PRIMARY ENERGY RECYCLING CORPORATION

Management's Discussion and
Analysis of Financial Condition and Results of Operations
(In US Dollars)

Three Months Ended March 31, 2007 and 2006

Primary Energy Recycling Corporation
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following management's discussion and analysis of the financial condition and results of operations ("MD&A") of Primary Energy Recycling Corporation (the "Company") dated April 30, 2007 should be read in conjunction with the unaudited interim consolidated financial statements of the Company for the three months ended March 31, 2007. The Company's financial statements are prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). All amounts described in this MD&A are in thousands of U.S. dollars, unless otherwise stated.

Forward-Looking Statements

Certain statements in this MD&A may constitute ''forward-looking statements'', which reflect the expectations of management regarding future growth, results of operations, performance and business prospects and opportunities of the Company. Such forward-looking statements reflect current expectations regarding future events and operating performance and speak only as of March 31, 2007. These forward-looking statements involve significant risks and uncertainties, and should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not or the times at or by which such performance or results will be achieved.

A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under ''Risk Factors'' in this MD&A and in the Company's Annual Information Form dated March 8, 2007. Additional information relating to the Company, including its Annual Information Form, is available on SEDAR at www.sedar.com. Although the forward-looking statements contained in this MD&A are based upon what are believed to be reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward-looking statements, and the differences may be material. These forward-looking statements are made as of the date of this MD&A and the Company assumes no obligation to update or revise them to reflect new events or circumstances.

Overview

General

The Company owns a majority interest in Primary Energy Recycling Holdings LLC ("PERH") which is headquartered in Oak Brook, Illinois. PERH indirectly owns and operates four recycling energy projects and a 50% interest in a pulverized coal facility (collectively, the ''Projects''). The Projects have a combined electrical generating capacity of 283 megawatts and a combined steam generating capacity of 1.8 MMlbs/hour. PERH creates value for its customers by capturing and recycling waste energy from industrial processes and converting it into reliable and economical electricity and thermal energy for its customers' use.

On August 24, 2005, the Company completed an initial public offering (the "Offering") through the issuance of 28.5 million enhanced income securities ("EISs") at a price of Cdn$10.00 per EIS, each representing one common share of the Company ("Common Share") and Cdn$2.50 principal amount of 11.75% subordinated notes ("Subordinated Notes"). In addition, the Company issued Cdn$18.5 million separate Subordinated Notes (not forming part of EISs) ("Separate Subordinated Notes") with the same terms as the EIS Subordinated Notes. A new credit facility was also entered into contemporaneously with the Offering consisting of a term loan facility of $135.0 million and a $15.0 million revolving credit facility (the "Credit Facility"). On September 27, 2005, the underwriters of the Offering exercised their over-allotment option to purchase 2.5 million additional EISs.

The Company used the proceeds of the Offering, and the proceeds of the over-allotment, to acquire an ownership interest in PERH. On completion of the Offering and closing of the over-allotment, the

Company owned 85.8% of the preferred interests and 83.0% of the common interests in PERH, through its ownership of all of the issued and outstanding Class A preferred membership interests and all of the issued and outstanding Class A common membership interests of PERH. Primary Energy Ventures LLC (the "Manager"), indirectly holds the remaining 14.2% of the preferred interests and 17.0% of the common interests in PERH, through its ownership of all of the issued and outstanding Class B preferred membership interests and all of the issued and outstanding Class B common membership interests in PERH.

