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EPCOR announces 2009 financial results

Edmonton - EPCOR Utilities Inc. (EPCOR) today filed its annual and fourth quarter results for 2009.

“This was a transformational year for EPCOR and that is reflected in our 2009 results. The Gold Bar Wastewater Treatment Plant was transferred to EPCOR early in the year and that, in itself, represented significant change," said President & CEO Don Lowry. "This was followed by the spin-off of our power generation business and the creation of Capital Power Corporation and the acquisition of potable water and wastewater facilities from Suncor.

“EPCOR took a one-time charge on the Capital Power transaction, but for the most part our results were consistent with plan. We have reduced EPCOR’s investment risk profile and, going forward, are poised for growth in our regulated and contracted water / wastewater and electricity distribution / transmission businesses.”

Highlights of EPCOR’s financial performance in 2009:

- Net income was $125 million on total revenues of $2.4 billion for the year ended December 31, 2009 compared with net income of $175 million on revenues of $3.4 billion for the previous year.
- Cash flow from operating activities for the year ended December 31, 2009 was $302 million compared with $403 million for the previous year.
- Investment in capital projects and business acquisitions for the year ended December 31, 2009 was $517 million compared with $747 million for the previous year.
- Other comprehensive income was $31 million for the year ended December 31, 2009 compared with other comprehensive income of $16 million for the previous year.
- The common dividend increased to $134 million for the year ended December 31, 2009 from $130 million in the previous year.

Management’s discussion and analysis (MD&A) of the annual and fourth quarter results for 2009 are shown below. The MD&A and audited consolidated financial statements are available on EPCOR’s website (www.epcor.ca), and will be available on SEDAR (www.sedar.com).

EPCOR’s wholly owned subsidiaries build, own and operate electrical transmission and distribution networks, water and wastewater treatment facilities and infrastructure in Canada. EPCOR, headquartered in Edmonton, is an Alberta top 50 employer. EPCOR’s website is www.epcor.ca.

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Management's discussion and analysis

This management's discussion and analysis (MD&A) dated March 12, 2010 should be read in conjunction with the audited consolidated financial statements of EPCOR Utilities Inc. and its subsidiaries for the years ended December 31, 2009 and 2008 and the cautionary statement regarding forward-looking information on page 49 of this MD&A. In this MD&A, any reference to "the Company", "EPCOR", "we", "our" or "us", except where otherwise noted or the context otherwise indicates, means EPCOR Utilities Inc., together with its subsidiaries. In this MD&A, Capital Power refers to Capital Power Corporation and its directly and indirectly owned subsidiaries including Capital Power LP, except where otherwise noted or the context otherwise requires. 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 and water and wastewater treatment facilities and infrastructure in Canada. We also provide energy and water services to residential and commercial customers. Our electricity, water and energy services businesses consist primarily of regulated and long-term commercial contracted operations.

Net income for the year ended December 31, 2009 was $125 million compared with $175 million for 2008. As more fully described later in this MD&A, the results for 2009 were lower than 2008 primarily due to a loss on the sale of the power generation business recorded in the third quarter of 2009, partly offset by income from the Gold Bar Wastewater Treatment Plant (Gold Bar) transferred to the Company from the City in the first quarter of 2009 and increased net income related to EPCOR's retained investment in the power generation business. The most significant event since EPCOR's incorporation took place in the third quarter of 2009 as we sold the power generation and related businesses to Capital Power as described more fully under Significant Events. Capital Power is a publicly traded company with a completely separate management team. Approximately 800 EPCOR employees transferred to Capital Power in connection with the sale. EPCOR retains a 72.2% economic interest in the power generation business through its equity investment in Capital Power. This transaction marked a significant milestone in EPCOR's evolution and represents a strategic change for EPCOR. Our primary focus is now on regulated and contracted operations in the water and electricity distribution and transmission businesses. While we continue to hold a significant investment in Capital Power, our goal is to prudently divest this remaining interest over time.

Other significant events in 2009 were as follows:

- The Company continued its work on the public consultation and route siting of the Heartland Transmission Project with project partners and stakeholders.
- In the fourth quarter of 2009, we filed our 2010-2011 rate applications for Regulated Rate Tariff (RRT) non-energy charges and Distribution and Transmission tariffs with the Alberta Utilities Commission (AUC).
- Also in the fourth quarter of 2009, we acquired potable water and wastewater treatment plant assets from Suncor Energy for approximately $100 million and entered into an agreement to lease the assets to Suncor Energy for a 20-year term.

- The Company raised $200 million in medium-term notes in the fourth quarter of 2009. The proceeds from this financing were used to repay short-term debt and for general corporate purposes. The Company also filed a renewal short-form prospectus for the issue of up to $1 billion in medium-term notes through January 2, 2012.
- In the first quarter of 2009, EPCOR received approval for the transfer of Gold Bar from the City to EPCOR, effective March 31, 2009. Earnings were favourably impacted by this transfer.
- The Canadian Asset Backed Commercial Paper (ABCP) restructuring plan took effect on January 21, 2009 whereby our investment in applicable ABCP was exchanged for floating-rate notes. A fair value loss of $5 million on our floating-rate notes was recognized in the fourth quarter of 2009 ($5 million for the full year) due to the recent degradation of the portfolio within certain classes of the Company's notes, increasing the probability of future principal default.

Each of the transactions noted are discussed in further detail 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 win new business growth opportunities. EPCOR's electricity strategy includes developing large transmission projects while maintaining our current distribution and transmission infrastructure. EPCOR's water strategy is to focus on: (a) developing municipal infrastructure; (b) providing design, build, finance and operate services for water and wastewater treatment and distribution infrastructure; and (c) providing potable and process water and wastewater treatment for industrial customers. Subject to acceptable business risk and the availability of financing, we intend to increase net income and shareholder value by growing our portfolio of electricity and water assets in both our regulated and competitive businesses.

We believe the long-term outlook for the North American electricity and water and wastewater treatment businesses remains relatively strong. While the current recession has reduced electricity demand in the short-term, economic recovery will require new transmission and distribution capacity in Alberta and other jurisdictions. Similarly, the demand for water and wastewater infrastructure in North America is also expected to increase due to population growth, aging infrastructures, 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 regulated facilities. We expect our regulated business investment opportunities to be in water distribution infrastructure upgrades, wastewater infrastructure and treatment, transmission infrastructure development, and electricity distribution system upgrades. We will also be monitoring our investment in Capital Power and seek opportunities or transactions to reduce our investment. These will depend on EPCOR's demand for capital and the market conditions at the time.

We will continue to pursue prudent investment or acquisition opportunities. We will only invest in new electricity or water and wastewater treatment assets in the short-term 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. As a utility with regulated and contracted operations based in Alberta, an investment grade credit rating and access to credit facilities and public debt financing, we believe we are able to withstand the impact of the current economic conditions. We also recognize that we are not immune from recessionary trends and we 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 both 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 generally common to each of our business units and shared service units.

There are specific measures established for each business unit and shared service unit in some or all of the categories that are important to the results of the respective unit and 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. In the customer service area of Energy Services, a key operational excellence measure relates to call answer times and billing accuracy. Business unit measures under the customer 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 2009, EPCOR's financial results were on plan aside from the loss on the sale of the power generation business and transfer of Gold Bar from the City. We were successful in our safety performance as we performed better than our safety targets for 2009. We continued to strive to reinforce a zero injury and occupational illness culture. Segment performance measures are also discussed by segment under Segment Results of this MD&A.

SIGNIFICANT EVENTS

Sale of the power generation business

The initial public offering of 21,750,000 common shares, at $23.00 per common share, of Capital Power, a power generation company created by EPCOR and headquartered in Edmonton, closed on July 9, 2009. Capital Power owns and operates the power generation and related businesses formerly owned by EPCOR.

Through a series of transactions (the Reorganization), EPCOR sold substantially all of its power generation assets net of certain liabilities and related operations including its 30.6% interest in Capital Power Income LP (CPILP) (formerly EPCOR Power LP), to Capital Power effective early July 2009. The assets and related operations were previously included in EPCOR's Generation and Energy Services segments. EPCOR also entered into various agreements with Capital Power to provide for certain aspects of the separation of the power generation business from EPCOR, to provide for the continuity of operations and services, and to govern the ongoing relationships between the two groups of entities.

The total consideration for the sale consisted of $468 million of cash (net of offering costs), 56.6 million exchangeable limited partnership (LP) units of Capital Power LP and $896 million in long-term loans receivable from Capital Power. Capital Power LP is a subsidiary of Capital Power. In addition, EPCOR holds one special limited voting share in Capital Power providing the right to vote separately as a class in connection with certain amendments to the articles of Capital Power, including an amendment to change or permit the change of the location of the head office of Capital Power from Edmonton.

Effectively, EPCOR sold 27.8% of its interest in the power generation business and through its equity investment in Capital Power, retains a 72.2% interest in that business. The difference between EPCOR's net carrying amount of its investment in the power generation business ($2,855 million) and the consideration received resulted in a loss on sale of $92 million including $37 million in direct expenses incurred in connection with the sale plus a $38 million income tax charge related to net future income tax assets that are not realizable by the Company as a result of the sale. Unrealized losses related to EPCOR's 27.8% interest in the power generation business that was sold, previously recorded in accumulated other comprehensive income (AOCI), were recognized in net income in the fourth quarter of 2009.

Investment in power generation business on 100% basis ($ millions)	
Consideration (before deducting offering costs)	$ 2,699
Carrying amount of investment in power generation business prior to sale	2,855
Carrying amount of investment in excess of consideration	156
Loss on sale of power generation business	
For 27.8% interest disposed of – carrying amount of investment in excess of consideration	43
Losses reclassified from AOCI to net income	12
Direct expenses (including offering costs)	37
Loss on sale before income taxes	92
Income taxes	38
Loss on sale after income taxes	$ 130

Immediately following completion of the Reorganization, EPCOR held 56.6 million exchangeable LP units of Capital Power LP (exchangeable for common shares of Capital Power Corporation on a one-for-one basis) representing approximately 72.2% of Capital Power LP. Each exchangeable LP unit is accompanied by a special voting share of Capital Power Corporation which entitles the holder to a vote at shareholder meetings, subject to the restriction that such voting shares must at all times represent not more than 49% of the votes attached to all Capital Power common shares and special voting shares together. The special shares also entitle EPCOR to elect a maximum of four out of 12 directors of Capital Power. As a result of these restrictive rights, EPCOR has significant influence, but not control, of Capital Power and therefore uses the equity method to account for its investment in Capital Power.

Effective July 2009, income from CPILP has been included in the income from EPCOR's equity investment in Capital Power as EPCOR no longer consolidates CPILP in its consolidated financial statements. CPILP is a subsidiary of Capital Power.

EPCOR plans to eventually sell all or a substantial portion of its ownership interest in Capital Power subject to market conditions, requirements for capital and other circumstances that may arise in the future, and reinvest the proceeds from the share sales in EPCOR's utility infrastructure businesses, including water and wastewater treatment, and electricity transmission and distribution.

EPCOR's interest in Capital Power is accounted for on an equity basis in the consolidated financial statements of the Company. The following table illustrates the assets, liabilities, results of operations and other financial data for Capital Power as at December 31, 2009:

($ millions)	2009
Revenues	$ 1,000
Net income	98
Total assets	5,031
Total liabilities	2,440
Long-term debt	1,719

Financing

On November 24, 2009, the Company completed a $200 million public offering in Canada of unsecured medium-term note debentures with a coupon rate of 5.75% and maturity date of November 24, 2039. Net proceeds from the offering were used to repay EPCOR's short-term debt and for general corporate purposes.

