or after:
IFRS 7 – Financial Instruments – Disclosures – Offsetting Financial Assets and Liabilities (Amendment)	January 1, 2013
IFRS 9 – Financial Instruments	January 1, 2015
IFRS 10 – Consolidated Financial Statements	January 1, 2013
IFRS 11 – Joint Arrangements	January 1, 2013
IFRS 12 – Disclosure of Interests in Other Entities	January 1, 2013
IFRS 13 – Fair Value Measurement	January 1, 2013
IAS 19 – Employee Benefits (Amendment)	January 1, 2013
IAS 28 - Investments in Associates and Joint Ventures (Amendment)	January 1, 2013
IAS 32 – Financial Instruments: Presentation	January 1, 2014

IFRS 7 – Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendment)

This standard was amended to require additional disclosure when an entity has the right to offset financial assets and financial liabilities and has presented the net amount in the statement of financial position. The Company does not expect this amendment to have a material impact on the financial statements.

IFRS 9 – Financial Instruments

This standard replaces IAS 39 – Financial Instruments: Recognition and Measurement, and eliminates the existing categories of financial assets and requires financial assets to be measured as either amortized cost or fair value. Gains and losses on re-measurement of financial assets at fair value will be recognized in profit or loss, except for an investment in an equity instrument which is not held-for-trading. Changes in fair value attributable to changes in credit risk of financial liabilities measured under the fair value option will be recognized in other comprehensive income with the remainder of the change recognized in profit or loss unless an accounting mismatch in profit or loss occurs at which time the entire change in fair value will be recognized in profit or loss. Derivative liabilities that are linked to and must be settled by delivery of an unquoted equity instrument must be measured at fair value. The Company does not expect the standard to have a material impact on the financial statements.

IFRS 10 – Consolidated Financial Statements (IFRS 10)

This standard replaces IAS 27 – Consolidated and Separate Financial Statements, and Standing Interpretations Committee (SIC) - 12 – Consolidation – Special Purpose Entities, and provides a single model to be applied in the control analysis for all investees, including entities that currently are special purpose entities in the scope of SIC 12. The Company does not expect this standard to have a material impact on the financial statements.

IFRS 11 – Joint Arrangements (IFRS 11)

This standard replaces IAS 31 – Interests in Joint Ventures, and SIC 13 - Jointly Controlled Entities - Non-Monetary Contributions by Vendors. IFRS 11 draws a distinction between joint operations and joint ventures. Entities which previously accounted for joint ventures using proportionate consolidation will generally be required to account for such ventures using the equity method. The Company does not expect the standard to have any impact on the treatment of its joint arrangements.

IFRS 12 – Disclosure of Interest in Other Entities (IFRS 12)

This standard contains the disclosure requirements for entities that have interests in subsidiaries, joint arrangements, associates and / or unconsolidated structured entities. When applied, it is expected that IFRS 12 will increase the current level of disclosure of the Company's interest in other entities.

IFRS 13 – Fair Value Measurement

This standard replaces the fair value measurement guidance contained in individual IFRS with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements. The Company does not expect the standard to have a material impact on the financial statements.

IAS 19 – Employee Benefits (Amendment)

This standard was amended and introduces changes related to: (a) eliminating the option to defer the recognition of actuarial gains and losses, known as the corridor method, (b) requiring a new method of calculating finance costs on defined benefit plans where a single discount rate is applied to the net pension assets or obligations, and (c) enhancing the disclosure requirements to provide better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in these plans. When applied, it is expected that $13 million in previously unrecognized net actuarial losses will be recognized in other comprehensive income.

IAS 28 – Investments in Associates and Joint Ventures

This standard was amended to conform with IFRS 10 and IFRS 11 accounting standards. The amendments apply to the measurement of a retained stake in an investment where significant influence is succeeded by joint control, and to the measurement of a retained stake in an investment, a portion of which has been classified as held for sale. The Company does not expect these amendments to have any impact on the financial statements.

IAS 32 – Financial Instruments: Presentation

This standard provides additional guidance on the application of offsetting criteria. The Company does not expect the standard to have a material impact on the financial statements.

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 financial statements.