Definitions of Distributable Cash

References to ''EBITDA'' are to earnings before interest, taxes, depreciation, amortization and certain other adjustments listed in the reconciliation table provided herein. References to "Distributable Cash" are to EBITDA, as adjusted for: interest on the Credit Facility and interest on the Separate Subordinated Notes. EBITDA and Distributable Cash are not recognized measures under Canadian GAAP and do not have standardized meanings prescribed by Canadian GAAP. Therefore, EBITDA and Distributable Cash may not be comparable to similar measures presented by other issuers. The Company intends to distribute substantially all of its cash excluding those amounts required for operation of the business on an ongoing basis. Accordingly, management believes that EBITDA and Distributable Cash are important measures in evaluating the Company's performance. However, EBITDA and Distributable Cash should not be construed as an alternative to net earnings or loss determined in accordance with Canadian GAAP as an indicator of the Company's performance or to cash flows from operating, investing and financing activities, as a measure of liquidity and cash flows.

Primary Energy Recycling Corporation
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations
(in 000's of US$, except per share data)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Revenue:		
Capacity	$ 9,018	$ 9,018
Energy Service	7,709	16,700
	16,727	25,718
Expenses:		
Operations and maintenance	6,371	8,727
General and administrative	2,893	3,711
Depreciation and amortization	10,131	10,150
Total Operating Expenses	19,395	22,588
Operating income (loss)	$ (2,668)	$ 3,130
Other income (expense):		
Interest income (expense), net	(5,183)	(5,058)
Unrealized gain on derivative hedge contracts	89	655
Unrealized gain (loss) on foreign currency translation	(803)	85
Income (loss) before income taxes	(8,565)	(1,188)
Income tax benefit (expense)	752	(989)
Income (loss) before non-controlling interest	(7,813)	(2,177)
Non-controlling interest in class B Preferred	(380)	(382)
Non-controlling interest in class B Common	913	1,243
Net Loss	$ (7,280)	$ (1,316)
Weighted average number of shares outstanding	31,000,000	31,000,000
Basic and Diluted net loss per share (Note 1)	$ (0.24)	$ (0.04)

Note 1: Basic and Diluted net loss per share has been calculated using the weighted average number of Common Shares outstanding of 31,000,000 for the three months ended March 31, 2007 and March 31, 2006.

Three Months Ended March 31, 2007 compared to Three Months Ended March 31, 2006

The Company's revenue of $16.7 million in the first quarter of 2007 decreased $9.0 million, or 35.0% compared with revenue of $25.7 million for the first quarter of 2006. This decrease is reflective of a decline in Energy Service revenue at the Company's Harbor Coal facility totaling $8.3 million comprised of reduced revenue based on volume of $2.2 million, pricing of $3.4 million which is due to the spread between the cost of coal supplied and the prices of the fuels that coal replaces (coke, natural gas and fuel oil), efficiency of operations of $0.4 million and a reserve against Harbor Coal revenue of $2.3 million. The amount of the reserve has been determined based on projected consumption at the facility using initial results of physical inventory measurements conducted by Harbor Coal's joint venture host customer. The remaining decrease in Energy Service revenue of $0.7 million is due in part to an outage incurred at one operating facility during the first quarter of 2007 and reduced generation at another operating facility compared to the same period in the prior year.

Operating and maintenance expense for the first quarter of 2007 was $6.4 million compared to $8.7 million for the first quarter of 2006, a decrease of $2.3 million or 27.0%. The Company's Harbor Coal facility experienced reduced processing expenditures of $0.3 million corresponding to decreased revenue. Harbor Coal also experienced lower prices for production commodities including oxygen, nitrogen and labor resulting in decreased costs of $1.6 million. These cost reductions were offset by increased maintenance expenses of $0.4 million. Operating and maintenance expense for the first quarter of 2006 included $0.8 million of overhaul expenses that were not recurring in the first quarter of 2007. As a percentage of revenue, operating and maintenance expenses increased to 38.1% for the first quarter of 2007 from 33.9% for the first quarter of 2006.

General and administrative expense for the first quarter of 2007 was $2.9 million compared to $3.7 million for the first quarter of 2006, a decrease of $0.8 million or 22.0%. The decrease was the result of a reduction in incentive fees of $0.7 million and professional fees of $0.1 million. As a percentage of revenue, general and administrative expenses increased to 17.3% for the first quarter of 2007 from 14.4% for the first quarter of 2006.