Acquisition of potable water and wastewater treatment plant assets

On October 7, 2009, the Company acquired potable water and wastewater treatment plant assets from Suncor Energy for approximately $100 million and entered into an agreement to lease the assets to Suncor Energy for a 20-year term after which Suncor Energy has the option to purchase the assets from the Company for a specified price. In addition, the Company has agreed to operate and maintain the assets as well as design, build, finance and operate upgrades to related assets, that will remain under the ownership of Suncor Energy, over the 20-year term. The Company will be compensated for all services in this agreement through payments over the 20-year term.

Transfer of Gold Bar Wastewater Treatment Plant

On March 31, 2009, the City transferred its Gold Bar assets to EPCOR. Gold Bar handles wastewater treatment requirements for over 700,000 residents of the City and has a current treatment capacity of 310 megalitres per day. The Edmonton City Council (City Council) continues to regulate wastewater treatment services and rates for the combined drainage utility, which includes the wastewater collection and transmission system owned by the City and the Gold Bar plant owned by EPCOR.

The assets were transferred from the City at their carrying amounts totaling $258 million including $48 million of contributed assets on which EPCOR cannot earn a return, offset by $48 million of capital contributions. Under the transfer agreement with the City, EPCOR issued approximately $112 million of long-term debt to the City, bearing a weighted average interest rate of approximately 5.21%. EPCOR also agreed to pay a transfer fee of $75 million to the City in annual installments commencing in 2009 and ending in 2015. The first installment of $17 million was paid on March 31, 2009. The remainder of the asset transfer, representing the difference between the carrying amount of the assets and the liabilities for the transfer fee and long-term debt, was reflected on the Company's consolidated balance sheet as a $24 million equity contribution from the City.

Asset-backed commercial paper (ABCP) exchanged for floating-rate notes

On January 21, 2009, the restructuring of Canadian non-bank ABCP was implemented. Under the restructuring, the affected ABCP was exchanged for term floating-rate notes (notes), maturing no earlier than the scheduled termination dates of the underlying assets. The exchange was recorded at the estimated fair value of the ABCP on January 21, 2009. The key information on EPCOR's notes is as follows:

(i) EPCOR's allocation of notes under the restructuring was as follows:

Pool	Series	Credit Rating	Face amount ($ millions)	
MAV2	Class A-1	A	$ 47	67%
	Class A-2	BBB	9	13%
	Class B	Unrated	2	2%
	Class C	Unrated	2	2%
MAV3	Class 34	BBB negative	5	7%
	Class 35	CC	4	6%
	Class 36	C	2	3%
			$ 71	100%

(ii) For the Master Asset Vehicle 2 (MAV2) floating-rate pool notes, the underlying assets are anticipated to mature in January 2017. The remaining floating-rate notes come from Master Asset Vehicle 3 (MAV3) in the form of Ineligible Asset Tracking notes separated into specific classes. These floating-rate notes are expected to amortize over the lives of the underlying assets which have a weighted average maturity date of 2027. In certain limited circumstances, the expected repayment dates could be longer than the expected asset lives.

(iii) ABCP investors, including EPCOR, were paid the accumulated accrued interest, net of ABCP restructuring costs, collateral requirements and other costs, on their existing ABCP from the date of the standstill in August 2007 to the date of the restructuring. For the three and twelve months ended December 31, 2009, EPCOR received $1 million and $5 million respectively, of accrued interest on ABCP and interest and principal repayments on the new notes.

At December 31, 2009, the Company held $37 million in notes, all of which were received in exchange for ABCP which was purchased during the third quarter of 2007 at an original cost of $71 million. As the notes are classified as held-for-trading financial assets, they are subject to ongoing fair value adjustments at each reporting date. At December 31, 2009, the fair value of the notes was estimated at $37 million compared with a fair value of $42 million for the ABCP at December 31, 2008, respectively. The $5 million decrease for the year (2008 - $18 million decrease in fair value of ABCP) was due to the recent degradation of the portfolio within the Company's MAV3 Class 35 and 36 notes. The fourth quarter decrease in the estimated fair value of the notes was $5 million in 2009 (2008 - $7 million decrease in the fair value of ABCP).

The estimate of fair value is subject to significant risks and uncertainties including the timing and amount of future cash payments, market liquidity, the quality and tenor of the assets and instruments underlying the notes, including the possibility of margin calls, and the future market for the notes. Accordingly, the fair value estimate of the notes may change materially.

CONSOLIDATED FINANCIAL INFORMATION

($ millions)	2009	2008	2007
Net income	$ 125	$ 175	$ 277
Revenues	2,354	3,438	3,666
Total assets	4,741	6,948	6,562
Long-term debt (including current portion)	1,917	2,728	2,139
Common share dividends	134	130	128

Note on comparisons

For the first half of 2009, EPCOR owned or controlled all of the power generation assets and related operations, including CPILP, that were sold to Capital Power in early July 2009. Accordingly, net income, results of operations and variances for the first half of the year include all the power generation assets, results of operations and variances presented on a consolidated basis. After the sale of the power generation business and related operations in early July 2009, we no longer controlled those operations. Consequently, from the 2009 third quarter onward, the Company no longer presents the power generation business and related operations on a consolidated basis. Those line items and variances are, in effect, replaced by the interest in Capital Power reported on the equity basis. In making year-over-year comparisons, variances include comparisons of power generation and related operations for the first half of 2009 to the first half of 2008, on an "apples to apples" comparative basis. On the other hand, the third and fourth quarters of 2009 only reflect the equity interest in Capital Power while the third and fourth quarters in 2008 reflect the power generation business while it was still consolidated. In this context, the results of operations are discussed below.

Analysis of net income

($ millions)

Net income for the year ended December 31, 2007	**$**	**277**
Higher Distribution and Transmission energy margins		14
Higher water rates		13
Higher fair value reduction in ABCP		(7)
Higher depreciation expense		(7)
Impact of recording a net future income tax asset associated with the Energy Services reorganization in 2007		(10)
Higher Water Services operations and maintenance costs		(10)
Higher administration expenses, excluding CPILP administration		(18)
Net decreases related to the power generation business that was sold effective early July 2009		(91)
Other		14
Decrease in net income		(102)
Net income for the year ended December 31, 2008	**$**	**175**

Net income for the year ended December 31, 2008	**$**	**175**
Loss on sale of power generation business		(130)
Equity income from Capital Power in 2009		68
Interest revenue in 2009 on long-term loans receivable from Capital Power		30
Gold Bar operating income in 2009 excluding administration expenses		17
Higher Distribution and Transmission energy margins		14
Lower unfavourable changes in the fair value of notes exchanged for ABCP		13
Higher water rates and sales volumes		12
Lower administration expenses, excluding those related to the power generation business		8
Higher Water Services operations and maintenance expenses, excluding those related to Gold Bar		(6)
Higher depreciation expenses, excluding those related to the power generation business and the Gold Bar facility		(9)
Higher financing expenses		(33)
Net decreases related to the power generation business that was sold effective early July 2009		(24)
Other		(10)
Decrease in net income		(50)
Net income for the year ended December 31, 2009	**$**	**125**

Net income for the year ended December 31, 2009 was $125 million compared with $175 million for 2008. Net income decreased by $50 million for the year ended December 31, 2009 compared with the previous year. Further explanations of the primary year over year variances are as follows:

- Loss on the sale of the power generation business reflects the difference between EPCOR's carrying amount of its investment in the power generation business that was sold and the consideration received for the business. This loss includes income tax related charges to recognize unrealizable future income tax assets and direct expenses incurred in connection with the sale.

- The Gold Bar operation was transferred to EPCOR from the City on March 31, 2009 and contributed $5 million and $17 million of operating income before administration expenses in the fourth quarter and year-to-date, respectively.
- Distribution and Transmission margins were higher in 2009 compared with 2008 primarily due to increased tariff rates and a larger customer rate base.
- Water revenues were higher in 2009 compared with 2008 primarily due to increased rates under the performance-based rate tariff (PBR) as approved by the City. Water sales volumes were also higher due to drier weather conditions in the second and third quarters of 2009 compared with the corresponding periods in 2008.
- Administration expenses were lower in 2009 compared with 2008 primarily due to lower staffing levels in corporate services and the Generation and Energy Services segments due to the sale of the power generation business.
- Water Services operations and maintenance expenses, excluding those related to Gold Bar, were higher in 2009 compared with 2008 primarily due to a higher incidence of main breaks in 2009 compared with 2008.
- Depreciation expense was higher in 2009 compared with 2008 due to regulated water and distribution and transmission asset additions.
- Financing expenses were higher in 2009 compared with 2008 due to the write-off of issue costs for the syndicated and bilateral credit facilities that were cancelled in July as a result of the Reorganization, lower capitalized interest compared with the prior year, the addition of the Gold Bar facility in 2009 and lower sinking fund earnings in 2009 compared with 2008.
- Net decreases related to the power generation business reflect numerous differences in 2009 compared with 2008 associated with the power generation business that was sold at the beginning of the third quarter of 2009. The most significant net income differences relate to unrealized fair value changes, availability incentive income, maintenance expenses for Genesee scheduled turnarounds in 2008, income from CPILP and administration expenses. See Segment Results – Generation and Segment Results – Energy Services.

Revenues

($ millions)

Revenues for the year ended December 31, 2007	**$**	**3,666**
Higher RRT electricity revenues		61
Higher Water Services commercial and transportation services revenues		56
Higher water rates and sales volumes		14
Higher Distribution and Transmission tariff revenues		11
Decreases related to the power generation business that was sold effective early July 2009		(369)
Other		(1)
Decrease in revenues		(228)
Revenues for the year ended December 31, 2008		**3,438**
Gold Bar revenue in 2009		42
Interest revenue in 2009 on long-term loans receivable from Capital Power		30
Higher Distribution and Transmission tariff revenues		15
Higher water rates and sales volumes		12
Lower Water Services commercial and transportation services activity		(20)
Lower RRT electricity revenues		(150)
Revenue decreases prior to the sale of the power generation business		(22)
Decreases related to the power generation business that was sold effective early July 2009		(986)
Other		(5)
Decrease in revenues		(1,084)
Revenues for the year ended December 31, 2009	**$**	**2,354**

Revenues decreased $1,084 million in 2009 compared with 2008 and further information on the year-over-year changes is as follows:

- Distribution and Transmission tariff revenues were higher in 2009 compared with 2008 primarily due to increased tariff rates, partly offset by higher rebates to customers.
- Water revenues were higher in 2009 compared with 2008 primarily due to increased rates under the PBR as approved by the City and increased sales volumes due to drier weather conditions in the second and third quarters of 2009 compared with the corresponding periods in 2008.
- Water Services commercial and transportation services revenues were lower in the year ended December 31, 2009 compared with the corresponding period in 2008 primarily due to reduced commercial water plant and distribution system construction activity in 2009, partly offset by increased construction activity for street lighting, signals and light rail transit overhead wires for the City in 2009.
- Regulated electricity revenues were lower in 2009 compared with 2008 primarily due to lower electricity prices in 2009 compared with 2008.
- Revenue decreases related to the power generation business reflect numerous differences in the first half of 2009 compared with the corresponding period in 2008 associated with the power generation business that was sold in early July 2009. The most significant revenue differences relate to trading activities in the Western U.S., natural gas sales, unrealized fair value changes and availability incentive revenue.
- Decreases related to the sale of the power generation business reflect the revenues of this business in the third and fourth quarters of 2008. The largest revenue items related to that period were CPILP revenues, unrealized fair value changes, natural gas sales and Alberta electricity sales.

