

## Management's Discussion & Analysis

Three and six months ended June 30, 2010

### FINANCIAL AND OPERATING HIGHLIGHTS

(\$ Thousands, except where noted)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Operating Highlights</b>				
Average daily volumes (100%)				
Pipeline				
Alliance – billion cubic feet per day	1.582	1.587	1.631	1.638
AEGS – thousand barrels per day <sup>(1)</sup>	283.1	273.4	283.4	278.7
NGL				
Aux Sable – thousand barrels per day	74.6	70.8	75.7	62.6
Power				
Fort Chicago Power – megawatt hours	97,308	112,525	184,818	295,211
NRGreen – megawatt hours	34,731	34,861	74,299	62,257
East Windsor Cogeneration – megawatt hours	52,810	–	75,340	–
<b>Financial Results</b>				
Revenues	167,965	149,290	327,942	300,094
Net income	18,419	19,959	32,493	31,263
Per Unit (\$) – basic and diluted	0.13	0.15	0.23	0.23
Adjusted net income <sup>(2) (3)</sup>	18,419	19,959	32,493	33,551
Per Unit (\$) – basic and diluted	0.13	0.15	0.23	0.25
Cash from operating activities	41,062	33,227	107,329	77,607
Distributable cash <sup>(2) (4)</sup>	49,276	38,619	80,985	69,629
Per Unit (\$) – basic and diluted	0.34	0.29	0.57	0.52
Distributions paid/payable <sup>(6)</sup>	35,564	33,788	70,576	67,301
Per Unit (\$)	0.25	0.25	0.50	0.50
Capital expenditures				
Growth <sup>(2) (5)</sup>	3,403	5,018	8,735	12,128
Maintenance and sustaining <sup>(2) (5)</sup>	4,080	537	5,789	1,946

As at	June 30, 2010	Dec. 31, 2009	June 30, 2009
<b>Financial Position</b>			
Cash and short-term investments	48,156	57,945	32,228
Total assets	2,893,917	2,864,899	3,076,263
Senior debt	1,707,566	1,679,703	1,777,004
Subordinated convertible debentures	24,126	24,054	23,981
Exchangeable debentures	27,936	25,248	27,088
Partners' equity	710,998	698,726	765,551
<b>Units</b>			
Units outstanding – as at period end <sup>(7)</sup>	143,049,300	138,955,646	135,746,287
Average daily volume (Units)	384,591	414,224	500,954
Price per Unit – close (\$)	10.55	9.98	8.55

(1) Average daily volume for AEGS is based on toll volumes.

(2) This item is not a standard measure under GAAP and may not be comparable to similar measures presented by other entities. See section entitled "Non-GAAP Financial Measures" in this MD&A.

(3) We have provided a reconciliation of adjusted net income to net income in the "Non-GAAP Financial Measures" section of this MD&A.

(4) We have provided a reconciliation of distributable cash to cash from operating activities in the "Non-GAAP Financial Measures" section of this MD&A.

(5) The sum of growth, and maintenance and sustaining capital expenditures equals total capital expenditures on our consolidated statement of cash flows.

(6) Includes \$22.1 million and \$42.2 million of distributions satisfied through the issuance of Units under our Distribution Reinvestment Plan for the three and six month periods ending June 30, 2010 (2009 – \$11.9 million and \$15.7 million), respectively.

(7) As at the close of markets on July 27, 2010 we had 143,787,057 Units outstanding.

## FORWARD-LOOKING AND NON-GAAP INFORMATION

*This Management's Discussion and Analysis dated July 28, 2010 provides a review of the significant events and transactions that affected our performance during the six months ended June 30, 2010 relative to the same period in 2009. Some of the information contained in this MD&A is forward-looking information under Canadian securities laws. All information that addresses activities, events or developments which may or will occur in the future is forward-looking information. Forward-looking information typically contains statements with words such as may, estimate, anticipate, believe, expect, plan, intend, target, project, forecast or similar words suggesting future outcomes or outlook. Forward-looking statements in this MD&A include statements about:*

- *the sources of additional rich-gas supplies for transportation on the Alliance pipeline and for processing at Aux Sable's Channahon facility;*
- *the ability of Aux Sable to recognize margin-based lease revenues over the balance of the year;*
- *the timing of inspection work to be performed at Aux Sable's Channahon facility;*
- *the timing of in-service and capital cost of Aux Sable's Septimus pipeline;*
- *the timing of in-service of Aux Sable Canada's Heartland Off-gas Facility;*
- *the timing of in-service of Swift Power's Dasque Cluster hydroelectric project;*
- *the sufficiency of our liquidity;*
- *the sufficiency of our available committed credit facilities to fund distributions and planned capital expenditures;*
- *the ability of each of our businesses to generate distributable cash;*
- *our ability to make cash distributions; and*
- *the impact of adoption of International Financial Reporting Standards.*

*The risks and uncertainties that may affect our operations, performance, development and the results of our businesses include, but are not limited to, the following factors:*

- *our ability to successfully implement our strategic initiatives and achieve expected benefits;*
- *levels of oil and gas exploration and development activity;*
- *the status, credit risk and continued existence of contracted customers;*
- *the availability and price of capital;*
- *the availability and price of energy commodities;*
- *the availability of construction services and materials;*
- *fluctuations in foreign exchange and interest rates;*
- *our ability to successfully obtain regulatory approvals;*
- *changes in tax, regulatory, environmental, and other laws and regulations;*
- *competitive factors in the pipeline, NGL and power industries;*
- *operational breakdowns, failures, or other disruptions; and*
- *the prevailing economic conditions in North America.*

*Additional information on these and other risks, uncertainties and factors that could affect our operations or financial results are included in our filings with the securities commissions or similar authorities in each of the provinces of Canada, as may be updated from time to time. We caution readers that the foregoing list of factors and risks is not exhaustive. The impact of any one risk, uncertainty or factor on a particular forward-looking statement is not determinable with certainty as these factors are independent and management's future course of action would depend on its assessment of all information at that time. Although we believe the expectations conveyed by the forward-looking information are reasonable based on information available to us on the date of preparation, we can give no assurances as to future results, levels of activity and achievements. Readers should not place undue reliance on the information contained in this MD&A, as actual results achieved will vary from the information provided herein and the variations may be material. We make no representation that actual results achieved will be the same in whole or in part as those set out in the forward-looking information. Furthermore, the forward-looking statements contained herein are made as of the date hereof, and, except as required by law, we do not undertake any obligation to update publicly or to revise any forward-looking information, whether as a result of new information, future events or otherwise. We expressly qualify any forward-looking information contained in this MD&A by this cautionary statement.*

*This MD&A should be read in conjunction with our consolidated financial statements as at and for the six months ended June 30, 2010 and the consolidated statements and MD&A included in the 2009 Annual Report. All financial information is in Canadian dollars unless otherwise noted and, as it relates to our financial results, has been derived from information used to prepare our consolidated financial statements, which have been prepared in accordance with Generally Accepted Accounting Principles in Canada. Financial information pertaining to our jointly held businesses reflects our proportionate share unless otherwise noted. Capitalized terms used in this MD&A that have not been defined have the same meanings attributed to them in our March 31, 2010 and December 31, 2009 consolidated financial statements. Additional information concerning our business is available on SEDAR at [www.sedar.com](http://www.sedar.com) or on our website at [www.fortchicago.com](http://www.fortchicago.com).*

Certain financial information contained in this MD&A may not be standard measures under GAAP in Canada and may not be comparable to similar measures presented by other entities. These measures are considered to be important measures used by the investment community and should be used to supplement other performance measures prepared in accordance with GAAP in Canada. For further information on non-GAAP financial measures used by us see the section entitled "Non-GAAP Financial Measures" contained in this MD&A.