Depreciation expense totaled $2.6 million for the first quarter of 2007 and was essentially flat when compared to the first quarter of 2006. As a percentage of revenue, depreciation expense increased to 15.7% for the first quarter of 2007 from 10.2% for the first quarter of 2006.

Amortization expense totaled $7.5 million for the first quarter of 2007 and was essentially flat when compared to the first quarter of 2006. As a percentage of revenue, amortization expense increased to 44.8% for the first quarter of 2007 from 29.3% for the first quarter of 2006.

Operating loss for the first quarter of 2007 was $2.7 million compared to operating income of $3.1 million for the first quarter of 2006, a decrease of $5.8 million. The decrease was primarily driven from the net effect of the items discussed above.

Interest expense for the first quarter of 2007 was $5.2 million compared to $5.1 million for the first quarter of 2006. The increase in interest expense resulted primarily from an increase in the weighted average interest rate.

Unrealized gain on derivative hedge contracts for the first quarter of 2007 was $0.1 million compared to $0.7 million for the first quarter of 2006. The decrease reflects the change in fair value of the foreign currency exchange contracts and interest rate swap agreements held by the Company at March 31, 2007.

Unrealized loss on foreign currency translation for the first quarter of 2007 was $0.8 million compared to an unrealized gain on foreign currency translation of $0.1 million for the first quarter of 2006. The decrease reflects the impact of the change in foreign exchange rates used to convert the Subordinated and Separate Subordinated Notes from Canadian dollars to U.S. dollars.

The Company recorded an income tax benefit for the first quarter 2007 of $0.8 million comprised of a current tax benefit of $0.3 million related to a tax loss for the first quarter of 2007 and a future tax benefit of $0.5 million based on the change in value of future tax assets and liabilities. For the first quarter of 2006, the Company recorded a tax expense of $1.0 million based on the change in value of future tax assets and liabilities.

Non-controlling interest for the first quarter of 2007 was $0.5 million compared to $0.9 million for the first quarter of 2006. These amounts represent the allocation of the non-controlling interest portion of the consolidated net loss before non-controlling interest and interest expense associated with the non-controlling interest in Class B preferred.

Net loss for the first quarter of 2007 was $7.3 million compared to $1.3 million for the first quarter of 2006, an increase of $6.0 million. The increase was primarily driven from the net effect of the items discussed above.

Summary of Quarterly Results

(In 000's of US$, except per share data)

	Period from 8/24 - 9/30 2005	4th Quarter 2005	1st Quarter 2006	2nd Quarter 2006	3rd Quarter 2006	4th Quarter 2006	1st Quarter 2007
Revenues	$ 9,165	$ 23,234	$ 25,718	$ 21,902	$ 21,177	$ 18,275	$ 16,727
Net income (loss)	$ 510	$ (1,474)	$ (1,316)	$ 1,874	$ (4,175)	$ (14,840)	$ (7,280)
Net income (loss) per share	$ 0.02	$ (0.05)	$ (0.04)	$ 0.06	$ (0.14)	$ (0.48)	$ (0.24)

Outstanding Share Data

At March 31, 2007, the Company had 31,000,000 Common Shares outstanding, of which 247,900 Common Shares were held separately and the remaining 30,752,100 Common Shares were held as a component of EIS's. Each EIS consists of one Common Share and Cdn$2.50 principal amount of 11.75% Subordinated Notes.

Loss Per Share

Basic loss per share is computed based on the weighted average number of Common Shares outstanding. For the three months ended March 31, 2007 and 2006, there were no potentially dilutive securities issued and outstanding. Accordingly, diluted loss per share is equivalent to basic loss per share.