Capital spending and investment

($ millions)	2009	2008	2007
Distribution and Transmission	$ 86	$ 120	$ 105
Water Services	187	74	122
Energy Services	8	10	12
Generation	228	436	240
Corporate – other	8	18	20
	517	658	499
Investment in Morris Cogeneration LLC	-	89	-
	$ 517	$ 747	$ 499

Capital expenditures for property, plant and equipment were lower in 2009 compared with 2008 primarily due to more extensive capital projects in 2008. In particular, power generation business capital spending was higher in 2008, capital expenditures for the Downtown Edmonton Supply and Substation project in Distribution and Transmission was completed in the third quarter of 2008 and the E.L. Smith water treatment plant upgrade in Water Services was completed in the second quarter of 2008.

These decreases in spending were partly offset by capital expenditures to maintain and improve the Gold Bar plant in 2009 and the acquisition of potable water and wastewater treatment plant assets from Suncor Energy.

There was no capital spending for the Generation segment and lower capital spending in the Energy Services segment in the third and fourth quarters of 2009 compared with the corresponding period in 2008 due to the sale of the power generation business.

SEGMENT RESULTS

Distribution and Transmission

Distribution and Transmission earns income principally by transmitting high-voltage electricity from generation plants to points of distribution and, from there, distributing low-voltage electricity to retailers' end-use customers. Our distribution and transmission assets are located in and around the City and are regulated by the AUC. We earn provincially regulated distribution and transmission tariffs intended to allow us to recover our prudent costs and earn a fair rate of return on our distribution and transmission infrastructure. Distribution and Transmission is also responsible for meter reading for all electricity suppliers within the City service area and acting as the load settlement agent for the City.

Distribution and Transmission operating income

Year ended December 31			2009		2008
Distribution and Transmission results					
(including intersegment transactions, $ millions)					
Revenues	Distribution	$	202	$	196
	Transmission		52		43
	Commercial and other		9		12
			263		251
Expenses	Energy purchases and fuel		53		59
	Operations, maintenance, administration and foreign exchange		67		60
	Franchise fee, property taxes and other taxes		49		43
	Depreciation, amortization and asset retirement accretion		34		30
			203		192
Operating income before corporate charges			60		59
Corporate charges			22		16
Operating income		**$**	**38**	**$**	**43**

Operating income for the year ended December 31, 2008	**$**	**43**
Higher distribution and transmission energy margins		14
Depreciation, administration and other		(19)
Decrease in operating income		(5)
Operating income for the year ended December 31, 2009	**$**	**38**

For the year ended December 31, 2009, Distribution and Transmission's operating income decreased $5 million from the prior year. Revenues reflect increased tariff rates, a larger customer rate base and higher franchise fees in 2009 compared with 2008. These increases in revenues were partly offset by higher rebates to customers set by the Alberta Balancing Pool in 2009, which were recognized as a reduction in revenues and energy purchases. Energy purchases also reflect lower average Alberta spot electricity prices in 2009 compared with 2008. Expenses were higher in 2009 compared with 2008, primarily due to higher allocations of corporate costs as a result of the Reorganization and depreciation expense due to a larger asset base in 2009.

	2009	2008
Distribution reliability and volumes		
Reliability (system average interruption duration index in hours)	1.67	0.96
Electricity distribution (gigawatt-hours)	7,202	7,215

The strategic focus of Distribution and Transmission continues to be operational excellence, primarily the safe and reliable distribution of electricity to our customers. Our primary measure of distribution system reliability is System Average Interruption Duration Index (SAIDI) which we attempt to minimize. This measure captures the annual average number of hours of interruption experienced by our customers, including scheduled and unscheduled interruptions to our primary distribution circuits. In 2009, we experienced a SAIDI of 1.67 hours compared with 0.96 hours in 2008. This decrease in reliability was the result of a significant storm that occurred on July 18, 2009 that accounted for 0.925 hours of the total annual SAIDI. The normalized SAIDI for 2009 was 0.75, an improvement over 2008. Distribution and Transmission continues its system availability improvement efforts, of which, the key improvement efforts were the rejuvenation or replacement of underground distribution cables to mitigate cable failures, the installation of automated switches on selected circuits to allow Distribution and Transmission to isolate faults and restore service to customers in a more timely manner and the construction of new circuits to strengthen Distribution and Transmission's system. Although improvements have been realized, the leading causes of customer interruptions continue to be major storms and cable faults. Distribution and Transmission will continue with its reliability improvement programs to further address these issues and help improve overall system reliability. Electricity distribution volumes were consistent with 2008 despite the downturn in economic conditions in the Edmonton region.

As a regulated utility service provider, Distribution and Transmission has not been and does not expect to be materially impacted by the recent economic conditions. Demand for our services is secure, we have limited credit exposure, we source the majority of our materials and labour from Canada and our inventory is for our own use. In fact, we may experience some benefit from the economic slowdown as the availability of contract labour for our capital and maintenance work increases.

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 exceeded. The majority of Water Services' income is earned through a PBR water tariff charged to its Edmonton customers. The PBR 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 PBR rate. On March 31, 2009, Water Services commenced the treatment of wastewater in Edmonton following the transfer of Gold Bar from the City. Edmonton wastewater treatment rates are subject to approval by City Council and are intended to allow us to recover our costs and earn a fair rate of return. 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 is to ensure the use of quality wastewater operating practices and the associated infrastructure is maintained while controlling costs.

Water Services manages EPCOR's Transportation Services business which provides competitive contract-based commercial services related to installation, maintenance and repair of street lighting, traffic signal and light rail transit. 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

			2009		2008
Water Services results					
(including intersegment transactions, $ millions)					
Revenues	Water sales revenues	$	162	$	150
	Wastewater services revenues		42		-
	Commercial and other		142		166
			346		316
Expenses	Operations, maintenance, administration and foreign exchange		210		206
	Franchise fees, property taxes and other taxes		14		10
	Depreciation, amortization and asset retirement accretion		27		20
			251		236
Operating income before corporate charges			95		80
Corporate charges			27		16
Operating income		**$**	**68**	**$**	**64**

Operating income for the year ended December 31, 2008	**$**	**64**
Gold Bar operating income excluding administration expenses in 2009		17
Higher water rates and sales volumes		12
Higher operations and maintenance expenses		(6)
Higher administration expenses		(22)
Other		3
Increase in operating income		4
Operating income for the year ended December 31, 2009	**$**	**68**

For the year ended December 31, 2009, Water Services' operating income increased by $4 million from the prior year due to the net impact of the following items:

- The Gold Bar operation, which was transferred from the City on March 31, 2009, contributed $42 million in revenues and $25 million in expenses, excluding administration expenses, in 2009.
- Revenues from water sales were higher in 2009 compared 2008, primarily due to increased rates April 1, 2009 under Water Services' PBR structure as approved by its regulator, the City, and increased sales volumes due to drier weather conditions in the second and third quarters of 2009.
- A higher incidence and cost of water distribution main breaks in 2009 compared with 2008 contributed to higher operations and maintenance expenses.
- Administration expenses increased in 2009 due to the addition of the Gold Bar operation and higher allocations of corporate costs as a result of the Reorganization.
- Transportation and other commercial services revenues were $20 million lower in 2009 compared with 2008 primarily due to reduced construction activity as a result of completion of projects for the towns of Chestermere, Wetaskiwin, Taber and Canmore as well as Suncor Voyageur. The decrease in revenues, offset by equivalent decreases in construction expenses, had minimal impact on operating income. Revenues related to the construction and maintenance of street lighting, signals and light rail transit overhead wires for the City were higher in 2009 compared with 2008 due to increased activity. This revenue increase was offset by increased labour and higher business development expenses for the commercial services business.

	2009	2008
Water volumes for the City and surrounding region		
Water sales (megalitres)	129,099	125,307

Water Services owns seven and operates 17 other water treatment and distribution facilities in Alberta and British Columbia. As well, it owns and operates 24 wastewater and collection facilities in Alberta and British Columbia. In 2009, Water Services completed construction of the Suncor Voyageur water and wastewater treatment facilities and also acquired various other water and wastewater treatment facilities from Suncor Energy. In owning and operating these facilities, EPCOR provides water and wastewater services to Suncor Energy under commercial arrangements. Our core market is stable as we are the sole supplier of water and provider of wastewater services within the City. In 2009, we saw a slight increase in water volumes, primarily due to weather impacts on water use, higher customer counts within the City and higher consumption by our regional customers, partly offset by lower commercial and multi-residential customer water use. Operationally, the facilities we own or manage performed well in both 2008 and 2009.

Lower economic activity did not have a material impact on Water Services' business in 2009 as most of these services are rate-regulated or are under contracts with municipalities and we have not experienced a decrease in volumes or a significant increase in credit losses to date. Higher availability of contractors as a result of the economic downturn did lead to more favourable pricing and reduced costs in certain capital projects. The cancellation or postponement of oil upgrader projects northeast of Edmonton reduced opportunities for new commercial industrial water contracts, but signs of an economic recovery may bring greater opportunities in 2010. Government funding announcements in support of economic stimulus should increase the likelihood for new public-private partnerships for water and wastewater infrastructure opportunities. The economic downturn in the United States may give rise to new commercial opportunities as financially challenged communities and businesses seek alternative partnerships and arrangements to deliver water and wastewater services to their customers. Although we plan to pursue new commercial contracts, we recognize that we may have to apply stricter investment criteria, including potentially higher financing costs.

Energy Services

Energy Services earns income from the supply of electricity to RRT and default rate customers in the EPCOR Distribution and Transmission Inc. and FortisAlberta Inc. service areas and from the provision of billing and customer care services to other EPCOR subsidiaries, the City and unrelated third parties. We operate under provincially regulated cost of service regulations intended to allow us to recover our prudent costs and earn a fair rate of return on a deemed capital structure. Energy Services also provides billing, collection, and contact center services to other EPCOR subsidiaries and related parties, the City of Edmonton Waste and Drainage Departments and to Alberta Energy Savings Limited Partnership (AESLP). Until the Reorganization in July 2009, Energy Services had wholesale contracts with AESLP to supply their retail customers with both natural gas and electricity.

Energy Services focuses on providing excellent service experiences for our customers. We measure call answer performance, billing performance and customer satisfaction and report results to our regulator on a quarterly basis.

As a result of the sale of the power generation business in the third quarter of 2009, Energy Services no longer holds competitive retail contracts for electricity and natural gas or wholesale natural gas supply contracts.