## OVERALL PERFORMANCE

### Net Income

(\$ Thousands, except per Unit amounts)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Net income (loss) before tax				
Pipeline	24,584	26,065	49,163	54,026
NGL	20,944	5,889	30,334	3,349
Power	(3,180)	(2,213)	(1,800)	(4,199)
Fort Chicago – Corporate	(17,329)	(7,919)	(34,557)	(19,325)
	25,019	21,822	43,140	33,851
Tax expense	(6,600)	(1,863)	(10,647)	(2,588)
<b>Net income</b>	<b>18,419</b>	<b>19,959</b>	<b>32,493</b>	<b>31,263</b>
<b>Per Unit (\$)</b>	<b>0.13</b>	<b>0.15</b>	<b>0.23</b>	<b>0.23</b>
Adjustments to net income for non-recurring (gains) losses (net of tax)				
Fair value loss reclassified from other comprehensive income	–	–	–	2,288
<b>Adjusted net income<sup>(1)</sup></b>	<b>18,419</b>	<b>19,959</b>	<b>32,493</b>	<b>33,551</b>
<b>Per Unit (\$)</b>	<b>0.13</b>	<b>0.15</b>	<b>0.23</b>	<b>0.25</b>

(1) See the reconciliation of adjusted net income to net income in the "Non-GAAP Financial Measures" section of this MD&A.

For the three months ended June 30, 2010, we generated net income of \$18.4 million or \$0.13 per Unit compared to \$20.0 million or \$0.15 per Unit for the same period in 2009. The decrease primarily results from higher non-cash corporate foreign exchange losses and a mark-to-market loss related to Fort Chicago Power's exchangeable debentures. In aggregate, the effect of foreign exchange and the mark-to-market exchangeable debenture loss resulted in a \$10.2 million or \$0.07 per Unit reduction in second quarter net income when compared to net income for the same period last year.

Aux Sable's earnings for the three months ended June 30, 2010 increased significantly compared to the same period last year. As a result of continued favourable NGL market conditions, Aux Sable recognized \$22.1 million of margin-based lease revenues this quarter and deferred the recognition of an additional \$8.0 million in margin-based lease revenues. This reflects a substantial improvement from the same period last year when Aux Sable recognized \$6.8 million of margin-based lease revenue.

Earnings from our power business, excluding the mark-to-market loss recorded in relation to Fort Chicago Power's exchangeable debentures, increased compared to the same period last year. This increase is due primarily to a contribution from the East Windsor cogeneration facility, which commenced operations in November 2009, and higher earnings from the Brush generation facility.

Earnings from our pipeline businesses, Alliance and AEGS, were relatively consistent with the same period last year, although Alliance's U.S.-generated earnings were impacted by the effect of the stronger Canadian dollar.

We incurred higher corporate costs during the second quarter of 2010, reflecting increased interest costs related to our July 2009 issuance of senior notes and foreign exchange losses. Corporate costs for the same period last year included foreign exchange gains. Taxes increased in the second quarter of 2010 compared to the same period last year due to higher Aux Sable earnings.

For the six months ended June 30, 2010, we generated net income of \$32.5 million or \$0.23 per Unit compared to \$31.3 million or \$0.23 per Unit for the same period in 2009. Aux Sable generated \$41.9 million of margin-based lease

revenues of which it has recognized \$33.9 million to date. During the same period last year, Aux Sable generated \$14.7 million of margin-based lease revenues and recognized \$6.8 million. Barring a significant downward shift in NGL market conditions, we expect Aux Sable to recognize the remaining \$8.0 million in margin-based lease revenues over the balance of this year.

Pre-tax losses from our power business for the six months ended June 30, 2010 and 2009 resulted primarily from non-cash charges associated with mark-to-market losses related to the exchangeable debentures. Results for the comparative period also included the effect of last year's \$2.4 million pre-tax fair value loss related to our investment in Pristine Power Inc. These non-cash charges offset solid operating results from our power facilities, including incremental earnings from East Windsor Cogeneration and Brush.

Year-to-date earnings from our pipeline businesses were relatively consistent with the same period last year, although Alliance's U.S.-generated earnings were impacted by the effect of the stronger Canadian dollar.

We incurred higher corporate costs during the first six months of 2010, reflecting increased interest costs and foreign exchange losses. Taxes increased in the first six months of 2010 compared to the same period last year due to higher Aux Sable earnings.

In aggregate, the effect of foreign exchange and the mark-to-market exchangeable debenture loss resulted in a \$12.0 million or \$0.09 per Unit reduction in year-to-date net income in comparison to net income for the same period last year.

#### Distributable Cash <sup>(1)</sup>

(\$ Thousands, except per Unit amounts)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Pipeline	33,881	33,835	67,842	68,468
NGL	23,583	6,357	34,370	5,582
Power	2,669	4,767	4,451	9,829
Fort Chicago - Corporate	(9,971)	(3,688)	(19,331)	(11,560)
Taxes	(886)	(2,652)	(6,347)	(2,690)
	49,276	38,619	80,985	69,629
<b>Per Unit (\$)</b>	<b>0.34</b>	0.29	<b>0.57</b>	0.52

(1) See the reconciliation of distributable cash to cash from operating activities in the "Non-GAAP Financial Measures" section of this MD&A.

Distributable cash for the three and six months ended June 30, 2010 was \$49.3 million or \$0.34 per Unit and \$81.0 million or \$0.57 per Unit, respectively, compared to \$38.6 million or \$0.29 per Unit and \$69.6 million or \$0.52 per Unit for the same periods last year. This reflects:

- comparable distributable cash generated from our pipeline business;
- significantly higher distributions from Aux Sable due to the relative strength of NGL market conditions;
- lower distributable cash from our power business due to reduced energy margins and higher maintenance capital expenditures at our California cogeneration facilities partially offset by higher capacity payments from our Brush facility and incremental cash flows from Glen Park;
- higher corporate interest costs;
- higher year-to-date cash taxes associated with higher Aux Sable earnings, although this was mitigated in the second quarter of 2010 as a result of loss utilization made available through corporate restructuring; and
- the effect of a stronger Canadian dollar.

In aggregate, the effect of the stronger Canadian dollar resulted in a \$2.2 million or \$0.02 per Unit and a \$4.7 million or \$0.03 per Unit reduction in distributable cash for the three and six months ended June 30, 2010, respectively, when compared to distributable cash for the same periods last year.

## Cash from Operating Activities

(\$ Thousands)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Pipeline	31,550	35,773	105,302	102,621
NGL	18,859	1,236	31,093	2,789
Power	5,245	4,777	6,614	14,217
Fort Chicago - Corporate	(14,592)	(8,559)	(35,680)	(42,020)
	41,062	33,227	107,329	77,607

We generated \$41.1 million of cash from operating activities for the three months ended June 30, 2010, a \$7.9 million increase from the same period last year, due to increased operating cash flows from Aux Sable driven by improved NGL market conditions, partially offset by:

- lower operating cash flows from Alliance as the effect of the stronger Canadian dollar more than offset higher cost of service recoveries; and
- higher corporate interest and income tax payments.

For the six months ended June 30, 2010 we generated \$107.3 million of cash from operating activities, a \$29.7 million increase from the same period last year, due to:

- increased operating cash flows from Aux Sable driven by stronger NGL market conditions;
- higher operating cash flows from Alliance due to increased cost of service recoveries, partially offset by the stronger Canadian dollar; and
- lower corporate income tax payments.

These increases were partially offset by lower Fort Chicago Power operating cash flows due to reduced energy margins at our California cogeneration facilities.