Liquidity and Capital Resources

For the three months ended March 31, 2007, the Company recorded a decrease in cash and cash equivalents of $2.0 million resulting in a balance of $13.6 million as of March 31, 2007. The Company's primary source of liquidity has historically been cash flow from operations. The Company has experienced some very recent operational difficulties that have impacted cash flow in the current quarter resulting in distributions in excess of cash generated through operating activities. In the near term, the Company may be challenged to generate sufficient cash flow from operations to maintain compliance with excess cash requirements under the Company's Indenture and Credit Facility. If the Company is unable to comply with its excess cash requirements it would be necessary for lenders to approve waivers to allow payment of future distributions. Over the long term, the Company believes available cash funds, in addition to cash to be generated from future operations and available credit facilities of $15.0 million will be sufficient to finance known or foreseeable liquidity and capital needs. Additionally, management believes that the Company's ability to generate positive cash flow from operations will be sufficient to meet anticipated maintenance requirements associated with the Company's facilities over the long term. The Company has one overhaul planned for the second quarter of 2007 with an estimated cost of $0.9 million, and has experienced an unplanned outage at one facility that will impact liquidity in the second quarter of 2007 by an estimated $1.0 million to $2.0 million due to lost revenue and added repair expenses.

Cash Flows for the Three Months Ended March 31, 2007

Net cash provided by operating activities for the three months ended March 31, 2007 was $5.2 million, which resulted from a net loss of $7.3 million, plus $9.9 million of net non-cash items charged to the Consolidated Statement of Operations, plus $2.6 million representing the net change in the Company's operating assets and liabilities. The net non-cash items consisted primarily of depreciation of property, plant and equipment and amortization of intangible assets. The net change in operating assets and liabilities resulted primarily from an increase in accounts receivable and reductions in accounts payable and amounts owed to affiliates. These uses of cash were offset by increases in accrued property taxes and accrued expenses.

Net cash used in financing activities for the three months ended March 31, 2007 was $7.2 million resulting from distribution payments of $5.7 million to holders of Common Shares and interest and distribution payments of $1.5 million to holders of Class B common and preferred membership interests in PERH.

Cash Flows for the Three Months Ended March 31, 2006
Net cash provided by operating activities for the three months ended March 31, 2006 was $10.5 million, which resulted from a net loss of $1.3 million, plus $9.9 million of net non-cash items charged to the Consolidated Statement of Operations, plus $1.9 million representing the net change in the Company's operating assets and liabilities. The net non-cash items consisted primarily of depreciation of property, plant and equipment and amortization of intangible assets. The net change in operating assets and liabilities resulted primarily from a decrease in accounts receivable and increases in accounts payable and accrued property taxes, offset by reductions in accrued expenses and amounts owed to affiliates.

Net cash used in financing activities for the three months ended March 31, 2006 was $6.8 million resulting from distribution payments of $5.3 million to holders of Common Shares and interest and distribution payments of $1.5 million to holders of Class B common and preferred membership interests in PERH.

Outstanding Debt
At March 31, 2007, the amount of outstanding debt under the Credit Facility was $135.0 million, with $15.0 million in additional borrowing capacity available under the revolving credit facility for working capital purposes. Also included in outstanding debt is $83.1 million in Subordinated Notes and Separate Subordinated Notes. The Credit Facility has a maturity date of August 24, 2009. The Subordinated Notes and Separate Subordinated Notes have a 12-year term and are due and payable on August 24, 2017. The Credit Facility, as well as the terms of the Subordinated Notes and Separate Subordinated Notes, requires the Company to meet certain financial covenants including, among other things, maintaining certain defined leverage and coverage ratios. As of March 31, 2007, the Company was in compliance with all such debt covenant requirements.

