

August 31, 2005

**Message from the President and CEO**

We are pleased to provide the Balancing Pool's 2005 mid-year report.

As outlined in our 2004 Annual Report and our presentation to stakeholders at our 2005 Annual Meeting, a deficit was expected to occur in 2005 as a result of the carrying costs of our Power Purchase Arrangements (PPAs) being higher than revenues received from the sale of generating capacity under the MAP II contracts. One of the main contributors to this deficit has been the Clover Bar PPA, which led to our decision in April to provide notice to terminate this PPA on October 1, 2005. Following the termination payment to be made on the Clover Bar PPA, we forecast to be in a deficit cash position and will drawdown on our credit facilities to cover this deficit.

The operating deficit incurred for the six months ending June 30, 2005 was \$4.3 million, compared to a \$26.1 million deficit for the same period in 2004. This represents a significant reduction in the operating deficit notwithstanding that average Pool prices during the six months ending June 30, 2005 were some 10% lower than the same period in 2004. The major factors which contributed to this reduced operating deficit were higher Payments in Lieu of Tax funding and lower PPA capacity payments.

Despite the operating deficit incurred, there was a small surplus attributed to the deferral account balance and our cash position increased by \$20.1 million from the year-end balance.

Major activities completed during the first six months of 2005 have included participation in the Wholesale Market Review and the Clean Air Strategic Alliance (CASA) electricity sector emissions initiative, consulting with representatives of customers and the Minister of Energy regarding termination of the Clover Bar PPA and planning for the auction of the PPA Capacity for the Sheerness Generating Station.

As per the Balancing Pool's legislated mandate, our overall objective continues to be to manage, in a commercial manner, the PPAs held by the Balancing Pool and any arrangements or agreements derived from those assets. The upcoming auctions of the Sheerness and Genesee PPA capacity is an important step in achieving this objective. Based upon feedback received from stakeholders earlier this year, the auctions will provide interested parties with more choice with respect to term and size of the strip contracts, including the potential sale of the

entire PPA. This will allow buyers to tailor bids to their specific needs and maximize the sale value to the Balancing Pool, which will ultimately benefit electricity consumers in Alberta.

The initial phase of the auction process for the Sheerness PPA is currently under way, with expressions of interest received in June, followed by the distribution of an information memorandum to interested parties commencing in July. The purchase contract will be provided shortly to all qualified parties. The final stage of the auction process will take place in November, with transfer of control of successful bids as early as January 1, 2006. The plan for the auction of the Genesee PPA capacity will be finalized early next year.

I hope stakeholders find the information in this mid-year report valuable and would be pleased to respond to any questions or comments.

A handwritten signature in black ink that reads "Gary Reynolds". The signature is written in a cursive style with a large, stylized "G" and "R".

**Gary Reynolds**  
*President and Chief Executive Officer*

**Management's Discussion and Analysis**

This Management's Discussion and Analysis ("MD&A"), dated August 31, 2005, should be read in conjunction with the unaudited interim financial statements of the Balancing Pool for the six months ended June 30, 2005 and 2004 and in conjunction with the audited financial statements and MD&A for the year ended December 31, 2004. The Audit and Finance Committee reviews the contents of the MD&A and recommends its approval to the Board.

The Balancing Pool's obligations and responsibilities are governed by the *Electric Utilities Act (2003)* (the "Act"). The Balancing Pool's mission is to operate in a commercial manner to enhance asset value and manage liabilities.

**Results at a Glance**

Six months ended June 30 (thousands of dollars)  
(unaudited)

	<b>2005</b>	2004
Revenues	<b>274,436</b>	288,933
Operating loss	<b>(4,384)</b>	(26,119)
Net surplus (deficit) attributed to the deferral account	<b>99</b>	(21,288)
<i>Other Information</i>		
Average Pool price per MWh	<b>\$48.68</b>	\$54.48
	<b>June 30 2005</b>	December 31 2004
Ending deferral account balance	<b>232,446</b>	232,545
Total assets/liabilities	<b>1,892,825</b>	1,959,227
Cash and short term investments	<b>61,301</b>	41,226

While an operating loss of \$4.4 million was incurred for the six months ended June 30, 2005, this outcome was expected based upon our financial forecast and was \$21.7 million lower than the same period in 2004. Factors contributing to this loss are discussed in this MD&A.

The reduction in Pool price year-over-year resulted in the Balancing Pool receiving less cash under the Hydro Power Purchase Arrangement (“PPA”) and paying higher amounts under the small power producer contracts.

### **Revenues and funding**

For the six months ended June 30, 2005, the largest portion of the Balancing Pool’s revenues was derived from the sale of generating capacity related to the MAP II contracts. Revenue from the sale of generating capacity was \$219.1 million (2004 - \$244.5 million). The Balancing Pool’s revenue related to the Sheerness, Genesee and Clover Bar Power Purchase Arrangements (“PPAs”) is not materially impacted by fluctuations in Pool price or actual generation of these plants because the output rights of these plants have been contracted out under MAP II.