## RESULTS OF OPERATIONS - BY BUSINESS SEGMENT

### Pipeline Business

(\$ Thousands, except where noted)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Net income before tax</b>				
Alliance Pipeline	23,415	25,080	47,017	51,875
AEGS	1,169	985	2,146	2,151
	24,584	26,065	49,163	54,026
<b>Volumes</b>				
Alliance Pipeline (100%) (bcf/d)	1.582	1.587	1.631	1.638
AEGS (mmbbls/d) <sup>(1)</sup>	283.1	273.4	283.4	278.7

(1) Average daily volumes for AEGS are based on toll volumes.

### Alliance Pipeline

#### Operational Highlights

Transportation deliveries, including utilized Authorized Overrun Service, for the three and six months ended June 30, 2010 averaged 1.582 billion cubic feet per day and 1.631 bcf/d, respectively, compared to 1.587 bcf/d and 1.638 bcf/d for the same periods last year.

### *Financial Highlights*

Transportation revenues for the three and six months ended June 30, 2010 were \$92.0 million and \$184.5 million, respectively, a \$4.8 million and \$10.5 million decrease compared to \$96.8 million and \$195.0 million for the same periods last year. The decreases primarily resulted from the effect of the stronger Canadian dollar and a lower equity return on investment base, which more than offset the effect of higher cost of service recoveries.

Net income before tax for the three and six months ended June 30, 2010 was \$23.4 million and \$47.0 million, respectively, a \$1.7 million and \$4.9 million decrease compared to \$25.1 million and \$51.9 million for the same periods last year, reflecting the effect of the stronger Canadian dollar and reduced equity return on investment base.

### *Pecan Pipeline (North Dakota), Inc. Receipt Point*

During the first quarter, Pecan Pipeline (North Dakota), Inc. completed construction of the Prairie Rose Pipeline, a gathering pipeline that connects with a new gas receipt point on the Alliance pipeline. Prairie Rose brings associated rich gas from the Bakken formation onto the Alliance system for transport to Aux Sable's Channahon fractionation facility. Alliance and Pecan have executed a 10-year firm transportation agreement, under which Pecan holds 40 million cubic feet per day of firm transportation capacity for the first year and 80 mmcf/d thereafter. The new receipt point was placed into service in February 2010.

### *Available Capacity*

On April 1, 2010, a short-term firm transportation agreement for 20 mmcf/d, or 1.5 percent of Alliance's firm transportation capacity, expired. For each of the months of June and July 2010, Sable NGL Services LP, in which we hold a 50 percent interest, contracted the 20 mmcf/d of capacity for a one-month term. Under these short-term agreements, Sable NGL Services paid tolls equal to those paid by third party firm transportation shippers.

### *Contract Renewals*

Alliance's discussions with shippers are ongoing in respect of the renewal of firm-service transportation agreements beyond 2015.

## **AEGS**

### *Operational Highlights*

Toll volumes for the three and six months ended June 30, 2010 were 283.1 thousand barrels per day and 283.4 bbls/d, respectively, compared to 273.4 bbls/d and 278.7 bbls/d for the same periods last year, reflecting increased deliveries to Fort Saskatchewan.

### *Financial Highlights*

AEGS generated \$10.4 million and \$20.1 million in revenues for the three and six months ended June 30, 2010, respectively, an increase of \$1.1 million in each case compared to \$9.3 million and \$19.0 million for the same periods last year. The increase reflects higher operating and overhead cost recoveries, partially offset by slightly lower toll revenues.

Net income before tax for the three and six months ended June 30, 2010 was \$1.2 million and \$2.1 million, respectively, which was comparable to net income before tax for the same periods last year.

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**NGL Business**

	Three months ended June 30		Six months ended June 30	
(\$ Thousands, except where noted)	2010	2009	2010	2009
<b>Net income before tax</b>	<b>20,944</b>	5,889	<b>30,334</b>	3,349
<b>Margin-based fees under NGL Sales Agreement</b>				
Estimated amount generated during period	<b>16,980</b>	10,041	<b>41,868</b>	14,747
Margin recognized from prior period (unrecognized margin generated in period)	<b>5,090</b>	(3,263)	<b>(7,932)</b>	(7,969)
Amount recognized as revenue	<b>22,070</b>	6,778	<b>33,936</b>	6,778
<b>Average daily NGL sales volumes (100%) (mmbbls/d)</b>				
Ethane - indigenous	<b>39.4</b>	36.4	<b>42.2</b>	29.5
Propane plus	<b>35.2</b>	34.4	<b>33.5</b>	33.1
	<b>74.6</b>	70.8	<b>75.7</b>	62.6
<b>Pricing Metrics</b>				
Crude oil (US\$ per bbl)	<b>78.02</b>	59.51	<b>78.25</b>	51.25
Natural gas (US\$ per mmbtu)	<b>4.30</b>	3.71	<b>4.73</b>	4.14
Crude to natural gas ratio	<b>18.1</b>	16.0	<b>16.5</b>	12.4
Ethane margin (US\$ per US gallon)	<b>0.26</b>	0.18	<b>0.33</b>	0.11
Propane plus (US\$ per US gallon)	<b>0.84</b>	0.49	<b>0.87</b>	0.41
Mont Belvieu to Edmonton propane differential (US\$ per US gallon)	<b>0.15</b>	0.12	<b>0.06</b>	0.02

*NGL Market Overview*

The NGL business environment was very favourable in the first half of 2010 compared to the same period in 2009. Average crude oil prices increased substantially as world-wide demand continued to improve during a steady economic recovery. On the other hand, natural gas prices did not recover to the same extent as crude oil prices as the market still perceives an oversupply of natural gas from the developing shale basins of the United States and Canada.

While second quarter NGL margins were higher than the same period last year, they declined compared to the first quarter of 2010 due to a decrease in ethane prices. This was driven by reduced demand as several ethylene crackers were down for turnaround work.

*Operational Highlights*

During the three and six months ended June 30, 2010, Aux Sable processed 96 percent and 98 percent, respectively, (2009 - 99 percent and 96 percent) of the natural gas delivered by Alliance. Modifications were successfully made to the Channahon Facility in the second quarter of this year to increase ethane recoveries. After performing detailed external assessments of remaining facilities to be internally inspected, Aux Sable determined it will complete required inspection work in 2011.

Aux Sable sold 74.6 thousand barrels per day of NGLs during the second quarter of 2010, up from 70.8 mmbbls/d for the same period in 2009. Average ethane volumes increased to 39.4 mmbbls/d in the second quarter of 2010 from 36.4 mmbbls/d in the second quarter of 2009, while year-to-date ethane volumes averaged 42.2 mmbbls/d compared to 29.5 mmbbls/d in the first half of 2009, reflecting higher ethane recoveries. As a result of weak market conditions in the first six weeks of 2009, Aux Sable reinjected ethane for that period.

### *Financial Highlights*

For the three and six months ended June 30, 2010, Aux Sable recorded NGL revenues of \$45.1 million and \$82.7 million, respectively, (2009 - \$28.2 million and \$49.7 million) including \$33.1 million and \$54.9 million of lease revenues (2009 - \$17.5 million and \$27.8 million), of which \$0.4 million and \$0.6 million related to lease revenues generated by the Septimus gas plant (2009 - nil). Aux Sable generated \$17.0 million and \$41.9 million of margin-based lease revenues during the three and six months ended June 30, 2010, of which \$22.1 million and \$33.9 million was recognized. The revenue increase in the first half of 2010 was partially offset by the effect of the stronger Canadian dollar. Barring a significant downward shift in NGL market conditions, we expect Aux Sable will recognize the remaining \$8.0 million of margin-based lease revenues over the balance of this year.

Operations and maintenance, natural gas, NGL and transportation costs for the three and six months ended June 30, 2010 were \$18.6 million and \$41.2 million, respectively, (2009 - \$17.2 million and \$35.5 million) primarily reflecting higher NGL input costs due to increased prices.