Cash Available for Distribution
The Company pays interest on the Subordinated Notes and Separate Subordinated Notes as stipulated and distributions on the Common Shares (when declared) in equal monthly amounts. Declarations of distributions on the Common Shares are based on periodic reviews of the Company's estimated annual earnings and related estimated annual cash flows. For the three months ended March 31, 2007, the Company generated Cdn$5.0 million of Distributable Cash and distributed Cdn$10.7 million, for a payout ratio of 216.5%. For three months ended March 31, 2006, the Company generated Cdn$12.1 million of Distributable Cash and distributed Cdn$10.2 million, for a payout ratio of 84.7%. The Board of Directors monitors the distribution policy of the Company with respect to excess cash, forecasted cash flows, debt levels and spending plans for the long term and may adjust distributions to retain appropriate liquidity for business operations. The Company expects to follow its distribution policy summarized in its Annual Information Form dated March 8, 2007 available on SEDAR at www.sedar.com.

Distributable Cash Summary

(in 000's of US$, except per share data and as otherwise indicated)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Reconciliation of cash flows from operating activities to Distributable Cash:		
Cash provided by operating activities	$ 5,203	$ 10,469
Cash interest expense	4,872	4,746
Changes in operating assets and liabilities	(2,557)	(1,884)
Accretion of asset retirement obligations	(54)	(51)
EBITDA (Note 1)	7,464	13,280
Less:		
Interest on new credit facility	2,759	2,481
Interest on separate subordinated notes	464	464
Distributable Cash (Note 1)	$ 4,241	$ 10,335
Per Common and equivalent Common Share (Note 2)	$ 0.11	$ 0.28
Interest on EIS Subordinated Notes	$ 1,944	$ 1,944
Distributions on Common Shares	5,693	5,335
Distributions on non-controlling Class B preferred interest	380	382
Distributions on non-controlling Class B common interest	1,164	1,091
Total distributions (Note 3)	$ 9,181	$ 8,752
Per Common and equivalent Common Share (Note 2)	$ 0.25	$ 0.24
Hedge rate (Cdn$ per US$) (Note 4)	$ 1.1671	$ 1.1712
Distributable Cash (Cdn$) (Note 1)	$ 4,950	$ 12,104
Per Common and equivalent Common Share (Cdn$) (Note 2)	$ 0.13	$ 0.33
Excess (shortfall) distributable cash (Cdn$)	$ (5,765)	$ 1,854
Per Common and equivalent Common Share (Cdn$) (Note 2)	$ (0.15)	$ 0.05

Note 1: EBITDA and Distributable Cash are not recognized measures under Canadian GAAP and do not have standardized meanings prescribed by Canadian GAAP. Therefore, EBITDA and Distributable Cash may not be comparable to similar measures presented by other issuers. As the Company intends to distribute substantially all of its cash on an ongoing basis, management believes that EBITDA and Distributable Cash are important measures in evaluating the Company's performance. Distributable Cash is not intended to be representative of cash flow or results of operations determined in accordance with Canadian GAAP.

Note 2: Common and equivalent Common Share computation for Distributable Cash purposes assumes 31,000,000 Common Shares are outstanding for the full period and the conversion of Class B common interests into equivalent Common Shares. For the three months ended March 31, 2007 and 2006, the number of Common and equivalent Common Shares outstanding is 37,265,455.

Note 3: Includes distributions declared, but not distributed in reporting period.

Note 4: Hedge rate is based on weighted average of outstanding hedge contracts in place in each respective period.

Foreign Currency Exchange Contracts

On closing of the Offering, the Company entered into forward contracts to purchase Canadian dollars sufficient to make monthly distributions through September 2010 at the initial distribution level to all EIS holders, including non-controlling investors, as well as interest payments on the Separate Subordinated Notes. The forward contracts applicable for distributions to EIS holders and the non-controlling interest have an exchange rate of Cdn$1.1712 to U.S. $1.00 and a rate of Cdn$1.0840 to U.S. $1.00. The forward contracts for the Separate Subordinated Notes have an exchange rate of Cdn$1.1713 to U.S. $1.00. For the three months ended March 31, 2007 and 2006, the net impact of the change in the foreign exchange rate on the aggregate value of the hedges resulted in an unrealized gain of $0.5 million and unrealized loss of $0.2 million, respectively. At March 31, 2007 and December 31, 2006, the fair value of these contracts was a net amount of $2.9 million of which $0.6 million is recorded in current assets and $2.4 million of which $0.3 million is recorded in current assets, respectively.