Electricity Revenues, Costs and Unbilled Consumption

Due to the lag time between electricity consumption and receipt of final billing consumption information from the load settlement agents, the Company must use estimates for determining the amount of electricity consumed but not yet billed. These estimates affect accrued revenues and accrued electricity costs of the Energy Services segment. There are a number of variables and significant judgments required in the computation of these estimates, and the underlying electricity settlement processes within EPCOR and the Alberta electric systems are complex. Such variables and judgments include the number of unbilled sites, and the amount of and rate classification of the unbilled electricity consumed. Owing to the factors above and the statutory delays in final load settlement determinations and information, adjustments to previous estimates could be material. Estimates for unbilled consumption averaged approximately $77 million at the end of each month in 2012 (2011 - $78 million) and these estimates varied from $57 million to $117 million (2011 - $57 million to $103 million). Adjustments of estimated revenues to actual billings were not higher than $5 million per month in 2012 (2011 - $5 million).

Fair Values

We are required to estimate the fair value of certain assets or obligations for determining the valuation of certain financial instruments, asset impairments, asset retirement obligations and purchase price allocations for business combinations, and for determining certain disclosures. Significant judgment is applied in the determination of fair values including the choice of discount rates, estimating future cash flows, and determining goodwill. Following are the descriptions of the key fair value methodologies relevant for 2012.

Fair values of financial instruments are based on quoted market prices when these instruments are traded in active markets. In illiquid or inactive markets, the Company uses appropriate price modeling to estimate fair value. Fair values determined using valuation models require the use of assumptions concerning the amounts and timing of future cash flows and discount rates.

The Company reviews the valuation of long-lived assets subject to amortization when events or changes in circumstances may indicate or cause a long-lived asset's carrying amount to exceed the total undiscounted future cash flows expected from its use and eventual disposition. An impairment loss, if any, will be recorded as the excess of the carrying amount of the asset over its fair value, measured by either market value, if available, or estimated by calculating the present value of expected future cash flows related to the asset.

Estimates of fair value for long-lived asset impairments are mainly based on depreciable replacement cost or discounted cash flow techniques employing estimated future cash flows based on a number of assumptions, including the selection of an appropriate discount rate. The cash flow estimates will vary with the circumstances of the particular assets or reporting unit and will primarily be based on the lives of the assets, revenues and expenses, including inflation, and required capital expenditures.

Significant accounting estimates were made in determining the fair value of identifiable assets acquired and liabilities assumed in connection with the Water Arizona and Water New Mexico acquisition including discount rates, future income, replacement costs, useful lives, residual values and weighted average cost of capital. The fair values were determined using generally accepted methods and the assistance of a third party valuation expert.

Allowance for Doubtful Accounts

We continually review our aged accounts receivable and assess the underlying credit quality of our customers and counterparties. The allowance for doubtful accounts reflects an estimate of the accounts receivable that are ultimately expected to be uncollectible. It is principally based on the aging of receivables, historical write-offs within customer groups, assessments of the collectability of amounts from individual customers and general economic conditions. EPCOR's allowance for doubtful accounts averaged $4 million (2011 - $4 million) and reported bad debt expense was $9 million (2011 - $7 million). The estimate of the allowance affects accounts receivable and all segments' other administrative expenses.

Useful Lives of Assets

Depreciation and amortization allocate the cost of assets over their estimated useful lives on a systematic and rational basis. Depreciation and amortization also include amounts for future decommissioning costs and asset retirement obligation accretion expenses. Estimating the appropriate useful lives of assets requires significant judgment and is generally based on estimates of common life characteristics of common assets.

Income Taxes

EPCOR follows the asset and liability method of accounting for income taxes. Income taxes are determined based on estimates of our current taxes and estimates of deferred taxes resulting from temporary differences between the carrying values of assets and liabilities in the financial statements and their tax values. Deferred tax assets are assessed and significant judgment is applied to determine the probability that they will be recovered from future taxable income. For example, in estimating future taxable income, judgment is applied in determining the Company's most likely course of action and the associated revenues and expenses. To the extent recovery is not probable, a deferred tax asset is not recognized. Estimates of the provision for income taxes and deferred tax assets and liabilities might vary from actual amounts incurred.

Estimated fair values and useful lives are used in determining potential impairments for each long-lived asset, which will vary with each asset and market conditions at the particular time. Similarly, income taxes will vary with taxable income and, under certain conditions, with fair values of assets and liabilities. Accordingly, it is not possible to provide a reasonable quantification of the range of these estimates that would be meaningful to readers.