Net income before tax for the three and six months ended June 30, 2010 was \$20.9 million and \$30.3 million, respectively, compared to \$5.9 million and \$3.3 million for the same periods last year.

### *Septimus Gas Plant and Pipeline*

On December 18, 2009, Aux Sable purchased from Crew Energy Inc. the 25 mmcf/d Septimus Gas Plant in the liquids-rich Montney region of northeast British Columbia. The purchase price was \$9.6 million (100 percent - \$19.1 million). Crew operates the facility and pays Aux Sable capital throughput fees on a take-or-pay basis. Scoping engineering for an expansion of the Septimus plant is currently underway.

On January 15, 2010, Aux Sable received approval from the BC Oil and Gas Commission to construct a 20-inch, 20-kilometre rich-gas pipeline to interconnect with the Alliance pipeline. We expect the pipeline to be placed into service in the third quarter of 2010 at a capital cost of approximately \$10 million (100 percent - \$20 million). Aux Sable will collect a take-or-pay fee from Crew when the pipeline is operational and secure a new supply of NGL-rich gas for processing at Aux Sable's Channahon Facility.

### *Off-gas Facility*

On June 30, 2010, Aux Sable entered into a long-term off-gas processing agreement with Shell Canada Products to secure a new feedstock source for Aux Sable's Heartland Off-gas facility located in Fort Saskatchewan, Alberta.

The facility, which will require some modification, will process up to 20 mmcf/d of off-gas and produce hydrogen, ethane and a propane-plus mix. All of the products from the facility will be delivered to Shell's Scotford Refinery via a three-kilometre pipeline. The facility is expected to be operational by the summer of 2011.

The facility was originally designed to process off-gas from a nearby upgrader, which ceased construction in 2008. Aux Sable reached agreements with all third parties to settle cancellation costs related to the supply contracts under the original agreement with the owner of the upgrader.

### *Other Growth Projects*

In addition to the Septimus projects, Aux Sable is focused on a number of initiatives to ensure an optimal level of rich gas is delivered into the Alliance pipeline for processing at the Channahon Facility. These developments are largely focused on northwest Alberta and northeast B.C., but with new oil and gas developments in the Bakken region in North Dakota and Saskatchewan, Aux Sable is also developing NGL-rich gas supply opportunities in these areas. A significant development in this area is the Prairie Rose Pipeline placed into operation on February 4, 2010. Prairie Rose is currently delivering over 15 mmcf/d of high heat content gas (approximately 1,450 btu per cubic feet) onto the U.S. portion of Alliance's pipeline system. We expect the volume will increase to 40 mmcf/d by the end of the year.

**Power Business**

	Three months ended June 30		Six months ended June 30	
(\$ Thousands, except where noted)	2010	2009	2010	2009
<b>Net income (loss) before tax</b>				
Fort Chicago Power	<b>(4,154)</b>	(2,398)	<b>(3,682)</b>	(2,051)
NRGreen	<b>428</b>	343	<b>1,092</b>	540
East Windsor Cogeneration	<b>546</b>	(158)	<b>790</b>	(246)
Other	–	–	–	(2,442)
	<b>(3,180)</b>	(2,213)	<b>(1,800)</b>	(4,199)
<b>Electricity Volumes (MWh)</b>				
Fort Chicago Power	<b>97,308</b>	112,525	<b>184,818</b>	295,211
NRGreen	<b>34,731</b>	34,861	<b>74,299</b>	62,257
East Windsor Cogeneration	<b>52,810</b>	–	<b>75,340</b>	–

**Fort Chicago Power**

Fort Chicago Power is comprised of our wholly-owned power facilities.

On March 18, 2010, we acquired a 100 percent interest in Northbrook New York, LLC, which owns the Glen Park facility, a 33 megawatt hydro-power generation facility in upstate New York. The aggregate purchase price, including transaction costs, was \$83.1 million, which we financed from existing bank credit facilities.

*Operational Highlights*

Fort Chicago Power produced lower energy volumes in the three and six months ended June 30, 2010 compared to the same period last year.

For the three and six months ended June 30, 2010, the Ripon and San Gabriel cogeneration facilities generated aggregate electricity volumes of 63,560 megawatt hours and 133,722 MWh, respectively, compared to 92,301 MWh and 223,957 MWh during the same periods last year. Under the new Short Run Avoided Cost energy reimbursement formula, which came into effect in August 2009, it is less economic to dispatch these facilities during non-peak periods. While the SRAC formula limits our ability to earn energy margins, it does not affect capacity payments, which comprise the majority of earnings before interest, taxes, depreciation and amortization from these facilities.

Brush produced 5,329 MWh of electricity for each of the three and six months ended June 30, 2010 (it was not dispatched during the first quarter of 2010) compared to 19,634 MWh and 59,577 MWh during the same periods last year, reflecting the dispatch profile under its replacement toll agreement. London Cogeneration generated 2,719 MWh of electricity in the second quarter compared to 441 MWh in the same period last year, reflecting warmer weather, which increased electricity demand. For the six months ended June 30, 2010, London Cogeneration generated 7,550 MWh of electricity, down from 11,381 MWh during the same period last year reflecting weaker demand for the year-to-date period. The majority of earnings for Brush and London Cogeneration are comprised of fixed capacity payments. As such, their earnings and cash flows are not significantly influenced by the volume of electricity generated.

Glen Park generated 25,546 MWh of electricity for the three months ended June 30, 2010 and 37,855 MWh from the date of acquisition.

*Financial Highlights*

For the three and six months ended June 30, 2010, Fort Chicago Power generated \$4.7 million and \$7.3 million, respectively, of earnings before interest, taxes, depreciation and amortization, and non-cash mark-to-market adjustments compared to \$4.4 million and \$9.6 million during the same periods last year. Each facility's financial performance was consistent with our expectations. The second quarter increase primarily reflects a \$0.5 million contribution from Glen Park and a \$0.5 million increase in capacity payments from Brush, partially offset by the effect of the stronger Canadian dollar. The \$2.3 million year-to-date decrease primarily reflects reduced first quarter energy margins at the California

cogeneration facilities resulting from the new SRAC formula and the effect of the stronger Canadian dollar, partially offset by a \$0.8 million contribution from Glen Park and a \$0.7 million increase in capacity payments from Brush.

For the three and six months ended June 30, 2010, Fort Chicago Power recorded non-cash mark-to-market losses of \$4.4 million and \$2.7 million, respectively, relating to our U.S. dollar-denominated exchangeable debentures (2009 – \$1.9 million and \$1.4 million loss).

Net loss before tax was \$4.2 million and \$3.7 million for the three and six months ended June 30, 2010, respectively, compared to \$2.4 million and \$2.1 million loss for the same periods last year. In addition to the factors discussed above, depreciation and amortization for the three and six months ended June 30, 2010 was lower in comparison to the same periods last year, resulting from the reduced carrying value of the California cogeneration facilities.

#### *Agreement to Acquire Swift Power Corp.*

On June 22, 2010, we announced that we had entered into an agreement with Swift Power Corp. pursuant to which we agreed to make an offer to acquire all of the issued and outstanding common shares of Swift Power by way of a take-over bid. The aggregate transaction value, not including the Swift shares owned by us, is approximately \$8.47 million. The offer is scheduled to close on August 9, 2010.

In April of this year, Swift Power was awarded a long-term Electricity Purchase Agreement by BC Hydro for the Dasque Cluster hydroelectric project, a 20 megawatt project located near Terrace, B.C. The Dasque Cluster project is expected to be in operation by late 2012, pending receipt of necessary regulatory approvals.

## **NRGreen**

#### *Operational Highlights*

NRGreen generated 34,731 MWh and 74,299 MWh of electricity for the three and six months ended June 30, 2010, compared to 34,861 MWh and 62,257 MWh during the same periods last year. While second quarter volumes were comparable, the year-to-date increase reflects improved reliability of the four waste heat electrical generation units.