Interest Rate Swap Agreements

The Company entered into interest rate swap agreements on August 31, 2005. The contracts were purchased to mitigate the cash flow risk associated with the impact of changing interest rates on payments due under the Credit Facility. The agreements do not qualify as a cash flow hedge for accounting purposes and the change in the fair value of the derivative is recorded in income. For the three months ended March 31, 2007 and 2006, the net impact of the exchange in the fair value of the agreements resulted in an unrealized loss of $0.4 million and unrealized gain of $0.9 million, respectively. At March 31, 2007 and December 31, 2006, the fair value of these agreements was a net amount of $0.5 million of which $0.3 million is recorded in current assets and $0.9 million of which $0.4 million is recorded in current assets, respectively.

Commitments and Contractual Obligations

The following table reflects the Company's contractual obligations and commitments related to outstanding indebtedness as of March 31, 2007, including payments due for each of the next five years and thereafter.

Maturities of long-term debt are as follows (in 000's):

	March 31, 2007 Balance	2007	2008	2009	2010	2011	Thereafter
Term Loan Facility	$ 135,000	$ -	$ -	$ 135,000	$ -	$ -	$ -
Subordinated debt	83,147	-	-	-	-	-	83,147
Total	$ 218,147	$ -	$ -	$ 135,000	$ -	$ -	$ 83,147

The Company pays a management fee under the Management Agreement which continues through August 2025. For more detailed discussion, please see "Transactions with Related Parties".

The Company has no off-balance sheet debt or similar obligations.

Subsequent Event

The Company was notified on April 19, 2007 of a steam turbine generator failure at one of its operating facilities. The Company is in the process of determining the requirements to repair the generator. The estimated timeframe for repairs to be completed and the facility to return to normal operations could be up to sixty days. Management estimates that the negative impact in the second quarter of 2007 on revenue and expenses as a result of this outage could be between $1.0 million to $2.0 million.

Transactions with Related Parties

The Manager is engaged to provide management and administrative services to the Company and its subsidiaries pursuant to the terms of the Management Agreement for which it earns a fixed fee that adjusts annually based on inflation factors. The Manager is also entitled to an incentive fee under the Management Agreement. The incentive fee is designed to align the financial interests of the Manager with those of the Company. The incentive fee for each year will equal 25% of the product of (a) the excess of the Company's Distributable Cash per Common Share and (b) the weighted average number of EISs, Common Shares not represented by EISs and Class B Common Interests outstanding for such fiscal year. The Management Agreement has an initial 20-year term which commenced August 24, 2005.

A detailed description of the principal terms of the Management Agreement is included in the Company's Annual Information Form dated March 8, 2007 and a copy of the Management Agreement is available for review on SEDAR at www.sedar.com.

On November 1, 2006, the Manager was acquired by EPCOR Power L.P. ("EPCOR Power"), a Canadian public company. As a result of the acquisition, all the employees of the Manager were transferred to EPCOR Operations (U.S.) Inc. ("EPCOR Operations"), a wholly owned subsidiary of EPCOR Utilities Inc. and an affiliate of EPCOR Power. EPCOR Operations now provides all management and administrative services to the Manager which continues to act as Manager under the Management Agreement.

In connection with the acquisition of the Manager by EPCOR Power on November 1, 2006, the Company, EPCOR Power, EPCOR Operations, the Manager and Thomas Casten (former Chair and Chief Executive Officer of the Manager) entered into an allocation agreement (the "Allocation Agreement") which allocates among the parties rights to new and certain existing development and acquisition opportunities, where such opportunities have been or will be developed or identified by any of the Manager, EPCOR Operations or Thomas Casten. The principal terms of the Allocation Agreement are summarized in the Company's Annual Information Form dated March 8, 2007 and a copy of the Allocation Agreement is available for review on SEDAR at www.sedar.com.

