PRIMARY ENERGY RECYCLING CORPORATION

Management's Discussion and
Analysis of Financial Condition and Results of Operations

Three Months and Nine Months Ended September 30, 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 of Primary Energy Recycling Corporation (the "Company") should be read in conjunction with the unaudited interim consolidated financial statements of the Company for the three months and nine months ended September 30, 2006. The Company's financial statements are prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). All amounts described in the management discussion and analysis of financial condition and results of operations are in thousands of U.S. dollars, unless otherwise stated.

Forward-Looking Statements

Certain statements in this management's discussion and analysis report 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 September 30, 2006. 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 management's discussion and analysis and in the Company's Annual Information Form dated March 30, 2006. 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 management's discussion and analysis 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 October 31, 2006 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 1,851 Mlbs/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.

With the completion of its Initial Public Offering (the "Offering") on August 24, 2005 and after the exercise of the underwriter's over-allotment on September 27, 2005, the Company owns an 83.2% financial interest in PERH through its ownership of all of the Class A Preferred and Common shares and Primary Energy Holdings LLC ("PEH") owns a 16.8% interest in PERH through its ownership of all of the Class B Preferred and Common shares.

Matters Affecting Comparability

The Company began operations on August 24, 2005, the same day as the Company completed the Offering. There are no financial statements for the 2005 fiscal year for the Company (or its subsidiaries) that can be used on a comprehensive basis for comparing the three months and nine months ended September 30, 2006 operating results to the comparative period in the prior period.

In order to enhance its usefulness, this management discussion and analysis includes a summary of the operating results of the Company for the three month and nine month periods ended September 30, 2006 and comparative pro forma operating results for the corresponding three and nine month periods in 2005. As the periods, or portions thereof, are prior to the closing of the Offering, this information is provided for reference purposes only, and is not intended as a comprehensive comparison of financial results.

Definition of EBITDA and 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 New 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 September 30,			
	Actual 2006	Actual 38 Days 8/24/05 - 9/30/05	Predecessor Pro forma 54 Days 7/1/05 - 8/23/05 (Note 1)	Pro forma 2005 (Note 1)
Revenue:				
Capacity	$ 9,018	$ 3,782	$ 5,236	$ 9,018
Energy Service	12,159	5,383	4,943	10,326
	21,177	9,165	10,179	19,344
Expenses:				
Operations and maintenance	7,197	2,945	3,002	5,947
General and administrative	2,457	935	962	1,897
Depreciation and amortization	9,981	4,117	1,871	5,988
Total Operating Expenses	19,635	7,997	5,835	13,832
Operating income	$ 1,542	$ 1,168	$ 4,344	$ 5,512
Other income (expense):				
Interest income (expense), net	(5,194)	(2,166)		
Unrealized gain (loss) on derivative hedge contracts	(2,279)	5,672		
Unrealized gain (loss) on Foreign Currency Translation	23	(2,679)		
Income (loss) before income taxes	(5,908)	1,995		
Income tax benefit (expense)	363	111		
Income (loss) before non-controlling interest	(5,545)	2,106		
Non-controlling interest in class B Preferred	(381)	(160)		
Non-controlling interest in class B Common	1,751	(1,436)		
Net Income (Loss)	$ (4,175)	$ 510		
Weighted average number of shares outstanding	31,000,000	28,697,368		
Basic and Diluted net income (loss) per share (Note 2)	$ (0.14)	$ 0.02		

Note 1: Proforma financial data has been adjusted to reflect investment in PCI Associates on a proportionate consolidation basis for all periods presented and to remove the financial results of Lakeside Energy LLC from historical predecessor financial results.

Note 2: Basic and Diluted net income (loss) per share has been calculated using the weighted average number of Common Shares outstanding of 31,000,000 for the three month period ended September 30, 2006 and 28,697,638 for the thirty eight day period ended September 30, 2005.

Three Months Ended September 30, 2006 Compared to the Pro forma for the Three Months Ended September 30, 2005

The Company's revenue of $21.2 million in the third quarter of 2006 increased $1.9 million, or 9.5% compared with revenue of $19.3 million for the comparable pro forma third quarter of 2005. The improvement in Energy Service revenue for the quarter was primarily the result of increased revenue at the Company's Harbor Coal facility of $1.7 million due to increases in volume and in the spread between the cost of coal supplied and the prices of the fuels that coal replaces.

Operating and maintenance expense for the third quarter of 2006 was $7.2 million compared to $5.9 million for the pro forma third quarter of 2005, an increase of $1.3 million or 21.0%. The increase was due to additional operating and maintenance expenses at the Company's Harbor Coal facility corresponding to increased revenue. As a percentage of revenue, operating and maintenance expenses increased to 34.0% for the third quarter of 2006 from 30.7% for the third quarter of 2005.

General and administrative expense for the third quarter of 2006 was $2.5 million compared to $1.9 million for the pro forma third quarter of 2005, an increase of $0.6 million or 29.5%. The increase was primarily due to additional management fees of $0.5 million and property taxes of $0.4 million offset by reductions in incentive fees and other expenses totaling $0.3 million. As a percentage of revenue, general and administrative expenses increased to 11.6% for the third quarter of 2006 from 9.8% for the third quarter of 2005.

Depreciation expense for the third quarter of 2006 was $2.6 million compared to $2.5 million for the pro forma third quarter of 2005, an increase of $0.1 million. The increase in depreciation expense was associated with the fair value adjustment to fixed assets resulting from the allocation of purchase price upon the completion of the Offering. As a percentage of revenue, depreciation expense decreased to 12.4% for the third quarter of 2006 from 12.7% for the third quarter of 2005.