#### *Financial Highlights*

For the three and six months ended June 30, 2010, NRGreen revenues were \$1.4 million and \$2.9 million, respectively, compared to \$1.3 million and \$2.3 million for the same period last year. The year-to-date increase reflects improved reliability of the units during the current period.

Net income before tax was \$0.4 million and \$1.1 million for the three and six months ended June 30, 2010, respectively, compared to \$0.3 million and \$0.5 million for the same period last year, primarily due to the increase in revenues discussed above.

## **East Windsor Cogeneration**

#### *Operating Highlights*

East Windsor Cogeneration's 86 MW gas-fired cogeneration facility commenced operations on November 6, 2009. East Windsor Cogeneration produced 52,810 MWh and 75,340 MWh of electricity for the three and six months ended June 30, 2010. Electricity production increased relative to the first quarter of 2010 as demand in the Ontario market strengthened. Under its combined heat and power agreement with the Ontario Power Authority, East Windsor Cogeneration earns capacity payments which are not influenced by the volume of electricity produced.

#### *Financial Highlights*

For the three months ended June 30, 2010, East Windsor Cogeneration revenues and EBITDA were \$5.6 million and \$2.8 million, respectively. For the six months ended June 30, 2010, revenues and EBITDA were \$11.1 million and \$5.3 million.

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Net income before tax was \$0.5 million and \$0.8 million for the three and six months ended June 30, 2010, respectively, compared to net losses of \$0.2 million for each of the same periods last year. East Windsor Cogeneration recorded \$1.4 million and \$2.8 million of interest costs on its senior bonds and \$0.9 million and \$1.7 million of depreciation for the three and six months ended June 30, 2010, respectively. In the first six months of 2009, interest costs were capitalized as the facility was still under construction. The 2009 net losses were primarily comprised of unrealized losses related to interest rate and foreign currency hedges.

### Fort Chicago - Corporate

(\$ Thousands)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Net expenses</b>				
Net expenses before taxes	17,329	7,919	34,557	19,325
Current tax expense	1,040	2,717	6,602	2,819
Future tax expense (recovery)	5,560	(854)	4,045	(231)
	<b>23,929</b>	9,782	<b>45,204</b>	21,913

During the three and six months ended June 30, 2010, we incurred net corporate expenses before taxes of \$17.3 million and \$34.6 million, respectively, compared to \$7.9 million and \$19.3 million during the same period last year. The variance resulted primarily from:

- a \$2.8 million and \$5.0 million increase in interest and other finance costs largely due to our \$200 million senior note issuance in July 2009;
- a \$0.1 million and \$2.0 million increase in project development costs; and
- a \$6.4 million and \$8.4 million increase in foreign exchange losses, due primarily to higher recognition of translation losses previously deferred and recorded in other comprehensive income, and the absence of foreign exchange gains recorded in 2009 on repayment and translation of U.S. dollar-denominated debt.

Net tax expenses increased by \$4.7 million and \$8.1 million, primarily reflecting higher Aux Sable earnings.

### SELECTED QUARTERLY FINANCIAL INFORMATION

(\$ Thousands, except where noted)	2010			2009			2008	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenues	167,965	159,977	185,873	163,166	149,290	150,804	168,629	180,900
Net income (loss)	18,419	14,074	(24,454)	30,766	19,959	11,304	(17,949)	27,286
Net income (loss) per Unit (\$)	0.13	0.10	(0.18)	0.23	0.15	0.08	(0.13)	0.20
Distributable cash	49,276	31,709	34,001	45,435	38,619	31,010	22,484	53,285
Distributable cash per Unit (\$)	0.34	0.23	0.25	0.33	0.29	0.23	0.17	0.40
Cash from operating activities	41,062	66,267	43,867	89,449	33,227	44,380	39,279	88,222

Significant items that affected quarterly financial results include the following:

- Second quarter 2010 reflects the continuation of robust NGL market conditions resulting in \$22.1 million of NGL margin-based lease revenues recognized in net income and distributable cash.
- First quarter 2010 reflected strong NGL market conditions resulting in \$11.9 million of NGL margin-based lease revenues recognized in net income and distributable cash.
- Fourth quarter 2009 net income reflected the \$50.8 million (after-tax) asset impairment loss recorded in relation to our California cogeneration facilities; distributable cash and cash from operating activities reflected strong cash flow generation from Aux Sable.
- Third quarter 2009 reflected continued strengthening of NGL market conditions resulting in \$22.1 million of NGL margin-based lease revenues recognized in net income and distributable cash.

- Second quarter 2009 reflected a strengthening of NGL market conditions resulting in \$6.8 million of NGL margin-based lease revenues recognized in net income and distributable cash.
- First quarter 2009 reflected no NGL margin-based lease revenues recognized in net income or distributed to us.
- Fourth quarter 2008 reflected a \$21.1 million asset impairment loss related to power assets, as well as the significant weakening of NGL market conditions, resulting in pre-tax losses and a small distributable cash contribution from our NGL business segment. Cash from operating activities reflected Alliance's scheduled semi-annual interest payments.
- Third quarter 2008 reflected strong NGL margins, resulting in increased amounts of margin-based lease revenues generated and recognized by Aux Sable during the period, and strong earnings and cash flows from Fort Chicago Power.

## LIQUIDITY AND CAPITAL RESOURCES

Overall, there has not been any significant change in our financial condition or that of our businesses compared with our position as at December 31, 2009.

Cash and short-term investments at June 30, 2010 totaled \$48.2 million (December 31, 2009 - \$57.9 million), of which \$16.1 million (December 31, 2009 - \$23.3 million) represents funds held in trust accounts pursuant to applicable security and financing agreements. The majority of these trust funds are used by Alliance for current operating and working capital purposes, including scheduled principal and interest payments each June and December.

At June 30, 2010 we had a working capital deficiency of \$250.1 million (December 31, 2009 - \$152.3 million). We do not believe this balance sheet condition affects our liquidity. Our working capital will generally be in a negative position as the majority of our long-term debt is amortizing debt, resulting in a significant amount of debt being due within one year. A large portion of our debt relates to Alliance, for which scheduled repayments of long-term debt have been designed to match the depreciation of its rate base. Depreciation is recovered through Alliance's firm transportation toll and is utilized to fund the debt repayments. Our 2004 and 2008 Credit Facilities mature on April 1, 2011 and August 31, 2010, respectively. As such, the aggregate \$126.2 million balance drawn at June 30, 2010 is classified as current. Discussions regarding the renewal of our 2004 Credit Facility are underway. The term of our 2008 Credit Facility was recently extended to August 31, 2010 (see "Financing Activities" below). Our Series B convertible debentures are classified as current as they mature on December 31, 2010. Until that time, debenture holders have the option of exchanging these debentures for Units. Further, our exchangeable debentures are classified as current since exchangeable debenture holders have the right to redeem these instruments for cash at any time up until the date of maturity.

### Cash from Operating Activities

(\$ Thousands)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Alliance	27,922	32,234	96,705	92,384
AEGS	3,628	3,539	8,597	10,237
Aux Sable	18,859	1,236	31,093	2,789
Fort Chicago Power	3,300	3,884	2,552	13,185
Other Power	1,945	893	4,062	1,032
Corporate	(14,592)	(8,559)	(35,680)	(42,020)
	41,062	33,227	107,329	77,607

For the three and six months ended June 30, 2010, cash generated from operating activities was \$41.1 million and \$107.3 million compared to \$33.2 million and \$77.6 million for the same period last year.