Critical Accounting Estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the financial statements. Management bases its estimates on historical experience and other assumptions, which it believes are reasonable. If actual amounts are ultimately different from these estimates, the revisions are included in the Company's results of operations for the period in which the actual amounts become known.

Accounting policies are considered critical when they require management to make assumptions about matters that are highly uncertain at the time the estimate is made and when different estimates than those management reasonably could have made have a material impact on the presentation of the Company's financial condition, changes in financial condition or results of operations. The following is a description of the Company's accounting policies that management believes require subjective and complex judgments, and could potentially have a material effect on reported financial condition and results of operations.

Property, Plant and Equipment

Property, plant and equipment have been adjusted, giving effect to the purchase method of accounting. Depreciation for all asset classes is recorded on a straight-line basis over the estimated useful lives of the assets. Generally, the estimated useful lives are 30 years for buildings, plant and equipment. The estimated useful life of office furniture and equipment is 7 years. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful lives of the assets. Expenditures for maintenance and repairs are charged to income as incurred. The carrying amount for long-lived assets is reviewed whenever events or changes in circumstances indicate that impairment may have occurred.

Intangible Assets

Identifiable intangible assets were fair valued based on valuation techniques for the purpose of applying purchase accounting to the acquisition of PERH on August 24, 2005 and represent contract rights associated with customer contracts and nitrogen oxide allowances. The respective intangible values are amortized over specified time horizons and evaluated for impairment if events or changes in circumstances indicate that the asset might be impaired. Fair value under Canadian GAAP is defined as "the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act". Assessing the fair value of intangible assets requires management estimates on future cash flows to be generated by the assets.

Impairment of Long-Lived Assets

Management continually evaluates whether events or circumstances have occurred that indicate that the remaining estimated useful lives of property, buildings and equipment may warrant revision or that the remaining balances may not be recoverable. If this review indicates that the assets will not be recoverable, as determined based on the undiscounted future cash flows from the use of the assets, the carrying value of the assets will be reduced to their estimated fair value.

Asset Retirement Obligations

The fair value of estimated asset retirement obligations is recognized in the consolidated balance sheet when identified and a reasonable estimate of fair value can be made. The asset retirement cost, equal to the estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long-lived asset. The fair value of asset retirement obligations depends on the total undiscounted amount of the estimated cash flows required to settle the obligations and the appropriate credit-adjusted risk-free discount rate. The asset retirement costs are amortized over the asset's estimated useful life and included in depreciation expense on the consolidated statement of operations and members' deficit. Increases in the asset retirement obligation resulting from the passage of time are recorded as accretion of asset retirement obligation, and are included in general and administrative expenses in the consolidated statement of operations and shareholders' deficit. Actual expenditures incurred are charged against the accumulated obligation.

Revenue Recognition

Revenue is recorded as services are delivered. Revenue is recorded on the accrual basis and may include estimates for services delivered. Capacity revenue represents the fixed revenue amounts established in the tolling agreements with the Company's customers and is billed on a monthly basis. Energy Service revenue represents the revenue earned based on measurements of services performed and delivered each period. The Company provides estimates for doubtful accounts it deemed necessary based on the aging category and specific knowledge of the customer's ability to pay. No such allowances were recorded at March 31, 2007 and 2006.

Future Income Taxes

The Company utilizes the liability method of accounting for income taxes under which future income tax assets and liabilities are recognized based upon the differences between the tax basis of an asset or liability and its reported amount in the financial statements. Future tax balances are determined by using estimates of future tax rates expected to be in effect when the taxes will actually be paid or refunds received.