MAP II contracts are comprised of fixed and variable amounts that are paid on a monthly basis to the Balancing Pool. The fixed component of the monthly payment was established through the MAP II competitive sale process, while the variable component was structured to cover other costs payable by the Balancing Pool under the PPAs. For the six months ended June 30, 2005, MAP II revenue decreased by \$25.4 million due mainly to lower variable transmission and availability incentive revenues.

For the six months ended June 30, 2005, funding from payments in lieu of tax (“PILOT”) was \$32.5 million (2004 - \$15.5 million). PILOT funding is not determined by the Balancing Pool, as it is solely based on the income of the unregulated businesses of ENMAX, EPCOR, and the City of Medicine Hat. The increase in PILOT funding from 2004 is mainly due to payments received from EPCOR resulting from their settlement with Alberta Tax and Revenue Administration.

For the six months ended June 30, 2005, Hydro PPA revenue of \$20.3 million (2004 - \$27.2 million) represents accretion of the value of the Hydro PPA asset (as per Canadian Institute of Chartered Accountants (“CICA”) guidelines), settled hedging gains and losses, and the difference between the actual Pool price and the Pool price used to value the Hydro PPA asset at the beginning of the year.

### **Expenses**

For the six months ended June 30, 2005 cost of sales of \$241.5 million (2004 - \$278.1 million) is comprised of fixed and variable operating costs payable under the Sheerness, Genesee, and Clover Bar PPAs, and transmission charges. The decrease in cost of sales from 2004 is due to lower PPA capacity payments,

transmission charges and availability incentive payments. PPA capacity payments fluctuate from year to year as a result of changes in indices, annual fixed costs defined in the PPA, and pass-through charges.

For the six months ended June 30, 2005, other PPA charges consist mainly of a negative bid payment of \$2.1 million (2004 - \$2.1 million) under the Rainbow PPA.

The Balancing Pool is obligated to make certain payments directed by the Minister of Energy. For the six months ended June 30, 2005, \$1.8 million (2004 - \$2.7 million) has been accrued, but not yet paid, for the Office of the Utilities Consumer Advocate.

Under the Act, the Balancing Pool is required to make monthly payments to TransAlta, the utility that administers the small power producer contract payments, for the amount by which Pool price falls below contracted amounts for small power producers. For the six months ended June 30, 2005, small power producer contract expense of \$2.1 million (2004 - \$0.3 million) represents accretion of the value of the liability (as per CICA guidelines) and the difference between the actual Pool price and the Pool price used to value the liability at the beginning of the year.

### **Operating Loss**

For the six months ended June 30, 2005 an operating loss of \$4.4 million was incurred, compared to a loss of \$26.1 million in the same period in 2004. This loss was consistent with the Balancing Pool's financial forecast and is primarily due to the carrying costs of the Clover Bar, Genesee, and Sheerness PPAs being higher than the revenue generated from the MAP II contracts.

### **Other Income and Expense**

For the six months ended June 30, 2005, the Balancing Pool increased the provision for reclamation and abandonment of the isolated generation sites by \$19.1 million (2004 – nil) due to revised engineering estimates to complete the remaining work. The remaining reclamation and abandonment expense relates to H.R. Milner.

For the six months ended June 30, 2005, the Balancing Pool received \$24.1 million (2004 – nil) from EPCOR Power Development Corp. and TransAlta Energy Corp. for Genesee common facilities, pursuant to the *Common Facilities Costs Regulation* of the Act. This regulation requires an owner to pay a share of the common facilities costs to the Balancing Pool when the owner constructs a

new generating unit at an existing power plant whose capacity is already contracted under a PPA.

### **Cash and Short-Term Investments**

The cash and short-term investments balance was \$61.3 million at June 30, 2005 compared to \$41.2 million at December 31, 2004. This increase is due mainly to the payment received for the Genesee common facilities and increased PILOT funding. Based on financial forecasts, the Balancing Pool expects the cash balance to decline over the current fiscal year. However, the deficit position is expected to be short-term in nature. At June 30, 2004, the Balancing Pool had an unsecured credit facility available to borrow up to an aggregate amount of \$50 million.

### **Subsequent Event**

On August 2, 2005, the Balancing Pool finalized another \$50 million unsecured credit facility, thereby providing a total of \$100 million in unsecured credit facilities.

### **Outlook**

The Balancing Pool continues to focus on planning contract offerings and implementing the auction process for the Sheerness PPA capacity. The final stage of the auction process will take place in November 2005, with transfer of control as early as January 1, 2006.

The Balancing Pool provided EPCOR Generation Inc. ("EPCOR") with notice to terminate the Clover Bar PPA, effective October 1, 2005. The Balancing Pool estimates the termination payment to EPCOR will be in the range of \$80 to \$90 million.

Based on our financial forecast, the Balancing Pool expects to be in a cash deficit position later in 2005. To cover this expected short-term cash deficit position, the Balancing Pool will utilize its unsecured credit facilities.

The Balancing Pool continues to participate in discussions with TransAlta Utilities Corporation related to a negotiated settlement on the Wabamun decommissioning matter.