Alliance operating cash flows decreased for the three months ended June 30, 2010 compared to the same period last year, primarily reflecting the effect of the stronger Canadian dollar, partially offset by higher cost of service recoveries. Operating cash flows for the six months ended June 30, 2010, increased due to higher cost of service recoveries and the impact of changes in non-cash working capital, partially offset by the effect of the stronger Canadian dollar.

AECS operating cash flows were consistent for the second quarter compared to the same period last year. Operating cash flows decreased on a year-to-date basis reflecting the timing of annual insurance renewal payments.

Aux Sable cash from operating activities for the three and six months ended June 30, 2010, increased significantly compared to the same periods last year as improved NGL market conditions resulted in higher margin-based lease revenues.

Fort Chicago Power generated lower operating cash flows for the three months ended June 30, 2010, due to reduced energy margins generated by the California cogeneration facilities and the effect of the stronger Canadian dollar, partially offset by incremental cash flows from Glen Park and Brush. Cash flows for the six months ended June 30, 2010, decreased due to the same factors impacting the second quarter and the effect of the first quarter 2009 receipt of funds previously held by Brush's customer as a security deposit.

Our other power businesses generated higher operating cash flows during the three and six months ended June 30, 2010, compared to the same periods last year due to improved NRGreen unit reliability and the East Windsor Cogeneration facility having commenced operations in November 2009.

Higher corporate cash outflows for the second quarter of 2010 reflect higher income tax and corporate interest payments. Lower corporate cash outflows on a year-to-date basis reflect the timing of income tax payments which relate primarily to Aux Sable earnings. Aux Sable's earnings became currently taxable in 2008. This, in conjunction with the record earnings generated by Aux Sable in 2008, resulted in a significant tax payment in the first quarter of 2009.

#### *Financing Activities*

For the six months ended June 30, 2010, our financing activities included:

- senior debt repayments of \$38.0 million;
- a net increase in credit facility drawings of \$55.5 million, primarily to fund our acquisition of Glen Park; and
- \$29.9 million of cash distributions.

Financing activities for the same period last year included:

- senior debt repayments of \$37.3 million;
- a net increase in credit facility drawings of \$6.5 million; and
- \$55.6 million of cash distributions.

Our 2008 Credit Facility, comprised of a \$25 million revolving credit facility and a \$25 million term facility was scheduled to mature on July 15, 2010. On July 12, 2010, we executed an amendment to extend the maturity date to August 31, 2010.

On July 19, 2010, we issued through a public offering \$75 million of 5.75 percent convertible unsecured subordinated debentures, Series C, at a price of \$1,000 per Series C Debenture. The Series C Debentures, which mature on July 31, 2017, are convertible, at the option of the holder, at any time into fully paid Class A limited partnership units of Fort Chicago ("Class A Units") at a conversion price of \$14.60 per Class A Unit. We used the net proceeds of approximately \$71.5 million to repay amounts borrowed under our credit facilities. On July 22, 2010 the underwriters exercised the over-allotment option in full and purchased an additional \$11.25 million principal amount of Series C Debentures. We intend to use the proceeds of approximately \$10.8 million to repay amounts borrowed under our credit facilities, to finance our ongoing acquisition and development activities and for general corporate purposes.

Aux Sable's U.S. Facility, comprised of a US \$14.9 million revolving facility and a US \$17.1 million term facility, matures on August 16, 2010. Aux Sable is currently in the process of negotiating the renewal of this facility.

*Investing Activities*

Investing activities for the six months ended June 30, 2010 included:

- \$80.7 million acquisition of Glen Park, net of \$1.9 million cash acquired and excluding \$0.5 million of transaction costs paid in 2009; and
- capital expenditures of \$14.5 million, primarily related to:
  - o construction of Aux Sable's Septimus pipeline (\$5.2 million);
  - o steam and chilled water expansion projects at Fort Chicago Power's London district energy system (\$1.5 million) and maintenance capital expenditures at the Ripon and San Gabriel facilities (\$2.6 million); and
  - o capital expenditures incurred by Alliance (\$2.8 million).

Investing activities for the same period last year included:

- \$14.1 million in capital expenditures; and
- a \$11.9 million drawdown of restricted cash to fund construction of the East Windsor Cogeneration facility.

**DISTRIBUTIONS****Policy**

We pay distributions on a monthly basis to Unitholders of record as at the last business day of each month on the 23rd day of the month following such record date, or if not a business day, then on the preceding business day.

Our general distribution policy is to establish and maintain a sustainable and stable monthly distribution over time, having regard for forecast distributable cash and our growth capital requirements.

**Sustainability of Distributions and Productive Capacity**

We intend to continue to make cash distributions although such distributions are not guaranteed and do not represent a legal obligation. The sustainability of distributions is a function of several factors including, among other things, the:

- earnings and cash flows we and our businesses generate;
- ongoing maintenance of each business' physical and economic productive capacity; and
- ability to comply with debt covenants and refinance debt as it comes due.

For a complete discussion of the significant risks and uncertainties affecting us and each of our businesses, see "Risks" contained in our 2009 MD&A.

**Distributions Paid/Payable Relative to Cash from Operating Activities and Net Income**

(\$ Thousands)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Cash from operating activities	<b>41,062</b>	33,227	<b>107,329</b>	77,607
Net income	<b>18,419</b>	19,959	<b>32,493</b>	31,263
Distributions paid/payable	<b>35,564</b>	33,788	<b>70,576</b>	67,301
Less distributions paid in Units under Distribution Reinvestment Plan	<b>(22,064)</b>	(11,922)	<b>(42,159)</b>	(15,685)
Net distributions paid/payable	<b>13,500</b>	21,866	<b>28,417</b>	51,616
Excess of cash from operating activities over net distributions paid/payable	<b>27,562</b>	11,361	<b>78,912</b>	25,991
Excess (shortfall) of net income over net distributions paid/payable	<b>4,919</b>	(1,907)	<b>4,076</b>	(20,353)

The excess of cash from operating activities over net distributions paid/payable generally represents the cash we use for maintenance capital expenditures, scheduled amortization of any long-term debt, and cash we retain to fund growth, including cash held in trust.

Net distributions paid/payable are often greater than net income as our net income includes certain non-cash expenses such as foreign exchange gains and losses, asset impairment losses, depreciation and future income taxes, which are not reflected in calculating the amount of cash available for distribution.

**Determination of Distributable Cash**

The amount of distributable cash we earn is comprised of and will vary depending on:

- distributions received/receivable from our operating businesses, which, in each case, are after providing for scheduled amortization of long-term debt and capital expenditures that are not growth-oriented or recoverable;
- operating support payments required by each of our businesses;
- cash taxes and financing costs we incur, including scheduled principal repayments on long-term debt;
- our general and administrative costs; and
- cash we hold in reserve.

The calculation of distributable cash for the three and six months ended June 30, 2010 and 2009 is set out on the following page.

**Distributable Cash**

(\$ Thousands, except where noted)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Cash inflows</b>				
Alliance distributions, prior to withholdings for capital expenditures and net of debt service	30,166	30,285	60,592	61,173
AEGS distributable cash, after non-recoverable capital expenditures and debt service	3,715	3,550	7,250	7,295
Aux Sable distributions, net of support payments, non-recoverable debt service costs and maintenance capital	23,583	6,357	34,370	5,582
Fort Chicago Power distributable cash, after maintenance capital expenditures and debt service	2,104	4,327	3,321	8,949
NRGreen distributions, prior to withholding for project development costs	565	440	1,130	880
Interest income and other	–	3,691	–	4,347
	<b>60,133</b>	48,650	<b>106,663</b>	88,226
<b>Cash outflows</b>				
General and administrative	(3,845)	(3,825)	(7,749)	(8,454)
Interest and other finance	(5,348)	(2,669)	(10,015)	(5,632)
Taxes	(886)	(2,652)	(6,347)	(2,690)
Principal repayments on senior debt	(778)	(885)	(1,567)	(1,821)
	<b>(10,857)</b>	(10,031)	<b>(25,678)</b>	(18,597)
Distributable cash <sup>(1)</sup>	<b>49,276</b>	38,619	<b>80,985</b>	69,629
Distributable cash per Unit (\$) <sup>(2)</sup>	<b>0.34</b>	0.29	<b>0.57</b>	0.52
Distributions paid/payable <sup>(3)</sup>	<b>35,564</b>	33,788	<b>70,576</b>	67,301
Distributions paid/payable per Unit (\$)	<b>0.25</b>	0.25	<b>0.50</b>	0.50

(1) See “Non-GAAP Financial Measures” for reconciliation of distributable cash to cash flows from operating activities.