Energy Services operating income

Year ended December 31			2009		2008
Energy Services results					
(including intersegment transactions, $ millions)					
Revenues	Energy revenues	$	1,356	$	2,171
	Commercial and other		37		37
			1,393		2,208
Expenses	Energy purchases		1,188		1,965
	Operations, maintenance, administration and foreign exchange		62		71
	Depreciation, amortization and asset retirement accretion		18		28
			1,268		2,064
Operating income before corporate charges			125		144
Corporate charges			22		30
Operating income		**$**	**103**	**$**	**114**

Operating income for the year ended December 31, 2008	**$**	**114**
Higher billing charge revenues in 2009		3
Higher administration related to ongoing EPCOR operations		(4)
Higher income in the first six months of 2009 prior to the sale of the power generation business		86
Decreases related to the sale of the power generation business in early July 2009		(96)
Decrease in operating income		(11)
Operating income for the year ended December 31, 2009	**$**	**103**

The Energy Services segment operating income includes $89 million (2008 - $99 million) related to the wholesale electricity and natural gas business that was sold to Capital Power. For the year ended December 31, 2009, Energy Services' operating income decreased by $11 million from the prior year due to the net impact of the following items:

- Billing charge revenues were higher in 2009 compared with 2008 primarily due to higher rates as approved by the AUC. These revenues reflect the recovery of administrative costs from RRT customers for the provision of customer billing services.
- Administration expenses increased in 2009 compared with 2008 primarily due to higher allocations of corporate costs as a result of the Reorganization.
- Higher income in the first six months of 2009, prior to the sale of the power generation business, was mainly due to favourable unrealized fair value changes compared with the first half of 2008 primarily due to a net short position in both years for derivative electricity contracts that were not designated as hedges for accounting purposes combined with decreasing forward Alberta power prices in the first half of 2009 compared with increasing forward Alberta power prices in the first half of 2008. These results were part of the wholesale marketing and trading activities that were sold as part of the generation business in July 2009. This favourable variance was partly offset by lower electricity margins on our Alberta portfolio due to reduced Alberta power prices in the first half of 2009 compared with the first half of 2008 and higher administration expenses in the six months ended June 30, 2009 for the operations sold as part of the Reorganization compared with the corresponding period in 2008 primarily due to costs incurred in connection with the Reorganization.
- The decrease due to the sale of the power generation business reflects the sale of a significant portion of the Energy Services segment as part of the Reorganization. The operating income for

this portion of the segment for the six months ended December 31, 2008 reflected EPCOR's control of the generation and trading operations, including CPILP, and reflected positive margins for Alberta electricity, trading activities in Ontario and the northeastern U.S. and unrealized fair value gains due to a net short position combined with decreasing forward prices.

Energy Services' retail customer sales volumes, which exclude electricity and natural gas trading activities, were as follows:

	2009	2008
Retail sales		
Electricity (gigawatt-hours)		
RRT	5,647	5,638
Default	811	780
	6,458	6,418

The increase in RRT and default retail sales was primarily due to a higher number of default customers.

The downturn in the economy did not have a significant impact on Energy Services' performance in 2009, as power is an essential commodity regardless of the state of the economy. However, we expect the condition of the economy will present challenges for us in 2010. Electricity consumption by regulated and default supply customers is expected to remain flat as the economy recovers. The possibility of a slight decrease in the number of RRT customers is based on the Regulated Rate Option (RRO) pricing framework which is transitioning over a five-year period to a month ahead forward price by mid-2010 and the availability of competitive contracts in the province. Customers may opt for competitive contracts to eliminate their exposure to price volatility, but we do not anticipate that the economy will necessarily impact this trend. We do not expect bad debt expense to be significantly impacted as 75% of the RRT bad debt expense variance from an AUC-approved target is charged or refunded to the RRT customers through future non-energy rates.

Generation

Substantially all of the net assets of the Generation segment were sold to Capital Power at the beginning of the third quarter of 2009. As a result, the Company's 2009 results only reflect the operations of the Generation segment for the first six months of the year.

Generation operating income

Year ended December 31		2009	2008
Generation results			
(including intersegment transactions, $ millions)			
Revenues		$ 518	$ 935
Expenses	Energy purchases and fuel	184	347
	Operations, maintenance, administration and foreign exchange	126	300
	Franchise fees, property taxes and other taxes	10	17
	Depreciation, amortization and asset retirement accretion	84	168
		404	832
Operating income before corporate charges		114	103
Corporate charges		23	22
Operating income		**$ 91**	**$ 81**

Operating income for the year ended December 31, 2008	**$**	**81**
Lower income in the first six months of 2009, prior to the sale of the power generation business		(118)
Increase related to the sale of the power generation business in early July 2009		128
Increase in operating income		10
Operating income for the year ended December 31, 2009	**$**	**91**

For the year ended December 31, 2009, Generation's operating income increased by $10 million from the prior year due to higher income in the last six months of 2009 despite the sale of the power generation business to Capital Power. The generation segment incurred a $128 million operating loss in the last six months of 2008 primarily as a result of unrealized losses on the change in fair value of natural gas contracts and forward foreign exchange contracts. This increase was mostly offset by lower income in the first six months of 2009, when EPCOR owned the power generation business, primarily due to unrealized losses on the change in fair value of natural gas contracts and forward foreign exchange contracts.

As a result of the sale of the power generation business, there will be no direct activity from the Generation segment in the future. However, the Company will be impacted by the results of the power generation business through its 72.2% equity investment in Capital Power.

CONSOLIDATED BALANCE SHEETS

Significant changes in consolidated assets: December 31, 2009 and 2008				
($ millions)	2009	2008	Increase (decrease)	Explanation
Cash and cash equivalents	$ 11	$ 111	$ (100)	Refer to cash flows summary below.
Accounts receivable (including income taxes recoverable)	246	503	(257)	Sale of the power generation business partly offset by receivables related to Gold Bar sales.
Current portion of long-term receivables	255	6	249	Reflects current portion of the long-term loans receivable from Capital Power and the reclassification of commercial water loans receivable from non-current.
Derivative instruments assets (current)	-	130	(130)	Sale of the power generation business.
Other current assets	14	84	(70)	Sale of the power generation business. The 2008 balance primarily reflects generation plant inventories. The 2009 balance primarily reflects Distribution and Transmission and Water Services inventories.
Property, plant and equipment	1,778	4,654	(2,876)	Sale of the power generation business and depreciation and amortization expenses in the current year, partly offset by 2009 capital additions and Gold Bar assets.
Power purchase arrangements	-	550	(550)	Sale of the power generation business.
Contract and customer rights and other intangible assets	110	293	(183)	Sale of the power generation business and amortization of RRT customer rights.
Long-term investment in Capital Power	1,481	-	1,481	Reflects the Company’s 72.2% equity interest in Capital Power received on the sale of the power generation business.
Derivative instruments assets (non-current)	-	75	(75)	Sale of the power generation business.
Future income tax assets (non-current)	40	103	(63)	Sale of the power generation business.
Goodwill	2	161	(159)	Sale of the power generation business.
Long-term receivables	643	102	541	Reflects non-current portion of the long-term loans receivable from Capital Power and commercial water loans receivable.
Other assets	161	133	28	Sale of the power generation business. The 2009 balance primarily reflects floating-rate notes and increase in long-term water lease receivables.
Assets held for sale	-	43	(43)	Sale of the power generation business. The 2008 balance reflects the portion of the Battle River Purchase Sale Agreement (PSA) held for sale.

Significant changes in consolidated liabilities and shareholder's equity: December 31, 2009 and 2008				
($ millions)	2009	2008	Increase (decrease)	Explanation
Short-term debt	$ -	$ 140	$ (140)	Repayment of commercial paper with proceeds on the sale of the power generation business and issue of medium-term notes.
Accounts payable and accrued liabilities	241	587	(346)	Sale of the power generation business partly offset by the current portion of the transfer fee payable to the City for the Gold Bar transfer.
Derivative instruments liabilities (current)	-	131	(131)	Sale of the power generation business.
Other current liabilities	32	58	(26)	Sale of the power generation business.
Long-term debt (including current portion)	1,917	2,728	(811)	Sale of the power generation business including CPILP's outstanding long-term debt.
Derivative instruments liabilities (non-current)	-	110	(110)	Sale of the power generation business.
Other non-current liabilities	81	125	(44)	Sale of the power generation business partly offset by the non-current portion of the transfer fee owing to the City for the Gold Bar asset transfer.
Future income tax liabilities (non-current)	-	100	(100)	Sale of the power generation business.
Non-controlling interests	-	540	(540)	Due to the sale of the power generation business and interest in Capital Power reported on the equity basis. This had the impact of removing the non-controlling interests in CPILP from the balance sheet.
Shareholder's equity	2,470	2,429	41	Reflects net income, other comprehensive income and the Gold Bar asset capital contribution partly offset by common share dividends.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Cash inflows (outflows) and cash position:

	($ millions)					
	Years ended December 31					
	2009	2008	Change	2008	2007	Change
Operating	$ 302	$ 403	$ (101)	$ 403	$ 541	$ (138)
Investing	27	(643)	670	(643)	(469)	(174)
Financing	(429)	272	(701)	272	(253)	525
Opening cash and cash equivalents	111	79	32	79	260	(181)
Closing cash and cash equivalents	$ 11	$ 111	$ (100)	$ 111	$ 79	$ 32

Operating changes:

The 2008 to 2009 decrease in cash inflows reflects lower cash receipts due to the sale of the power generation business, partly offset by the receipt of interest revenue on the long-term loans receivable from Capital Power and payment in 2008 of income taxes related to the 2006 gain on sale of the Battle River PSA.

Investing changes:

The 2008 to 2009 increase in cash from investing activities reflects the proceeds on the sale of the power generation business, principal payments received on the long-term loans receivable from Capital Power and lower capital expenditures in 2009, primarily due to the sale of the power generation business, partly offset by the payment of a Gold Bar transfer fee installment in 2009.

Financing changes:

Net financing outlays in 2009 included $140 million in net repayments of bankers' acceptances, commercial paper and U.S. dollar bank loans and repayment of $224 million of long-term debt that was outstanding under the syndicated bank credit facility, and other ongoing debt repayments, partly offset by net proceeds from a $200 medium-term note debenture issue in the fourth quarter. Net financing receipts in 2008 included the issuance of $600 million of medium-term note debentures, partly offset by repayment of $200 million of medium-term note debentures and $155 million of long-term debt that was outstanding under the syndicated bank credit facility, and ongoing long-term debt repayments.

LIQUIDITY AND CAPITAL RESOURCES

($ millions) Years ended December 31	2009	2008	2007
Funds from operations[1]	$ 356	$ 484	$ 517
Long-term borrowings during the year	238	910	395
Cash and cash equivalents, at end of year	11	111	79
Short-term debt, at end of year	-	(140)	(138)
Ratios[1]			
Debt to equity[2]	44:56	49:51	42:58
Interest coverage (excluding gain on sale of PPA and impairment charges) on long-term debt:			
Income before financing, taxes and non-controlling interest[3]	2.1 X	1.7 X	3.3 X
Income before financing, taxes, non-controlling interest, and depreciation and amortization[4]	3.2 X	3.2 X	4.7 X
Funds from operations to interest bearing debt (%)[5]	18.6	16.9	22.7
Credit ratings[6]			
Standard & Poor's			
Long-term debt	BBB+	BBB+	BBB+
Preferred shares of subsidiary companies	P-2 (Low)	P-2 (Low)	P-2 (Low)
DBRS Limited			
Short-term debt	R-1 (low)	R-1 (low)	R-1 (low)
Long-term debt	A (low)	A (low)	A (low)
Preferred shares of subsidiary companies	-	Pfd-3 (high)	Pfd-2 (low) / Pfd-3 (high)

(1) Funds from operations and ratios in this table are non-GAAP (Generally Accepted Accounting Principles) financial measures that do not have any standardized meaning prescribed by GAAP and are unlikely to be comparable to similar statistics published by other entities. They are presented since they are commonly referred to by debt holders and other interested parties in evaluating the Company's financial position and in assessing its creditworthiness. See "Non-GAAP Measures" for a reconciliation of funds from operations. The ratios are explained in the following notes.

(2) Debt to equity is expressed as a ratio of debt as a percentage of total capital to equity as a percentage of total capital. Debt is the sum of short-term debt and long-term debt (including the current portion). Equity is the sum of non-controlling interests and shareholder's equity. Total capital is the sum of debt and equity.

(3) Revenue and foreign exchange gains less energy purchases, fuel, operations, maintenance and administration, franchise fee, property taxes and other taxes and depreciation, amortization and asset retirement accretion, divided by interest on long-term debt and capital lease obligation.