Accounting for Derivatives

The Company evaluates derivatives in accordance with Accounting Guideline 13 "Hedging Relationships" ("AcG-13"). For those derivatives that do not qualify for hedge accounting under AcG-13 the derivative instrument is recorded on the balance sheet as either an asset or liability measured at estimated fair value, with changes in fair value recognized currently in earnings.

Risk Factors

See the Company's Annual Information Form dated March 8, 2007 which can be found on SEDAR at www.sedar.com for a full description of the Company's risk factors, which factors are incorporated by reference herein.

Recent Accounting Pronouncements

The Canadian Accounting Standards Board has recently issued new Handbook sections:

- 1530, Comprehensive Income;
- 3855, Financial Instruments – Recognition and Measurement; and
- 3865, Hedges.

Under these new standards, all financial assets should be measured at fair value with the exception of loans, receivables and investments that are intended to be held to maturity and certain equity investments, which should be measured at cost. Similarly, all financial liabilities should be measured at fair value when they are held for trading or they are derivatives. Gains and losses on financial instruments measured at fair value will be recognized in the income statement in the periods they arise with the exception of gains and losses arising from:

- Financial assets held for sale, for which unrealized gains and losses are deferred in other comprehensive income until sold or impaired; and
- Certain financial instruments that qualify for hedge accounting.

Sections 3855 and 3865 reference "other comprehensive income". Other comprehensive income comprises revenues, expenses, gains and losses that are excluded from net income. Unrealized gains and losses on qualifying hedging instruments, foreign currency, and unrealized gains or losses on financial instruments held for sale will be included in other comprehensive income and reclassified to net income when realized. Comprehensive income and its components will be required disclosure under the new standard.

The adoption of these standards as of January 1, 2007 did not have a material impact on the Company's consolidated financial statements.

Capital Disclosures

In December 2006, the CICA released new Handbook Section 1535, Capital Disclosures, effective for interim and annual financial statements beginning on or after October 1, 2007. Section 1535 establishes standards for disclosing information about an entity's capital and how it is managed. It requires the disclosure of information about an entity's objectives, policies and processes for managing capital. The Company does not expect adoption of Section 1535 to have a material impact on its consolidated financial statements.

Financial Instruments – Disclosures and Presentation

In December 2006, the CICA released new Handbook Section 3862, Financial Instruments – Disclosures and Handbook Section 3863, Financial Instruments – Presentations effective for interim and annual financial statements beginning on or after October 1, 2007. Section 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments on the entity's financial position and its performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, losses and gains, and circumstances in which financial assets and financial liabilities are offset. The Company does not expect adoption of Section 3862 and Section 3863 to have a material impact on its consolidated financial statements.

Accounting Changes

CICA Handbook Section 1506: Accounting Changes ("CICA 1506") effective for fiscal years beginning on or after January 1, 2007 establishes standards and new disclosure requirements for the reporting of changes in accounting policies and estimates and the reporting of error corrections. CICA 1506 clarifies that a change in accounting policy can be made only if it is a requirement under Canadian GAAP or if it provides reliable and more relevant financial statement information. Voluntary changes in accounting policies require retrospective application of prior period financial statements, unless the retrospective effects of the changes are impracticable to determine, in which case the retrospective application may be limited to the assets and liabilities of the earliest period practicable, with a corresponding adjustment made to opening retained earnings. At this time, we are not aware of any pending accounting changes other than those mandated by the CICA, and as such we do not anticipate any material effects as a result of this change.

Internal Control over Financial Reporting

Internal control over financial reporting, designed by management, has the objective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. No changes were made by management to the Company's internal control over financial reporting have occurred during the three months ended March 31, 2007, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Additional Information

Additional information relating to the Company, including the audited consolidated financial statements for the three months ended March 31, 2007 and the Company's Annual Information Form dated March 8, 2007, is available on SEDAR at www.sedar.com.