Impact of Current Market Conditions on Estimates

Although the current condition of the economy has not impacted our methods of estimating accounting values, it has impacted the inputs in those determinations and the resulting values. Future cash flow estimates for assessing long-lived assets for impairment were updated to reflect any increased uncertainties of recoverability. With the exception of our investment in Capital Power, the assessments did not result in any impairment losses because a large portion of the Company's long-lived assets are subject to rate-regulation. Similarly, the assessment of the useful lives of our long-lived assets did not change since many of our distribution and transmission assets and water assets located in the City and surrounding area are amortized based on rates approved by the applicable regulator. Our valuation models for estimating the fair value of long-lived asset impairments depend partly on discount rates which were updated to reflect changes in credit spreads and market volatility. Our methods for determining the allowance for doubtful accounts are based on historical rates of bad debts in relation to the aged accounts receivable balances by customer group for RRT and default customer bases. These analyses did not reveal any significant changes in our assessment of the recoverability of accounts receivable at December 31, 2012.

NON-IFRS FINANCIAL MEASURE

We use income from core operations to distinguish operating results from the Company's core water and electricity businesses from results with respect to its investment in Capital Power. It is a non-IFRS financial measure, which does not have any standardized meaning prescribed by IFRS and is unlikely to be comparable to similar measures published by other entities. However, it is presented since it provides a useful measure of the company's primary operations and it is referred to by debt holders and other interested parties in evaluating the Company's financial position and in assessing its creditworthiness.

A reconciliation of net income from core operations to net income is as follows:

($ millions) **Years ended December 31,**		**2012**		**2011**
Net income from core operations	**$**	**126**	**$**	**78**
Equity share of income from Capital Power		41		90
Loss on sale of a portion of and net loss on dilution of investment in Capital Power		(36)		(24)
Impairment of investment in Capital Power		(124)		-
Income tax recovery related to the above items		11		-
Net income	**$**	**18**	**$**	**144**

FINANCIAL INSTRUMENTS

The Company classifies its cash and cash equivalents and current and non-current derivative financial instruments assets and liabilities as held at fair value through profit or loss and measures them at fair value. Trade and other receivables are classified as loans and receivables. Debentures and borrowings, trade and other payables, Gold Bar transfer fee payable and customer deposits are classified as other financial liabilities. Both loans and receivables and other financial liabilities are measured at amortized cost and their fair values are not materially different from their carrying amounts due to their short-term nature. The Company's beneficial interest in the sinking fund related to the City debentures is classified as available for sale and measured at fair value.

The classification, carrying amounts and fair values of the Company's other financial instruments held at December 31, 2012 and December 31, 2011 are as follows:

($ millions) **Years ended December 31,**		**2012**		**2011**	
	Classification	**Carrying amount**	**Fair value**	**Carrying amount**	**Fair value**
Cash and cash equivalents	Fair value through profit or loss	$ 232	$ 232	$ 316	$ 316
Trade and other receivables	Loans and receivables	335	335	340	340
Derivatives	Fair value through profit or loss	(2)	(2)	11	11
Finance lease receivables	Loans and receivables	128	146	130	145
Other financial assets	Loans and receivables	404	447	431	486
Trade and other payables	Other liabilities	303	303	264	264
Loans and borrowings					
Debentures and borrowings	Other liabilities	2,128	2,561	1,943	2,336
Beneficial interest in sinking fund	Available for sale	(158)	(158)	(244)	(244)
Other liabilities					
Customer deposits	Other liabilities	20	20	21	21
Gold Bar transfer fee payable	Other liabilities	17	17	29	29

Loans and borrowings include the City debentures which are offset by the payments made by the Company into the sinking fund. Although the accumulated contributions to the sinking fund are classified as available for sale, they are included as an offset to long-term debt under other financial liabilities in the table above, consistent with their presentation on the balance sheet. The accumulated contributions to the sinking fund are measured at fair value.

The fair values of the Company's net investments in leases, included in finance lease receivables above, are based on the estimated interest rates implicit in comparable lease arrangements or loans plus an estimated credit spread based on the counterparty risk as at December 31, 2012 and December 31, 2011.

OTHER COMPREHENSIVE INCOME

For the year ended December 31, 2012, the Company's transactions in other comprehensive income included the Company's share of other comprehensive income of Capital Power of $11 million (2011 - $4 million of other comprehensive loss) and the reclassification to net income of retained power generation business accumulated other comprehensive loss upon the sale of a portion of and dilutions of the investment in Capital Power of $2 million (2011 - $5 million of other comprehensive income).