(4) Revenue and foreign exchange gains less energy purchases, fuel, operations, maintenance and administration and franchise fee, property taxes and other taxes, divided by interest on long-term debt and capital lease obligation.

(5) Funds from operations to interest bearing debt (expressed as a percentage) is cash flow from operations divided by short-term debt plus long-term debt (including the current portion).

(6) Rating agencies have disclosed that all current ratings are stable.

Generally, our external capital is raised at the corporate level and invested in the operating business units. Our external financing has consisted of borrowings under committed credit facilities, debentures payable to the City, public debentures and preferred and common shares.

Financing

On November 24, 2009, the Company completed a public offering in Canada of unsecured medium-term note debentures in the aggregate principal amount of $200 million. The notes have a coupon of 5.75% and mature on November 24, 2039. The net proceeds of the offering were used to repay EPCOR's commercial paper debt and for general corporate purposes. The issue was made under a shelf prospectus which expired in November 2009. On December 2, 2009, EPCOR renewed its

Canadian shelf prospectus permitting the Company to raise up to $1 billion of debt with maturities of not less than one year. The renewal shelf prospectus expires on January 2, 2012.

As of March 12, 2010, 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 has remained unchanged since 2000. Under the policy, the annual dividend is set in the fall for the following year at the greater of the current year's dividend adjusted for the forecast change in the consumer price index, and 60% of the following year's forecast earnings available to the common shareholder. This policy is subject to amendment in the event of a significant change in EPCOR's business or financial condition. In accordance with the policy, the annual dividends for 2009 were $134 million (2008 - $130 million).

Subsidiaries of EPCOR's power generation business paid preferred share dividends and related income taxes of $3 million (2008 - $7 million). The decrease from 2008 was due to the sale of the power generation business. CPILP paid $40 million (2008 - $94 million for the year ended December 31, 2008) of distributions to the non-controlling unitholders before the sale of the power generation business in July 2009.

Operating activities

Cash flow from operating activities, which includes changes in non-cash operating working capital, decreased to $302 million in 2009 from $403 million in 2008. The decrease was primarily due to lower cash receipts due to the sale of the power generation business partly offset by the receipt of interest revenue on the long-term loans receivable from Capital Power and payment in 2008 of income taxes related to the 2006 gain on sale of the Battle River PSA.

Cash flow from operating activities is anticipated to increase in 2010 from 2009 due to higher income from operations. Earnings in 2010 will benefit from a full year of operations of the Gold Bar facility and from the acquisition of water and wastewater assets from Suncor Energy in the fourth quarter of 2009. Working capital requirements are expected to be substantially lower in 2010 than in 2009 due to the sale of the power generation business. The Company will fund its 2010 working capital requirements with cash flow from operating activities, the issuance of commercial paper and with existing credit facilities. No significant increases in working capital requirements are expected over the long-term for existing operations.

2010 cash requirements

EPCOR's 2010 projected cash requirements include approximately $230 million for capital expenditures, $225 million for long-term debt repayments and $136 million for common dividends.

If total cash requirements for 2010 remain as planned, the sources of capital will be from cash on hand, operating cash flows, partnership distributions from Capital Power, interest and principal payments related to the long-term loans receivable from Capital Power, the issuance of commercial paper and existing credit facilities. Additional requirements for growth opportunities that emerge may be funded by new public debt offerings or the sale of additional interests in Capital Power. The payments from Capital Power comprise a significant amount of the cash required to fund the Company's 2010 contractual obligations. Should Capital Power be unable to fulfill its obligations to EPCOR in 2010, the Company will rely more heavily on its credit facilities, or possible debt financing to fund its obligations in 2010. The Company does not expect that the funds invested in floating-rate notes will impede the Company's ability to fulfill its capital requirements for 2010 and should acceptable market conditions emerge, the Company could sell all or some of the notes and use the proceeds as a source of funding for the cash requirements outlined above.

The Company has a good contractual liquidity position. The Company continues to be in compliance with the financial covenants of its credit facilities and publicly issued debt and, at December 31, 2009, it had $11 million (2008 - $111 million) in cash and cash equivalents and the following bank lines of credit:

($ millions) December 31,	2009	2008	2009	2008
	EPCOR		CPILP	
Bank lines of credit – committed	$ 500	$ 1,890	$ -	$ 300
Bank lines of credit – uncommitted	41	49	-	20
	541	1,939	-	320
Outstanding loans	-	(251)	-	(87)
Letters of credit outstanding	(99)	(253)	-	-
Bank lines of credit available	$ 442	$ 1,435	$ -	$ 233

Committed bank lines are used principally for the purpose of providing capital and letters of credit. Letters of credit are issued to meet the credit requirements of energy market participants and conditions of certain service agreements. At December 31, 2009, the Company had undrawn bank credit facilities of $442 million (2008 including CPILP - $1,668 million), of which $155 million (2008 including CPILP - $562 million) is committed for at least two years. The majority of the credit facilities are with Canadian tier 1 banks. The decrease in the bank lines from 2008 to 2009 was due to lower cash requirements as a result of the sale of the power generation business.

The committed bank lines also back the Company's commercial paper program which has an authorized capacity of $500 million and an issuance limit of $225 million under the committed credit facilities, of which nil was outstanding at December 31, 2009 (2008 - $113 million).

The Company has a Canadian shelf prospectus under which it may raise up to $1 billion of debt with maturities of not less than one year. At December 31, 2009, the available amount remaining under this shelf prospectus was $1 billion.

One of the Company's lines of credit totaling $21 million expires in 2010. EPCOR plans to renew this facility.

The Company expects to have sufficient liquidity to finance its plans and fund its obligations in 2010.

Credit ratings

In November 2009, Standards & Poor's affirmed EPCOR's credit rating for long-term unsecured debt at BBB+ stable and DBRS affirmed its credit rating for EPCOR's long-term unsecured debt at A (low) stable. These 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 served to improve certain creditworthiness measures, however a portion of the power generation related risks still remain through the remaining 72.2% 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, 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 of investment capital.

Financial covenants

EPCOR is currently in compliance with all of its financial covenants as set out in the Amended and Restated Credit Agreement dated July 9, 2009. The Company maintains sufficient capacity to borrow under all financial covenants 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.

Effects of economic downturn and market uncertainty

Canadian and U.S. financial markets stabilized somewhat in 2009. The Company secured financing to fund its capital expenditures and working capital requirements at a weighted average interest rate of 0.89% through the issue of medium-term note debentures, commercial paper and bankers' acceptances in the year. The Company plans to continue using commercial paper, existing credit facilities or medium-term notes for its financing requirements in 2010. Should instability in the credit and economic environments worsen, it may adversely affect the interest rates at which we are able to borrow.

Notwithstanding the signs of improvement in the global economy, if the economy were to deteriorate further in the longer term, particularly in Canada, this may adversely affect the Company's ability to renew credit facilities, arrange long-term financing for its capital expenditure programs and acquisitions, or refinance outstanding debt when it matures. Worsening economic conditions could also negatively impact Capital Power's operations and its ability to repay the long-term loans receivable. This could also negatively impact the Company's ability to sell-down some or all of its remaining interest in Capital Power. If market conditions worsen, the Company may suffer a credit rating downgrade and be unable to renew its credit facilities or access the public debt markets. Although we continue to believe that these circumstances have a low probability of occurring, we are continually monitoring EPCOR's capital requirements and sources of funding and assessing the Company's ability to borrow.

CONTRACTUAL OBLIGATIONS

$ millions	Payments due by period					
	2010	2011	2012	2013	2014 and thereafter	Total
Capital projects[1]	$ 38	$ -	$ -	$ -	$ -	$ 38
Water and wastewater infrastructure projects[2]	47	19	12	10	6	94
Asset retirement obligations	5	10	4	-	-	19
Long-term debt, net of sinking fund payments received	242	232	24	18	1,414	1,930
Interest on long-term debt	150	130	107	97	1,244	1,728
Short-term debt	-	-	-	-	-	-
Operating leases	5	5	11	11	194	226
Total contractual obligations	$ 487	$ 396	$ 158	$ 136	$ 2,858	$ 4,035

(1) EPCOR's obligations for capital projects include obligations for the Summerside substation and upgrades at Gold Bar.

(2) EPCOR's obligations for water and wastewater projects include obligations for the town of Chestermere, Suncor Energy projects and the transfer fee related to the purchase of Gold Bar from the City.

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. In connection with the sale of Alberta mass-market competitive contracts to AESLP, effective February 1, 2005, EPCOR made arrangements to provide AESLP's prudential obligations with AESO and Alberta's wire service providers and natural gas distributors. On December 31, 2009, prudential obligations posted under this arrangement, in the form of letters of credit and guarantees, were $28 million (2008 - $31 million).

Prior to the sale of the power generation business to Capital Power, the Company had issued parental guarantees on behalf of former subsidiaries to meet the credit requirements of energy market participants and to meet conditions of certain service agreements. At December 31, 2009, the Company continues to have outstanding parental guarantees on behalf of Capital Power totaling $1,295 million. The Company also has an outstanding parental guarantee which provides for the obligations of Capital Power under a power purchase arrangement (PPA). This guarantee does not have a defined limit; however, it is practically limited by the contractual obligations under the PPA. The Capital Power subsidiary guarantees were required to be maintained by EPCOR in order to facilitate the sale transaction closing and on the basis that Capital Power will use its best reasonable efforts with the counterparties to assume the guarantor status for these guarantees by mid 2010, after which time EPCOR may charge guarantee fees on any outstanding guarantees. The Company and Capital Power expect to finalize transfer of these parental guarantees to Capital Power by the end of 2010. Capital Power has indemnified EPCOR for any demand for payments under these guarantees. The expected liability associated with these guarantees is not material.

As part of a 2003 disposition, EPCOR agreed to indemnify certain liabilities of UE Waterheater Operating Trust (the Trust) until 2010 primarily consisting of potential tax liabilities that could arise relating to operations of the water heater rental business prior to the sale by EPCOR to the Trust. Any known liabilities associated with this indemnification are reflected on the balance sheet at December 31, 2009 and it is uncertain what, if any, additional amounts may be incurred in the future.

In December 2007, the Company entered into a 20-year lease for space in a new office tower for its headquarters in downtown Edmonton. The lease will commence January 1, 2012 or earlier and the existing lease for Edmonton offices will expire at the end of 2011.

On October 7, 2009, the Company acquired potable water and wastewater treatment plant assets from Suncor Energy for approximately $100 million and entered into an agreement to lease the assets to Suncor Energy for a 20-year term after which Suncor Energy has the option to purchase the assets from the Company for a specified price. In addition, the Company has agreed to operate and maintain the assets as well as design, build, finance and operate upgrades to related assets that will remain under the ownership of Suncor Energy, over the 20-year term. The Company will be compensated for all services in this agreement through payments over the 20-year term.

On January 21, 2009, City Council approved a motion to transfer the Gold Bar assets and associated long-term debt to EPCOR. Gold Bar handles wastewater requirements for over 700,000 residents of the City and has a current treatment capacity of 310 megalitres per day. On March 31, 2009, 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 long-term debt bears interest at a weighted average interest rate of approximately 5.21% and matures over the period from 2009 to 2033 as follows:

(Unaudited, $ millions)	
2009	$ 6
2010	6
2011	6
2012	5
2013 to 2033	89
Total	$ 112

The transfer fee is payable in annual instalments over the period from 2009 to 2015 and is included in the table of contractual obligations above. The first instalment of $17 million was paid on March 31, 2009.