(2) The number of Units used to calculate distributable cash per Unit is based on the average number of Units outstanding at each record date. For the three months ended June 30, 2010 the average number of Units outstanding for this calculation was 142,312,387 and 144,574,000 (2009 – 135,207,357 and 137,468,978) on a basic and diluted basis, respectively. For the six months ended June 30, 2010 the average number of Units outstanding for this calculation was 141,207,060 and 143,468,681 (2009 – 134,659,117 and 136,920,738) on a basic and diluted basis, respectively. The number of Units outstanding would increase by 2,261,621 (2009 – 2,261,621) Units if the outstanding Convertible Debentures on June 30, 2010 were converted into Units.

(3) Includes \$22.1 million and \$42.2 million of distributions for the three and six months ended June 30, 2010, respectively, (2009 – \$11.9 million and \$15.7 million) satisfied through the issuance of Units under our Distribution Reinvestment Plan.

Distributable cash for the three and six months ended June 30, 2010 was \$49.3 million or \$0.34 per Unit and \$81.0 million or \$0.57 per Unit, respectively, compared to \$38.6 million or \$0.29 per Unit and \$69.6 million or \$0.52 per Unit for the same periods last year. This reflects:

- consistent distributions from Alliance as higher income tax recoveries were offset by the effect of the stronger Canadian dollar and reduced return on investment base;
- comparable distributable cash from AEGS;
- higher distributions from Aux Sable, reflecting more favourable NGL market conditions;
- lower distributable cash from Fort Chicago Power, reflecting lower energy margins and higher maintenance capital expenditure costs at the California cogeneration facilities and the effect of the stronger Canadian dollar, partially offset by higher capacity payments from our Brush facility and incremental earnings from Glen Park;
- the absence of a foreign exchange gain realized in the second quarter of 2009;
- increased corporate interest costs, due primarily to the senior notes issued in July 2009; and

- increased year-to-date current taxes related to Aux Sable's higher 2010 earnings, although this was mitigated in the second quarter of 2010 as a result of loss utilization made available through corporate restructuring.

In aggregate, the effect of the stronger Canadian dollar amounted to a \$2.2 million or \$0.02 per Unit and a \$4.7 million or \$0.03 per Unit reduction in distributable cash for the three and six months ended June 30, 2010, respectively, when compared to distributable cash for the same periods last year.

## FINANCIAL INSTRUMENTS

There has been no significant change to the composition or valuation of our financial instruments since December 31, 2009.

## CONTRACTUAL OBLIGATIONS AND COMMITMENTS

There have been no new material contractual obligations or commitments entered into since December 31, 2009.

## INTERNATIONAL FINANCIAL REPORTING STANDARDS

Effective January 1, 2011 Canadian publicly accountable enterprises are required to adopt International Financial Reporting Standards. Some Canadian standards will change to converge with IFRS prior to the conversion date. We will continue to prepare our consolidated financial statements for periods up to and including the year ending December 31, 2010 in accordance with Canadian GAAP as it exists at each reporting date. Financial statements for the three months ended March 31, 2011, including comparative amounts, will be reported in accordance with IFRS.

In order to transition to IFRS, we have established a project team and formed an executive steering committee. We are implementing our plan to convert the consolidated financial statements to IFRS. We have provided training to key employees and this will be ongoing throughout the conversion process. We continue to monitor the effect of the transition on information systems, internal controls over financial reporting and disclosure controls and procedures and do not anticipate significant changes. We continue to review debt covenants and other agreements to determine what changes may be required upon adoption of IFRS. Where changes are necessary we anticipate amending agreements prior to adoption of IFRS on January 1, 2011.

In accordance with our IFRS project plan, during the three months ended June 30, 2010, we continued to evaluate accounting policy alternatives and the potential impact on the consolidated financial statements. Due to uncertainty with respect to certain IFRS pronouncements we are unable to quantify the impact of adopting IFRS on the consolidated financial statements at this time.

On July 23, 2010, the Accounting Standards Board proposed that qualifying entities with rate-regulated activities be permitted, but not required, to continue applying the accounting standards in Part V of the CICA Handbook - Accounting for an additional two years. Entities choosing to defer their IFRS changeover date would be required to disclose that fact and when they will first present financial statements in accordance with IFRS. The Accounting standards Board expects to issue an exposure draft by the end of July. We will continue to monitor this issue and consider the impact of this proposal to our IFRS conversion. As a result of the ongoing uncertainty with respect to rate-regulated accounting under IFRS, we initiated preliminary scoping to determine the implications of registering with the United States Securities and Exchange Commission and adopting United States GAAP as an alternative to adopting IFRS.

## IFRS Accounting Policies

We continue to analyze differences between IFRS and our current accounting policies and to assess the impact of various alternatives. There are several accounting policy changes which may materially impact our consolidated financial statements, as described in our December 31, 2009 MD&A. Changes in IFRS and our continued assessments between now and December 31, 2011 may result in further accounting policy changes with material impacts on our consolidated financial statements. Two significant areas of uncertainty are outlined below.

Several of our investments, including Alliance and Aux Sable, are entities that we control jointly with other owners. We currently proportionately consolidate these entities so each line of our financial statements includes our proportionate

share of amounts recorded by each joint venture. Under current IFRS standards, we can choose between using proportionate consolidation and the equity method to account for joint ventures. There is presently an IFRS Exposure Draft outstanding which would eliminate the use of proportionate consolidation and require the use of equity accounting for interests in jointly controlled entities. The final standard is scheduled to be released in the third quarter of 2010. Under the equity method, investments in jointly controlled entities are recorded on one line on the balance sheet, and income from jointly controlled entities is recorded on one line on the income statement. Similarly, the statement of cash flows reflects investments in and distributions received from jointly controlled entities rather than our proportionate share of their cash flows on a line-by-line basis. While this change in policy would not, in and of itself, change the amount of net assets or net income we would expect almost every line item on the balance sheet, income statement and statement of cash flows to change, many by a material amount. We cannot quantify the impact of all other accounting policy changes resulting from the adoption of IFRS until the accounting standard for jointly controlled entities is known. We will determine our IFRS accounting policy after the Exposure Draft is finalized and an adoption date and transition rules are published with the final standard.

Alliance has certain rate-regulated accounting policies that vary from policies otherwise permitted under Canadian GAAP. IFRS does not presently address rate-regulated entities. An IFRS standard is currently scheduled to be released in late 2011, and will not likely be required to be adopted at the time we initially report under IFRS. *Improvements to IFRS* issued in May 2010 included an exemption permitting rate-regulated entities to use their Canadian GAAP capital asset balances at January 1, 2010 as their opening IFRS deemed cost amounts. *Improvements to IFRS* also requires that an impairment test be completed for rate-regulated assets as at January 1, 2010. We anticipate that we will utilize this exemption with respect to Alliance's rate-regulated assets and that an impairment test will be completed prior to transition to IFRS. The treatment of regulatory assets and liabilities under IFRS cannot presently be determined. While we continue to monitor developments regarding rate-regulated accounting under IFRS, at this time we cannot determine the impact of adopting IFRS for our rate-regulated businesses.