RELATED PARTY TRANSACTIONS

The Company provides utility services to key management personnel as it is the sole provider of certain services. Such services are provided in the normal course of operations and are based on normal commercial rates, as approved by regulation.

The following summarizes the compensation of the Company's key management personnel:

($millions)		2012		2011
Short-term employee benefits	$	4	$	3
Post-employment benefits		1		1
Other long-term benefits		2		1
	$	7	$	5

EPCOR enters into various transactions with its sole shareholder, the City, and with Capital Power. These transactions are in the normal course of operations and are recorded at the exchange value generally based on normal commercial rates or as agreed to by the parties.

The following summarizes the Company's related party transactions with the City:

($ millions)		2012		2011
Consolidated Income Statements				
Revenues (a)	$	97	$	90
Other raw materials and operating charges (b)		15		14
Franchise fees and property taxes (c)		79		76
Finance expense (d)		17		25

(a) Included within revenues are electricity and water sales of $3 million (2011 - $2 million), service revenue includes the provision of maintenance, repair and construction services of $86 million (2011 - $81 million), and customer billing services of $8 million (2011 - $7 million).

(b) Includes certain costs of printing services and supplies, mobile equipment services, public works and various other services pursuant to service agreements.

(c) Comprised of franchise fees of $50 million (2011 - $49 million) at 0.66 cents per kilowatt hour of electric distribution capacity (2011 – 0.66 cents per kilowatt hour), franchise fees of $16 million at 8% (2011 - $15 million at 8%) of qualifying revenues of water services and Gold Bar, and property taxes of $13 million (2011 - $12 million) on properties owned within the City municipal boundaries.

(d) Comprised of interest expenses on the obligation to the City at interest rates ranging from 5.20% to 9.00% (2011 – 5.21% to 9.01%).

The following summarizes the Company's related party balances with the City:

($ millions)		2012		2011
Consolidated Statements of Financial Position				
Trade and other receivables	$	30	$	23
Property, plant and equipment (e)		2		3
Trade and other payables (f)		11		20
Loans and borrowings		151		172
Deferred revenue (g)		26		20
Other liabilities (h)		17		29
Equity attributable to the Owner of the Company		24		24

(e) Costs of capital construction for water distribution mains and infrastructure.

(f) Includes $2 million (2011 - $2 million) for drainage and construction services provided by the City.

(g) Capital contributions received for capital projects and rebates relating to maintenance, repair and construction services.

(h) Relates to a transfer fee payable to the City for Gold Bar of which $10 million (2011 - $12 million) is the current portion and $7 million (2011 - $17 million) is the non-current portion.

The following summarizes the Company's related party transactions with Capital Power:

($ millions)	2012	2011
Consolidated income statements		
Revenues (i)	$ 25	$ 29
Other income (j)	25	39
Electricity purchases	-	230
Other raw materials and operating charges (k)	8	7
Other administrative expenses (l)	(6)	-
Equity share of income of Capital Power	41	90
Other Comprehensive Income		
Equity other comprehensive income (loss)	14	(5)

(i) Relates to electricity distribution and transmission services provided to Capital Power.

(j) Relates to financing revenue on long-term receivable.

(k) Relates to utility bills and charges for provision of transitional services by Capital Power to EPCOR under service agreements.

(l) Relates to the provision of services by EPCOR to Capital Power under services agreements.

The following summarizes the Company's related party balances with Capital Power:

($ millions)	2012	2011
Consolidated Statements of Financial Position		
Trade and other receivables (m)	$ 18	$ 22
Other financial assets	354	379
Trade and other payables	2	2
Deferred revenue (n)	(7)	(7)

(m) Includes $6 million (2011 - $6 million) relating to the accrued interest on the long-term receivable from Capital Power.

(n) Contributions for the construction of aerial and underground transmission lines.

FOURTH QUARTER REVIEW AND QUARTERLY RESULTS

(Unaudited, $ millions) **Quarters ended**	**Revenues**	**Net income (loss)**
December 31, 2012	$ 495	$ (69)
September 30, 2012	512	63
June 30, 2012	424	(20)
March 31, 2012	500	44
December 31, 2011	512	53
September 30, 2011	480	59
June 30, 2011	391	23
March 31, 2011	411	9

Events for 2012 and 2011 quarters that have significantly impacted net income and cash flows and the comparability between quarters are:

- December 31, 2012 fourth quarter results included an impairment charge to the investment of Capital Power, lower income from our equity share of Capital Power, lower water sales, increased staff and employee benefit costs, partially offset by positive fair value adjustments on financial electricity purchase contracts.