There were no other material guarantee obligations outstanding in respect of third parties.

OUTLOOK

In 2009, we focused on operational excellence, electricity transmission and water development projects including new commercial contracts in Water Services, the transfer of Gold Bar from the City, and the sale of the power generation business and the efficient transfer of the associated operations to Capital Power. In 2010, we intend to focus on prudent and responsible business operations and growth in water and wires infrastructure.

Our 2010 capital expenditure program is expected to be approximately $230 million and will focus on the construction of the Summerside substation and continuation of upgrades at Gold Bar and the Suncor site facilities.

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 the lack of capital available, there is a current trend for municipal governments to turn to public-private partnerships. We will pursue expanding our portfolio of commercial water contracts.

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.

The addition of the Gold Bar business to our portfolio has expanded our wastewater management expertise which should strengthen our competitive position for developing new wastewater treatment plants outside Edmonton.

Our continuous improvement objective means that we will continue to seek out ways of maximizing the efficiency of our existing electricity and water operations.

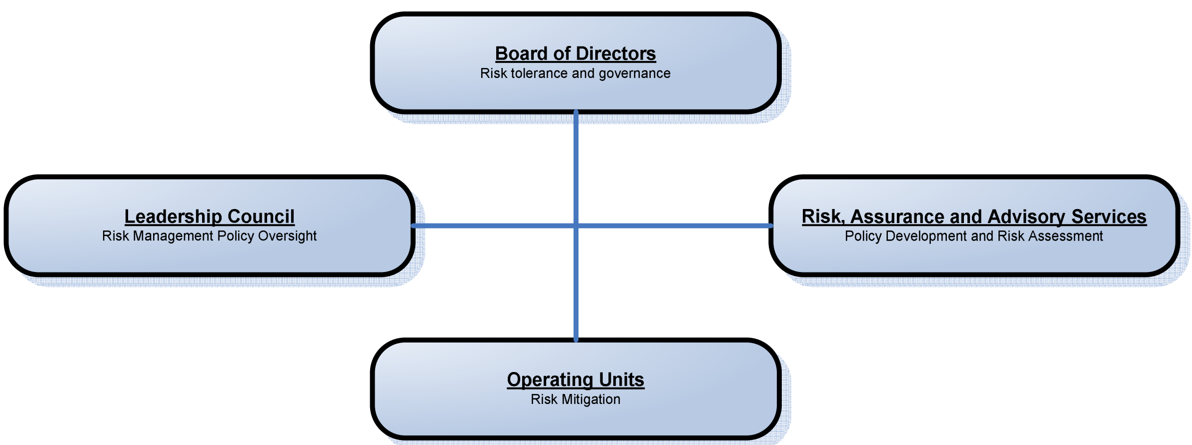
We expect our earnings to be higher in 2010 and factors contributing to that include:

- No items similar to the sale of the power generation business in 2010;
- Net income from a full year of Gold Bar operations;
- A full year of interest revenue on the long-term loans receivable from Capital Power;
- Increased earnings from our expanding portfolio of commercial water services contracts; and
- Lower financing costs due to lower average debt levels in 2010, partly offset by lower capitalized interest; partly offset by
- Increased expenses for water business development activity.

In addition, our direct exposure to earnings volatility from changes in the fair value of commodity portfolios will be non-existent in 2010 with the sale of the power generation business to Capital Power. However, the Company will have indirect exposure to the volatility, albeit somewhat less, through our 72.2% equity share of income of Capital Power.

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 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 review and recommendation, and reviews of risk compliance are provided by Leadership Council, EPCOR's senior executive group. 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. 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. We believe 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, we view risk management as an ongoing process and continually review our risks and look for ways to enhance our risk management processes.

In 2009, with the establishment of Capital Power, the risk profile for EPCOR has changed. Prior to the sale of the power generation and related businesses, our ERM framework had a heavier focus on the risks associated with those businesses such as commodity, environmental and credit related risks. While such risks are still present through our remaining investment in Capital Power, we no longer directly manage those risks since we do not manage that business. Accordingly, we have modified our ERM framework under the Committee of Sponsoring Organizations (COSO) framework, with greater relative focus on the risks associated with our remaining water and electricity infrastructure businesses.

The Company's Ethics Policy includes Accounting and Auditing Complaint 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 2009, no complaints were received under the Accounting and Auditing Complaint Procedures.

Risks related to investment in Capital Power

Significant reliance is placed on the capacity of Capital Power to honour 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 to EPCOR would be reduced and EPCOR would need to satisfy its own debt obligations by other means.

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 LP, which EPCOR does not control. There can be no assurance that Capital Power LP will continue to pay distributions at current levels as the distributions may be reduced or eliminated entirely in the future.

Underlying these risks are the specific business risks of Capital Power. EPCOR's ability to manage these risks is limited. EPCOR, by virtue of its holdings of exchangeable units in Capital Power LP, has four elected directors on the Board of Capital Power. This does give EPCOR some influence over certain of the operating and strategic decisions made by Capital Power, including risk management.

Operational risks

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 testing of water on a continuous basis 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.

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 and revenues may be negatively affected.

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. 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, local or common law, regulations and permitting requirements in Canada. 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.

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 Default Supply 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 and a fair return. Our ability to recover the actual costs of providing service and to earn a fair return is dependent upon achieving the forecasts established in the rate-setting process. EPCOR filed its 2010-2011 rate applications for RRT non-energy charges and distribution and transmission tariffs with the AUC in the fourth quarter of 2009. These application processes have risks customarily associated with rate-regulated tariff filings.

Commencing on July 1, 2006, our charges to RRO-eligible customers for energy are regulated by the AUC's RRO Regulation. The RRO is the default option for RRO-eligible consumers who have not entered into contracts with an electricity retailer. Electricity rates under the RRO are based on a combination of long-term and monthly forward hedges, with an increasing percentage of monthly forward hedges over the 5-year transition period. At the end of the transition period in 2010, the RRO is intended to be similar to the design of the current Alberta natural gas default rate, which is based on monthly forward prices. As this electricity pricing model results in increasing volatility in prices to our customers over the transition period, it may impact our volume of electricity sales, as well as electricity margins. To date, the financial impact to EPCOR has been insignificant.

EPCOR's water treatment and distribution services to customers within the City are rate-regulated by City Council pursuant to a PBR bylaw. 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 rates are increased by the change in the rate of inflation less an efficiency factor. City Council approved a renewal of the PBR bylaw on July 4, 2006 for the 5-year period commencing April 1, 2007. 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 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 which has been approved by the AUC.

In December 2008, the Regional Water Customers Group, which represents the interests of these regional water customers, requested that the AUC issue a Notice of Application in respect of its complaints regarding wholesale water rates for the years 2004 to 2007. In January 2009, the AUC issued a Notice of Application inviting any parties wishing to intervene in the proceeding to submit a Statement of Interest to Participate by February 20, 2009. In March 2009, the AUC requested comments regarding a process to address the rate application. The Company has provided to the AUC information related to the water rates for the years in question and the timing of a decision from the AUC is estimated to be the second quarter of 2010.

EPCOR's growth strategy is primarily dependent on the development and operation of water and wastewater infrastructure for both municipal and commercial/industrial customers (primarily related to oil sands). 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 Ontario municipal market could potentially be delayed by public sentiment against private sector developers, or 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 or curtailed.

EPCOR's growth strategy is also dependent on the development and/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.

Financial liquidity risk

The Company's future development, enhancement or acquisition initiatives may require additional financing. 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, the ability to borrow funds or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes. Furthermore, if the foregoing are available, there can be no assurance that they 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 the Financial Exposure Management Policy administered by EPCOR's Treasurer.

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. Extreme weather can impact the physical operation of our facilities.

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

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. EPCOR's ability to complete projects successfully depends upon numerous factors beyond the Company's control such as unexpected cost increases, ability of third parties to access financing and/or credit facilities, accidents, availability of skilled labour, strikes and regulatory matters. We attempt to mitigate these risks by performing detailed project analysis and due diligence prior to and during construction or acquisition, and by entering into favourable contracts for various services to be provided as required.

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.

Availability of people

Our ability to continuously operate and grow the business is dependent upon retaining and developing sufficient labour and management resources. As with most organizations, we are facing the demographic shift where a large number of employees are expected to commence retirement over the next few years. We believe that we employ good human resource practices and have been named a top 50 employer in Alberta by MediaCorp Canada Inc. We continue to monitor developments and review our human resource strategies so that we have an adequate supply of labour 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. EPCOR manages credit risk and limits exposures through its credit policies and procedures. These include an established credit review 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 to shorter terms, our potential exposure to losses for the purchase of electricity that is not consumed has been largely mitigated.

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 economic conditions deteriorated worldwide in 2008 and early 2009 before stabilizing somewhat, the effects did not significantly impact the RRT and default supply market in Alberta. However, EPCOR may experience credit losses in 2010 should economic conditions deteriorate further.

EPCOR's exposure to RRT 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 a 60-day potential accounts receivable value for this portfolio.

December 31 ($ millions)	2009	2008
Unrated RRT and default supply customers[1][2]	$ 277	$ 347

[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 a recovery of a percentage of forecasted credit losses relating to RRT.

The year-over-year decrease in exposure relates to the 60-day potential accounts receivable and was driven mainly by lower RRO pricing.

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 but not yet paid for.

This portfolio is reasonably well diversified with no significant credit concentrations. While economic conditions deteriorated worldwide in 2008 and early 2009 before stabilizing somewhat, the effects did not significantly impact the water markets in Canada. However, EPCOR may experience credit losses in 2010.

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.

December 31 ($ millions)	2009	2008
Unrated customers	$ 93	$ 71
Rated customers	$ 48	$ 21

Health and safety

Our operations have hazardous elements like high voltage electricity that could have adverse health and safety consequences to our employees, on-site suppliers and customers. We manage our health and safety risks through a company-wide health and safety management system and measure our 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 and/or exceeds the regulatory requirements in which we operate our business. We have committed to working with industry partners to share and improve health and safety within the industry.

Our operations are subject to the risks of a widespread influenza outbreak or other pandemic illness. We have developed plans 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.

Environment risk

EPCOR's power and water operations are subject to laws, regulations, and operating approvals which are designed to reduce the impacts on the environment. Furthermore, the Company's facilities could experience incidents that result in spills or emissions in excess of those permitted by law, regulations or operating approvals.

EPCOR seeks to ensure that it complies, in all material respects, with the laws, regulations and operating approvals affecting its facilities, and minimizes the potential for incidents by incorporating environmental management practices in its strategy, policies, processes and procedures. To achieve this, EPCOR requires 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. EPCOR's Rossdale, E.L. Smith and Gold Bar facilities are EnviroVista Leaders in Alberta, a designation by Alberta Environment indicating an above average compliance record. Additionally, EPCOR Water Services is working towards formal implementation of an ISO 14001 Environmental Management System designation for the Gold Bar facility.

EPCOR's 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.

EPCOR complies, in all material respects, with federal, provincial and local environmental, health and safety legislation and guidelines with respect to its water, wastewater and power operations. Compliance with future environmental legislation may require significant capital and operating expenditures and failure to comply could result in fines and penalties or the curtailment of operations.

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. We are 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 undertaken 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.

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.

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 utility rates in Edmonton.

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 is an executive officer of EPCOR and has a casting vote or second vote in the case of a tie vote at any meeting of the Capital Power board of directors.

General economic conditions, business environment and other risks

The Company is exposed to potential recovery and fair value measurement uncertainty in respect of its investment in floating-rate notes. See Asset-backed commercial paper exchanged for floating rate notes under "Significant Events".