We described accounting for asset impairments under IFRS in our December 31, 2009 MD&A. With respect to the impairment charge we recorded in 2009 in relation to the Ripon and San Gabriel facilities, we have determined that the amount of the impairment charge would not change if it was calculated on an IFRS basis. Unlike under Canadian GAAP, asset impairment losses on assets other than goodwill will be reversed under IFRS if facts and circumstances change such that the asset is no longer deemed to be impaired.

Accounting for business combinations also differs between Canadian GAAP and IFRS. Business combinations prior to January 1, 2010 will not be restated on adoption of IFRS. Business combinations recorded during 2010, including the acquisition of Northbrook in March 2010, will be restated on adoption of IFRS. Under IFRS, transaction costs that are included in the determination of the purchase price under Canadian GAAP will be included in net income. Furthermore, all liabilities, including those that would not meet recognition requirements under Canadian GAAP will be recorded at fair value at the date of acquisition. Under IFRS, when a business combination occurs, all significant contracts are assessed to determine whether they are arrangements containing a lease using the facts and circumstances in existence at the date the contract was entered into. Under Canadian GAAP, this assessment is made using facts and circumstances as at the date of acquisition. Given the nature of our business, this change could be significant in future business acquisitions. Arrangements that are deemed to be leases are then assessed to determine whether the lease is operating or capital in nature, a determination that could materially impact net income and non-GAAP measures such as EBITDA. We anticipate that the only change related to the Northbrook acquisition will be the inclusion of transaction costs in net income.

## **NON-GAAP FINANCIAL MEASURES**

Certain financial measures referred to in this MD&A are not measures recognized under GAAP. These non-GAAP financial measures do not have standardized meanings prescribed by GAAP and therefore may not be comparable to similar measures presented by other entities. We caution investors not to construe these non-GAAP financial measures as alternatives to other measures of financial performance calculated in accordance with GAAP. We further caution investors not to place undue reliance on any one financial measure.

We provide the following non-GAAP financial measures to assist investors with their evaluation of us, including their assessment of our ability to generate distributable cash to fund monthly distributions. We consider these non-GAAP

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financial measures, together with other financial measures calculated in accordance with GAAP, to be important factors that assist investors in assessing performance.

**Adjusted Net Income** – represents net income adjusted for specific items that are significant, but are not reflective of our underlying operations. Specific items are subjective, however, we use our judgement and informed decision-making when identifying items to be included or excluded in calculating adjusted net income. Specific items may include, but are not limited to, certain income tax adjustments, bankruptcy settlements, gains or losses on sales of assets, certain fair value adjustments, and asset impairment losses. We believe our use of adjusted net income provides useful information to us and our investors by improving the ability to compare financial results among reporting periods, and by enhancing the understanding of our operating performance and our ability to fund distributions. The following is a reconciliation of adjusted net income to net income.

### Reconciliation of Adjusted Net Income to Net Income

(\$ Thousands)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Net income</b>	<b>18,419</b>	19,959	<b>32,493</b>	31,263
Adjustments to net income for non-recurring (gains) losses				
Power – fair value loss reclassified from other comprehensive income <sup>(1)</sup>	–	–	–	2,442
Taxes <sup>(2)</sup>	–	–	–	(154)
	–	–	–	2,288
<b>Adjusted net income</b>	<b>18,419</b>	19,959	<b>32,493</b>	33,551

(1) Net income for the six months ended June 30, 2009 included a non-cash expense transferred from other comprehensive income to net income, representing the fair value decrease of our investment in Pristine Power Inc. from Pristine's initial public offering in March 2008. As we consider such permanent decreases in the fair value of our investments to be non-typical, we have added this amount back to net income in arriving at adjusted net income.

(2) Represents the related taxes on the adjusting items described above.

**Distributable Cash** – represents the cash we have available for distribution to Unitholders after providing for debt service obligations and any maintenance and sustaining capital expenditures. Distributable cash does not include distribution reserves, if any, available in jointly held businesses or project development costs. Project development costs are discretionary, non-recoverable costs incurred to assess the commercial viability of greenfield business initiatives unrelated to our operating businesses. The investment community uses distributable cash to assess the source and sustainability of our cash distributions. The following is a reconciliation of distributable cash to cash flow from operating activities.

### Reconciliation of Distributable Cash to Cash From Operating Activities

(\$ Thousands)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Consolidated cash flow from operating activities	<b>41,062</b>	33,227	<b>107,329</b>	77,607
Adjusted for: Cash flow (generated from) used for operating activities applicable to jointly held businesses <sup>(1)</sup>	<b>1,877</b>	(3,914)	<b>(42,996)</b>	(40,883)
Cash flow from operating activities applicable to wholly-owned businesses <sup>(2)</sup>	<b>42,939</b>	29,313	<b>64,333</b>	36,724
Add (deduct) amounts applicable to wholly-owned businesses:				
Project development costs <sup>(3)</sup>	<b>3,152</b>	3,202	<b>7,651</b>	5,966
Change in non-cash working capital	<b>2,985</b>	756	<b>7,595</b>	17,709
Principal repayments on senior notes	<b>(1,448)</b>	(1,516)	<b>(2,894)</b>	(3,080)
Maintenance capital expenditures	<b>(2,059)</b>	231	<b>(2,926)</b>	18
Distributions earned greater than distributions received <sup>(4)</sup>	<b>3,707</b>	6,633	<b>7,226</b>	12,292
<b>Distributable cash</b>	<b>49,276</b>	38,619	<b>80,985</b>	69,629

- (1) Represents the net of (i) cash flow from operating activities applicable to jointly held businesses which is not under our sole control and, consequently, is not included in distributable cash until distributions are declared by the jointly held businesses; and (ii) distributions received from jointly held businesses.
- (2) Net of support payments made to Alliance Canada Marketing of \$2.4 million and \$5.1 million for the three and six months ended June 30, 2010 (2009 - \$1.3 million and \$4.1 million).
- (3) Represents costs incurred by us and our wholly-owned businesses in relation to projects where the recoverability of such costs has not yet been established. Amounts incurred for the six months ended June 30, 2010 relate primarily to the Jordan Cove LNG terminal project, the Pacific Connector Gas Pipeline project, and the Alton Gas Storage project.
- (4) Represents the difference between distributions declared by jointly held businesses and distributions received.

**Distributable Cash per Unit** - reflects the per Unit amount of distributable cash calculated based on the average number of Units outstanding on each record date.

**EBITDA** - refers to earnings before interest, taxes, depreciation and amortization. EBITDA is reconciled to net income before tax by deducting interest, depreciation and amortization, and asset impairment losses, if any. The investment community uses this measure, together with other measures, to assess the source and sustainability of cash distributions.

**Growth Capital Expenditures** - are generally defined as capital expenditures that expand existing capacity and/or increase earnings. The investment community uses this measure to assess the extent of discretionary capital spending.

**Maintenance and Sustaining Capital Expenditures** - are generally defined as expenditures that enhance existing assets or support operations without any associated increase in earnings. The investment community uses this measure to assess the extent of non-discretionary capital spending.

## DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the President & Chief Executive Officer (CEO) and the Vice President, Finance & Chief Financial Officer (CFO), on a timely basis so appropriate decisions can be made regarding public disclosure.

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, under the supervision of our CEO and CFO. Based on this evaluation, we concluded the disclosure controls and procedures, as defined in National Instrument 52-109, were effective as of June 30, 2010.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

We are responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. We assessed the design and effectiveness of internal controls over financial reporting as at June 30, 2010, and, based on that assessment, determined the design and operating effectiveness of internal controls over financial reporting was effective. However, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis.

No changes were made to internal control over financial reporting during the period ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.