## **Forward-Looking Information**

Certain information in this MD&A is forward-looking information and related to, among other things, anticipated financial performance, operational prospects and strategies. Forward-looking information typically contains statements with words such as “anticipate”, “believe”, “expect”, “target” or similar words suggesting future outcomes. By their nature, such statements are subject to various risks and uncertainties that could cause the Balancing Pool’s actual results and experience to differ materially from the anticipated results. Such risks and uncertainties include, but are not limited to: availability and price of energy commodities; regulatory decisions; the ability of the Balancing Pool to successfully implement the initiatives referred to in this MD&A; and electricity market factors (such as cost of transmission).

## Balancing Pool

### Balance Sheets

(in thousands of dollars)

	<b>As at June 30, 2005</b> (unaudited)	<b>As at December 31, 2004</b> (audited)
<b>Assets</b>		
<b>Current assets</b>		
Cash and short-term investments	61,301	41,226
Accounts receivable and prepaid expenses	45,468	109,484
Current portion of hydro power purchase arrangement	38,883	24,000
	<u>145,652</u>	<u>174,710</u>
<b>Long-term receivable</b>	7,085	9,622
<b>Property, plant and equipment</b>	891,483	920,248
<b>Deferred charges</b>	1,494	2,102
<b>Hydro power purchase arrangement</b>	614,665	620,000
<b>Balancing Pool deferral account</b>	232,446	232,545
	<u>1,892,825</u>	<u>1,959,227</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	64,199	91,358
Current portion of power purchase arrangement lease obligations	98,567	113,163
Current portion of reclamation and abandonment provision	21,650	11,822
Current portion of small power producer contracts	8,280	8,000
	<u>192,696</u>	<u>224,343</u>
<b>Power purchase arrangement lease obligations</b>	1,634,142	1,676,127
<b>Reclamation and abandonment provision</b>	32,503	22,757
<b>Small power producer contracts</b>	33,484	36,000
	<u>1,892,825</u>	<u>1,959,227</u>
<b>Equity</b>	<u>-</u>	<u>-</u>
<b>Contingencies and commitments</b>	<u>1,892,825</u>	<u>1,959,227</u>

## Balancing Pool

### Statements of Operations and Balancing Pool Deferral Account

For the six months ending June 30 (in thousands of dollars)  
(unaudited)

	2005	2004
<b>Revenues and funding</b>		
Sale of generating capacity	219,130	244,546
Payments in lieu of tax	32,475	15,535
Hydro power purchase arrangement	20,254	27,236
Investment income	2,546	1,572
Sale of electricity	31	44
	<hr/> 274,436	<hr/> 288,933
<b>Expenses</b>		
Cost of sales	241,470	278,138
Amortization and depreciation	29,485	29,472
Other power purchase arrangement charges	2,203	2,530
Small power producer contracts	2,054	340
General and administrative	1,827	1,872
Office of the Utilities Consumer Advocate	1,781	2,700
	<hr/> 278,820	<hr/> 315,052
<b>Operating loss</b>	(4,384)	(26,119)
<b>Other income (expense)</b>		
Genesee common facilities	24,061	-
Reclamation and abandonment	(19,578)	-
	<hr/> 4,483	<hr/> -
Gain on sale of H.R. Milner	-	4,831
<b>Net surplus (deficit) attributed to the deferral account</b>	99	(21,288)
<b>Balancing Pool deferral account, beginning of period</b>	<hr/> 232,545	<hr/> 168,603
<b>Balancing Pool deferral account, end of period</b>	<hr/> <b>232,446</b>	<hr/> <b>189,891</b>

## Balancing Pool

### Statements of Cash Flows

For the six months ending June 30 (in thousands of dollars)  
(unaudited)

	2005	2004
<b>Operating activities</b>		
Net surplus (deficit) attributed to the deferral account	99	(21,288)
Items not affecting cash		
Amortization and depreciation	29,485	29,472
Reclamation and abandonment provision	19,578	-
Increase in Hydro power purchase arrangement	(19,993)	(26,625)
Increase in small power producer contracts	2,050	340
Gain on disposal of discontinued operation	-	(4,831)
Reclamation and abandonment expenditures	(4)	-
Net change in non-cash working capital	39,394	7,950
	<u>70,609</u>	<u>(14,982)</u>
<b>Investing activities</b>		
Proceeds on sale of property, plant and equipment	-	5,182
Deferred charges	(100)	342
Regulatory deferral	-	(5,779)
Additions to property, plant and equipment	(12)	(3)
	<u>(112)</u>	<u>(258)</u>
<b>Financing activities</b>		
Net Hydro power purchase arrangement receipts	10,445	32,096
Power purchase arrangement lease obligations	(56,581)	(53,827)
Small power producer contracts payments	(4,286)	(2,785)
	<u>(50,422)</u>	<u>(24,516)</u>
<b>Increase (decrease) in cash and cash equivalents</b>	20,075	(39,756)
<b>Cash and cash equivalents, beginning of period</b>	41,226	138,383
<b>Cash and cash equivalents, end of period</b>	<u>61,301</u>	<u>98,627</u>