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. Our ability to mitigate these risks is dependent upon management's ability to anticipate such risks and, where possible, to develop appropriate mitigation plans.

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. We manage our relationships with regulators and governments to support the timely development of appropriate transmission capability and technology.

The following table outlines our estimated sensitivity to specific risk factors as at December 31, 2009. 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, 2009 and the degree of sensitivity to each factor will change as the Company's mix of assets and operations subject to these factors changes.

Factor ($ millions)	Change	Annual Cash Flow	Annual Net Income
Increase in RRT customers	+5.0%	+ 2	+ 2
Increase in water consumption – Alberta	+3.0%	+5	+5

Litigation update

On March 20, 2009, EPCOR was charged under Alberta's Occupational Health and Safety Act (the Act) and Occupational Safety Code (the Code) in relation to the 2007 fatality of a power lineman employee who came in contact with energized equipment at a job site in south Edmonton. The charge under the Act relates to failure to ensure, as far as it was reasonably practicable to do so, the health and safety of the employee. The three charges under the Code relate to safe work plan provisions, Alberta Electric Utility Code rules and work process safeguards with respect to energized electrical cables. We have entered not guilty pleas on all charges. The matter has been adjourned by consent until April 19, 2010 for the purpose of setting a trial date. Each charge could attract a fine of up to $500,000 upon conviction.

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, 2009. 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 and they do not contain any misrepresentations.

ACCOUNTING CHANGES IN 2009

Commencing January 1, 2009, the Company adopted new accounting standards as issued by the Canadian Institute of Chartered Accountants (CICA) for Rate-regulated operations, Intangible Assets, Credit Risk and fair value of financial assets and liabilities and Financial Instruments.

Rate-regulated operations

In December 2007, the CICA amended Handbook Section 1100 - Generally Accepted Accounting Principles, and made consequential amendments to Accounting Guideline 19 - Disclosures by Entities Subject to Rate Regulation. The amendments removed the temporary exemption from the requirement to apply Section 1100 to the recognition and measurement of assets and liabilities arising from rate regulation. These amendments have been adopted by the Company commencing January 1, 2009. The Company's adoption of the amendment did not have a material impact in the consolidated financial statements.

As permitted by Canadian GAAP, the Company is applying standards issued by the Financial Accounting Standards Board in the U.S. as another source of Canadian GAAP. The U.S. Statement of Financial Accounting Standards No. 71 – Accounting for the Effects of Certain Types of Regulation (FAS 71) allows for the recognition and measurement of rate regulated assets and liabilities.

Intangible assets

In February 2008, the CICA issued Handbook Section 3064 – Goodwill and Intangible Assets and made consequential amendments to Section 1000 – Financial Statement Concepts. The new section establishes standards effective January 1, 2009 for the recognition, measurement and disclosure of goodwill and intangible assets. The provisions relating to the definition and initial recognition of intangible assets, including internally generated intangible assets, are equivalent to the corresponding provisions in International Financial Reporting Standards (IFRS). EPCOR has adopted these amendments commencing January 1, 2009 and applied them on a retrospective basis, resulting in the reclassification of $86 million of net assets from property, plant and equipment to contract and customer rights and other intangible assets in the comparative December 31, 2008 balance sheet. The adoption of these amendments had no other material impact on our consolidated financial statements.

Credit risk and fair value of financial assets and liabilities

On January 20, 2009, the Emerging Issues Committee of the CICA issued EIC-173 Credit Risk and the Fair Value of Financial Assets and Liabilities, which clarifies that an entity's own credit risk and the credit risk of its counterparties should be taken into account in determining the fair value of financial assets and liabilities, including derivative instruments. Effective January 1, 2009, the Company adopted the recommendations of EIC-173 and applied them retrospectively without restatement of prior periods. Including counterparty credit risk in the estimate of the fair value of CPILP's natural gas and foreign exchange contracts on January 1, 2009 had the following impact on EPCOR's balance sheet on that date:

(Unaudited, $ millions)	**Increase (decrease)**
Derivative instruments assets – non-current	$ (1)
Derivative instruments liabilities – non-current	(6)
Future income tax liabilities – non-current	1
Non-controlling interests	3
Opening retained earnings	1

Financial Instruments

In June 2009, the CICA amended Handbook Section 3862 Financial Instruments – Disclosures, to adopt the amendments recently made by the International Accounting Standards Board to IFRS 7 Financial Instruments: Disclosures. The amendments require enhanced disclosures about fair value measurements, including the relative reliability of the inputs used in those measurements, and about the liquidity risk of financial instruments. Although the amendments apply to financial statements relating to fiscal years ending after September 30, 2009, comparative information is not required in the first year of application. We have assessed the impacts of these amendments on our financial statements and implemented the necessary additional disclosures commencing with the annual financial statements for 2009.

FUTURE ACCOUNTING CHANGES

Consolidated financial statements and non-controlling interests

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

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

Business combinations

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

IFRS

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

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

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

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

Financial Statement Adjustments

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

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

Property, plant and equipment (PP&E)

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

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

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

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

The Company has substantially completed its assessment of the cumulative impact of the above changes and estimates that upon transition there will be a decrease in the carrying value of PP&E in the range of $45 million to $55 million with an offset to retained earnings. We expect an annual decrease of $3 million to $5 million in depreciation expense.

Asset retirement obligations

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

We have concluded our review of our obligations and are assessing whether we are able to make an estimate of the obligations. We expect this to be resolved by the end of the first quarter of 2010.

Rate regulated accounting

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

IFRS 1 – First Time Adoption of IFRS

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

- Fair value or revaluation as deemed cost - An entity may choose to use fair value at the date of transition as deemed cost. This election is available on an asset by asset basis. We have initially concluded that we will not employ fair values on conversion and our estimate of the impact of IFRS on PP&E is based on management's current intent to not utilize this exemption.

- Employee benefits - An entity may elect to recognize all cumulative actuarial gains and losses associated with employee benefit plans at the date of transition to IFRS. A decision on whether to utilize this exemption will be made in the second quarter of 2010.

- Decommissioning liabilities – An entity may use a simplified calculation to calculate and restate the decommissioning liability and related property, plant and equipment and depreciation expense. A decision on whether to utilize this exemption will be made in the second quarter of 2010.

- Transfer of assets from customers - An entity does not have to restate property, plant and equipment for any customer contributions which were previously netted against property, plant and equipment. Customer contributions are a normal part of our business in the construction of power and water infrastructure. A decision on whether to utilize this exemption will be made in the third quarter of 2010.

Exposure Draft – Rate-Regulated Activities

On July 23, 2009, the International Accounting Standards Board (IASB) issued an exposure draft which if issued as a standard would significantly reduce the estimated impacts included in the PP&E and rate regulated accounting sections noted above. In February 2010, the staff of the IASB recommended to the IASB that the project be revisited and, as a result, a standard is not expected until the third or fourth quarter of 2011. The staff also recommended that an additional exemption be provided within IFRS 1 for rate regulated entities. A revised IFRS 1 with the additional exemption is not expected until April 2010. The Company will assess any election and its impact on the PP&E adjustments at that time.

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

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

Financial Statements

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

Systems Updates

Systems must be able to capture 2010 financial information under both the prevailing Canadian GAAP and IFRS to allow comparative reporting in 2011, the first year of reporting under IFRS. We completed our system updates in the third quarter of 2009 to capture both and are implementing the operational procedures to capture the applicable accounting data through 2010. In effect we have created a dual general ledger that captures the Canadian GAAP balances and a second ledger that captures the required financial adjustments to convert the Canadian GAAP balances to IFRS.

Policies and Internal Controls

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

The impact of IFRS on certain agreements, such as debt, shareholder and compensation agreements, has also been included in the plan. Assessments of most agreements have been completed and will continue to be monitored as IFRS differences are quantified.

Training

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

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 imprecision in customer consumption data received from load settlement agents, the lag time between billing dates and meter reading dates and the lag time between billing dates and financial reporting dates, we must use estimates for determining the amount of energy consumed but not yet billed. These estimates affect accrued revenues and accrued energy costs of the Energy Services segment. There are a number of variables in the computation of these estimates, and the underlying energy settlement processes within EPCOR and the Alberta electric systems are complex. 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 $69 million (2008 - $95 million) at the end of each month and these estimates varied from $55 million to $101 million (2008 - $86 million to $120 million). Adjustments of estimated revenues to actual billings were less than $5 million (2008 - $8 million) per month.

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. Following are the descriptions of the key fair value methodologies relevant for 2009.

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, would 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 and using an appropriate discount rate. The cash flow estimates will vary with the circumstances of the particular assets or reporting unit and will be based on, among other things, the lives of the assets revenues and expenses, including inflation, and required capital expenditures.

Allowance for doubtful accounts

We continually review our aged accounts receivable and assess the underlying credit quality of the customers or counterparties. The allowance for doubtful accounts reflects an estimate of the accounts receivable that are ultimately expected to be uncollectible. It is based on a number of factors including the aging of receivables, historical write-offs within customer groups, assessments of the collectibility of amounts from individual customers and general economic conditions, including the recent recession in Canada. EPCOR's allowance account averaged $4 million (2008 - $6 million) and reported bad debts net of recoveries were $4 million (2008 - $8 million). The estimate of the allowance affects accounts receivable and all segments' operations, maintenance and administration 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 judgement 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 income taxes and estimates of future income taxes resulting from temporary differences between the carrying values of assets and liabilities in the financial statements and their tax values. Future income tax assets are assessed to determine the likelihood that they will be recovered from future taxable income. To the extent recovery is not considered more likely than not, a valuation allowance is recorded and charged against income in the period that the allowance is created or revised. Estimates of the provision for income taxes, future income tax assets and liabilities and any related valuation allowance might vary from actual amounts incurred.

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. 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, our 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 our RRT and default customer bases. These analyses did not reveal any significant changes in our assessment of the recoverability of our accounts receivable at December 31, 2009.

NON-GAAP FINANCIAL MEASURES

We use funds from operations to measure the Company’s ability to generate funds from current operations. Funds from operations is a non-GAAP financial measure, does not have any standardized meaning prescribed by GAAP and is unlikely to be comparable to similar measures published by other entities. However, it is presented since it is commonly referred to by debt holders and other interested parties in evaluating the Company’s financial position and in assessing its creditworthiness. A reconciliation of funds from operations to cash flows from operating activities is as follows:

Year ended December 31	2009	2008	2007
Funds from operations	**$ 356**	**$ 484**	**$ 517**
Change in non-cash operating working capital	(54)	(81)	24
Cash flows from operating activities	**$ 302**	**$ 403**	**$ 541**

FINANCIAL INSTRUMENTS

We classify our cash and cash equivalents and floating-rate notes as held for trading and measure them at fair value. Accounts receivable (current and long-term), including the long-term loans receivable from Capital Power, are classified as loans and receivables; and short-term debt, accounts payable and accrued liabilities and other current liabilities are classified as other financial liabilities; all of which are measured at amortized cost and their fair values are not materially different from their carrying amounts due to their short-term nature.

The classification, carrying amounts and fair values of the Company's other financial instruments held at December 31, 2009 and December 31, 2008 were as follows:

December 31, 2009	Carrying amount					
($ millions)	Held for trading	Available for sale	Loans and receivables	Other financial liabilities	Total	Total fair value
Other assets	$ 48	$ -	$ 1,025	$ -	$ 1,073	$ 1,146
Long-term debt (including current portion)	-	-	-	1,917	1,917	2,058
December 31, 2008	**Carrying amount**					
($ millions)	Held for trading	Available for sale	Loans and receivables	Other financial liabilities	Total	Total fair value
Other assets	$ 153	$ 22	$ 160	$ -	$ 335	$ 323
Long-term debt (including current portion)	-	-	-	2,728	2,728	2,471

Long-term debt includes 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 financial liabilities in the table above, consistent with their presentation on the balance sheet. The accumulated contributions to the sinking fund are measured at cost as they are not quoted in an active market.