- September 30, 2012 third quarter results included increased income primarily due to higher approved electricity distribution and water and wastewater customer rates, higher electricity distribution and transmission sales volumes, the addition of Water Arizona and Water New Mexico operations, and slightly improved margins under the Company's EPSP, including any fair value adjustment on the related financial electricity purchase contracts. This was partially offset by lower billing charge income due to lower number of sites, and lower income from our equity share of Capital Power.
- June 30, 2012 second quarter results included, a loss on sale of a portion of our interest in Capital Power, lower income from our equity share of Capital Power and decreased income in Energy Services primarily due to reduction in the fair value of financial electricity purchase contracts and losses on the sale of excess electricity purchases, fees no longer earned as a result of the expiration of the Alberta Energy Savings (AES) contract in November 2011 and costs related to the contact center consolidation, partially offset by increased income in Distribution and Transmission primarily due to increased volumes and approved customer rates, increased income in Water Services primarily due to the addition of Water Arizona and Water New Mexico operations, increase in Edmonton water and wastewater approved customer rates, decreased provision related to a regulatory decision and lower chemical costs.
- March 31, 2012 first quarter results included increased income in Distribution and Transmission primarily due to increased rates, increased income in Energy Services primarily due to positive fair value adjustments on financial electricity purchase contracts, and higher income from our equity share of Capital Power, partially offset by fees no longer earned as a result of the expiration of the AES contract in November 2011, costs related to the contact center consolidation and losses on the sale of excess electricity purchased.
- December 31, 2011 fourth quarter results included increased income in Distribution and Transmission primarily due to increased rates, higher income from our equity share of Capital Power and a lower loss on sale of a portion of our interest in Capital Power, partially offset by negative fair value adjustments on foreign exchange forward contracts and integration expenses relating to the Water Arizona and Water New Mexico acquisition.
- September 30, 2011 third quarter results included positive fair value adjustments on foreign exchange forward contracts, higher income from our equity share of Capital Power, lower Energy Services operating income primarily due to negative fair value adjustments on financial electricity purchase contracts, lower Water Services operating income due to higher maintenance and chemical costs and lower commercial services margins, and higher Distribution and Transmission operating income primarily due to increased transmission and distribution tariff rates.
- June 30, 2011 second quarter results included a gain on sale of our floating-rate notes, higher Energy Services operating income primarily due to positive fair value adjustments on financial electricity purchase contracts, higher income from our equity share in Capital Power, lower Water Services operating income due to higher maintenance and chemical costs and lower commercial services margins and lower Distribution and Transmission operating income primarily due to higher electricity system operator costs.
- March 31, 2011 first quarter results included lower equity in the net income of Capital Power due to our reduced investment and lower Capital Power net income, lower Water Services operating income and higher Distribution and Transmission operating income.

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.

The purpose of forward-looking information is to provide investors with management's assessment of future plans and possible outcomes and may not be appropriate for other purposes. Forward-looking information in this MD&A includes: (i) long-term outlook for electricity, water and wastewater services in North America and the requirement for new electricity transmission infrastructure in Alberta; (ii) the Company's growth plans and expected future investment opportunities; (iii) expectations regarding future regulatory proceedings, decisions and filings and their potential impact on the Company; (iv) revenue, net income and operating cash flow expectations for 2013 and the expected items giving rise to them; (v) projected capital spending requirements for 2013 and expected sources of funding; (vi) expected sources of financing of future acquisitions; (vii) expectations regarding the Company's creditworthiness, liquidity, credit rating and potential impact of a credit rating downgrade; (viii) expected timeframes and amounts to settle existing contractual obligations; and (ix) expectations regarding the timing and completion of specific capital projects.

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 labor 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 and related credit spreads; (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 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 labor and management resources; (xi) performance of counterparties, partners, contractors and suppliers in fulfilling their obligations to the Company; (xii) availability and price of electricity; (xiii) customer consumption volumes of water and electricity; and (xiv) risks in addition to the above related to the Company's equity interest in Capital Power, including power plant availability and performance.

This MD&A includes the following update to previously issued forward-looking statements: (i) Expected capital spending on the Heartland project was previously disclosed to be $150 million for 2012, but actual spending was $92 million.

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.

ADDITIONAL INFORMATION

Additional information relating to EPCOR including the Company's 2012 Annual Information Form is available on SEDAR at www.sedar.com.