The fair values of the Company's net investments in leases 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, 2009 and December 31, 2008.

Risk management and hedging activities

At various times, we may be directly exposed to changes in foreign currency exchange rates and interest rates. We use various risk management techniques, including derivative instruments such as forward contracts, fixed-for-floating swaps, and option contracts, to reduce this exposure. The derivative instruments assets and liabilities used for risk management purposes consist of the following:

	Carrying amount at fair value			
	Energy		Foreign exchange	
($ millions)	Cash flow hedges	Non-hedges	Non-hedges	Total
Total derivative instruments net assets (liabilities) as at December 31, 2009	$ -	$ -	$ -	$ -
Total derivative instruments net assets (liabilities) as at December 31, 2008	(41)	39	(34)	(36)

When applicable, we use various open-market derivative instruments including contract for differences (CfD), with arm's-length parties to manage our exposure to risks associated with foreign exchange rates and interest rates. These derivative instruments are recorded at fair value on the balance sheet unless we elect the fair value exemption for non-financial derivatives that are entered into and continue to be held for the purpose of receipt or delivery of a non-financial item in accordance with our expected purchase, sale or usage requirements.

At December 31, 2009, the Company did not have any derivative assets or liabilities and was not engaged in any hedging activities.

OTHER COMPREHENSIVE INCOME

As of January 1, 2007, the changes in the fair value of the effective hedge portion of the financial derivative contracts used to manage our energy portfolio and designated as accounting hedges, were recorded in other comprehensive income. The ineffective portion of the contracts was recorded in net income.

Other comprehensive income transactions subsequent to the sale of the power generation business no longer reflect the impact of the effective hedge portion of financial derivative contracts as these contracts were transferred to Capital Power with the sale of the power generation business.

For the year ended December 31, 2009, the Company's equity share of other comprehensive income of Capital Power was recorded in other comprehensive income. In addition, an unrealized loss, net of income taxes, of $1 million (2008 - $26 million unrealized gain net of income taxes) for the effective portion of cash flow hedges, and an unrealized loss net of income taxes, of $12 million (2008 - $7 million) was reclassified to energy purchases and revenues as appropriate.

In the second and third quarters of 2008, venture capital investments were sold and the total realized gain of $10 million (net of taxes of $3 million) was reclassified from other comprehensive income to net income. During the fourth quarter of 2008, changes in economic circumstances caused CPILP to re-evaluate the functional currency of its indirectly-owned U.S. subsidiaries. Accordingly, commencing October 1, 2008, these operations were translated using the current rate method whereby gains and losses resulting from foreign currency translation were recorded as a component of shareholder's equity within accumulated other comprehensive income. The loss for the fourth quarter of 2008 was

$62 million and was recognized in other comprehensive income. Prior to the fourth quarter of 2008, CPILP's foreign currency translation gains and losses were recognized in net income. The Company does not foresee similar transactions as the Company no longer holds venture capital investments as these and CPILP operations were transferred to Capital Power with the sale of the power generation business.

RELATED PARTY TRANSACTIONS

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.

We recorded financing expenses of $41 million in 2009 (2008 - $44 million) on EPCOR's debt obligation to the City. This debt obligation includes debt capital issued by the City prior to 1996 when EPCOR commenced raising capital directly. The decrease in interest expense in 2009 corresponds to the decrease in the net obligation. The outstanding balance of the net obligation to the City was $251 million at December 31, 2009 (2008 - $189 million). We recorded $61 million (2008 – nil) in payables and other liabilities to the City, including $58 million (2008 – nil) related to Gold Bar transfer fee payables.

Sales from EPCOR to the City included electricity and water, and the provision of maintenance, repair, construction and customer care services totaling $87 million in 2009 (2008 - $98 million). We paid franchise fees and property taxes to the City of $62 million (2008 - $51 million). The City provided miscellaneous services to EPCOR totaling $10 million (2008 - $8 million).

We recorded financing revenues of $30 million in 2009 (2008 - nil) on the long-term loans receivable from Capital Power. The outstanding balance of the long-term loans receivable at December 31, 2009 was $857 million (2008 - nil). $9 million of interest was accrued in relation to the long-term loans receivable at December 31, 2009 (2008 - nil).

Sales from EPCOR to Capital Power included electricity sales of $13 million in 2009 (2008 - nil) at normal commercial rates. Energy and fuel purchases by EPCOR from Capital Power at normal commercial rates were $200 million in 2009 (2008 - nil). These transactions relate to EPCOR's Energy Price Setting Plan and Capital Power is our counterparty for these services which, prior to the sale, were within the business segment. The Company also recorded $60 million of accounts payable and accrued liabilities to Capital Power, primarily for energy purchases, at December 31, 2009 (2008 - nil). We recorded $5 million (2008 – nil) in Transition Services and Services Agreement income from Capital Power and $6 million (2008 – nil) in utility billings and Transition Services charges from Capital Power. Accounts receivable included $4 million (2008 – nil) for uncollected amounts related to transition services to Capital Power. Transition services transactions are primarily for general shared service administrative functions and are expected to cease by the end of 2010.

The Company has also recorded $8 million (2008 - nil) in contributions from Capital Power for the construction of capital assets.

Equity income, included in comprehensive income, earned by EPCOR from Capital Power was $68 million in 2009 (2008 - nil).

FOURTH QUARTER REVIEW AND QUARTERLY RESULTS

Quarters ended	Revenues	Net income (loss)
	(Unaudited, $ millions)	
December 31, 2009	$ 374	$ 27
September 30, 2009	350	(56)
June 30, 2009	740	50
March 31, 2009	890	104
December 31, 2008	820	15
September 30, 2008	954	76
June 30, 2008	865	16
March 31, 2008	799	68

For the quarter ended December 31, 2009, consolidated net income from continuing operations increased by $12 million from the corresponding quarter in the prior year primarily due to the write-down of CPILP goodwill in 2008 compared with no write-down in 2009, interest revenue on the long-term loans receivable from Capital Power in 2009 with no corresponding revenue in 2008 and positive operating income as a result of the transfer of Gold Bar on March 31, 2009, partly offset by adjustments to the loss on sale of the power generation business.

Events for 2009 and 2008 quarters that have significantly impacted net income from continuing operations and net income and cash flows and the comparability between quarters are:

- September 30, 2009 third quarter results included a loss on the sale of the power generation business and the write-off of syndicated credit facility issue costs related to the sale of the power generation business partly offset by equity income from Capital Power, interest revenue on the long-term loans receivable from Capital Power LP and positive operating income as a result of the transfer of Gold Bar on March 31, 2009.

- June 30, 2009 second quarter results included unrealized fair value gains resulting from the impact of low Alberta power prices on our derivative electricity contracts that were not designated as hedges for accounting purposes, unrealized fair value gains on CPILP's forward foreign exchange contracts used to economically hedge U.S. cash flows and positive operating income as a result of the transfer of Gold Bar on March 31, 2009.

- March 31, 2009 first quarter results included a $26 million gain on the sale of a 10% interest in the Battle River PSA, and unrealized fair value gains resulting from the impact of low Alberta power prices on our derivative electricity contracts that were not designated as hedges for accounting purposes. These gains were partly offset by unrealized fair value losses on CPILP's natural gas supply contracts, and forward foreign exchange contracts used to economically hedge U.S. cash flows.

- December 31, 2008 fourth quarter results reflected impairment charges on the goodwill associated with the investment in CPILP and on CPILP's investment in Primary Energy Recycling Holdings. CPILP also recognized unrealized fair value losses on its forward foreign exchange contracts used to economically hedge U.S. cash flows and on its natural gas supply contracts.

- September 30, 2008 third quarter results reflected unrealized fair value gains on financial electricity contracts, Joffre CfD and forward foreign exchange contracts and gains on the sale of portfolio investments. These gains were partly offset by administration costs resulting from Long-Term Incentive Plan adjustments, and lower income from CPILP.

- June 30, 2008 second quarter results reflected maintenance costs and Genesee PPA availability penalties resulting from major turnarounds at all three Genesee plants partly offset by the favourable impact of high Alberta power prices on our financial contract portfolio, and unrealized fair value gains on CPILP's natural gas supply contracts.

- March 31, 2008 first quarter results included a $30 million gain on the sale of a 10% interest in the Battle River PSA, the favourable impact of high Alberta power prices on our financial contract portfolio which was in a net long position and unrealized fair value gains on CPILP's natural gas supply contracts. These gains were partly offset by maintenance costs and Genesee PPA availability penalties resulting from a major planned outage at Genesee 1, and a fair value reduction of ABCP.

FORWARD-LOOKING INFORMATION

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. The primary forward-looking information in this MD&A comprises: (i) expectations regarding future Company growth, investment and operating plans and the impact of the current and future economic conditions; (ii) the Company plans to eventually sell all or a substantial portion of its ownership interest in Capital Power, subject to market conditions, its requirements for capital and other circumstances that may arise in the future, and reinvest the proceeds from the share sales in the Company's existing or new utility infrastructure businesses, including water and wastewater treatment, and power transmission and distribution; (iii) 2010 cash flow from operating activities will increase from 2009 due to higher income from operations; (iv) 2010 earnings will benefit from a full year of the Gold Bar facility and from the acquisition of water and wastewater treatment assets from Suncor Energy in the fourth quarter of 2009; (v) 2010 working capital requirements will be substantially lower than in 2009 due to the sale of the power generation business; (vi) the Company will fund its 2010 working capital requirements with cash flow from operating activities, the issuance of commercial paper and with existing credit facilities; (vii) 2010 projected cash requirements and sources of financing; (viii) primary sources of cash in 2010 will include cash on hand, partnership distributions from Capital Power LP, interest and principal payments related to the long-term loans receivable from Capital Power, cash flow from operating activities, the issuance of commercial paper and existing credit facilities; (ix) should Capital Power be unable to fulfill its obligations to EPCOR in 2010, the Company will rely more heavily on its credit facilities or debt financing to fund its own obligations; (x) the Company does not expect that the funds invested in floating-rate notes will impede the Company's ability to fulfill its capital requirements for 2010; (xi) the Company plans to renew its $21 million line of credit which expires in 2010; (xii) the Company's creditworthiness is expected to improve as both the equity interest and long-term loans receivable related to Capital Power decrease; (xiii) the Company and Capital Power expect to finalize transfer of parental guarantees supporting Capital Power power purchase arrangements to Capital Power by the end of 2010; (xiv) 2010 earnings will be higher than in 2009; and (xv) the timing of decisions related to and expected impacts of the transition to IFRS.

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

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

This MD&A includes the following updates to previously issued forward-looking statements: (i) the amount of capital spending over the last quarter of 2009 was $148 million compared with an expected $183 million due to delays on various projects; (ii) expected capital spending for the twelve and six months ended December 31, 2009 decreased from the previously disclosed $556 million and $245 million to approximately $517 million and $213 million due to project delays on various Distribution and Transmission and Water Services projects; and (iii) earnings in the fourth quarter of 2009, before fair value changes were not consistent with earnings in the first quarter primarily due to the sale of the power generation business.

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 2009 Annual Information Form is available on SEDAR at www.sedar.com.