Amortization expense for the third quarter of 2006 was $7.4 million compared to $3.5 million for the pro forma third quarter of 2005, an increase of $3.9 million. The increase was due to the additional amortization associated with the allocation of purchase price to Contract Value intangible upon the completion of the Offering. The Contract Value intangible is being amortized over an average term of 8 years. As a percentage of revenue, amortization expense increased to 34.7% for the third quarter of 2006 from 18.2% for the third quarter of 2005.

Operating income for the third quarter of 2006 was $1.5 million compared to $5.5 million pro forma operating income for the third quarter of 2005, a decrease of $4.0 million, or 72.0%. The decrease was primarily driven from the net effect of items discussed above.

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

	Nine Months Ended September 30,			
	Actual 2006	Actual 38 Days 8/24/05 - 9/30/05	Predecessor Pro forma 235 Days 1/1/05 - 8/23/05 (Note 1)	Pro forma 2005 (Note 1)
Revenue:				
Capacity	$ 27,054	$ 3,782	$ 23,271	$ 27,053
Energy Service	41,743	5,383	25,942	31,325
	68,797	9,165	49,213	58,378
Expenses:				
Operations and maintenance	24,650	2,945	15,895	18,840
General and administrative	7,275	935	5,287	6,222
Depreciation and amortization	29,983	4,117	8,295	12,412
Total Operating Expenses	61,908	7,997	29,477	37,474
Operating income	$ 6,889	$ 1,168	$ 19,736	$ 20,904
Other income (expense):				
Interest income (expense), net	(15,378)	(2,166)		
Unrealized gain on derivative hedge contracts	6,148	5,672		
Unrealized (loss) on Foreign Currency Translation	(3,736)	(2,679)		
Income (Loss) before income taxes	(6,077)	1,995		
Income tax benefit (expense)	(593)	111		
Income (Loss) before non-controlling interest	(6,670)	2,106		
Non-controlling interest in class B Preferred	(1,143)	(160)		
Non-controlling interest in class B Common	4,196	(1,436)		
Net Income (Loss)	$ (3,617)	$ 510		
Weighted average number of shares outstanding	31,000,000	28,697,368		
Basic and Diluted net income (loss) per share (Note 2)	$ (0.12)	$ 0.02		

Note 1: Proforma financial data has been adjusted to reflect investment in PCI Associates on a proportionate consolidation basis for all periods presented and to remove the financial results of Lakeside Energy LLC from historical predecessor financial results.

Note 2: Basic and Diluted net income (loss) per share has been calculated using the weighted average number of Common Shares outstanding of 31,000,000 for the nine month period ended September 30, 2006 and 28,697,638 for the thirty eight day period ended September 30, 2005.

Nine Months Ended September 30, 2006 Compared to the Pro forma for the Nine Months Ended September 30, 2005

The Company's revenue of $68.8 million in the first nine months of 2006 increased $10.4 million, or 17.9% compared with revenue of $58.4 million for the comparable pro forma 2005 period. The improvement in Energy Service revenue for the nine month period was primarily the result of increased revenue at the Company's Harbor Coal facility of $10.0 million due to increases in volume and in the spread between the cost of coal supplied and the prices of the fuels that coal replaces.

Operating and maintenance expense for the first nine months of 2006 was $24.6 million compared to $18.8 million for the pro forma first nine months of 2005, an increase of $5.8 million or 30.8%. The increase was due to additional plant maintenance expenses comprised of planned steam turbine overhaul expenses of $0.8 million and additional processing expenditures of $5.0 million corresponding to increased revenue at the Company's Harbor Coal facility. As a percentage of revenue, operating and maintenance expenses increased to 35.8% for the first nine months of 2006 from 32.3% for the first nine months of 2005.

General and administrative expense for the first nine months of 2006 was $7.3 million compared to $6.2 million for the pro forma first nine months of 2005, an increase of $1.1 million or 16.9%. The increase was the result of additional expenses associated with management fees of $2.0 million, professional fees of $0.7 million, incentive fees of $0.6 million, plant and liability insurance of $0.3 million and board compensation fees of $0.2 million offset by a $1.2 million reduction in property tax expense inclusive of property tax refunds and a reduction in accrued property taxes based upon completion of a successful appeal to the state taxing authorities for designation as a non-utility taxpayer. In addition, there was a $1.5 million reduction related to allocated parent company general and administrative expenses recorded in the prior year. As a percentage of revenue, general and administrative expenses decreased to 10.6% for the first nine months of 2006 from 10.7% for the first nine months of 2005.

Depreciation expense for the first nine months of 2006 was $7.9 million compared to $7.2 million for the pro forma first nine months of 2005, an increase of $0.7 million. The increase in depreciation expense was associated with the fair value adjustment to fixed assets resulting from the allocation of purchase price upon the completion of the Offering. As a percentage of revenue, depreciation expense decreased to 11.5% for the first nine months of 2006 from 12.4% for the first nine months of 2005.

Amortization expense for the first nine months of 2006 was $22.1 million compared to $5.2 million for the pro forma first nine months of 2005, an increase of $16.9 million. The increase was due to the additional amortization associated with the allocation of purchase price to Contract Value intangible upon the completion of the Offering. The Contract Value intangible is being amortized over an average term of 8 years. As a percentage of revenue, amortization expense increased to 32.1% for the first nine months of 2006 from 8.9% for the first nine months of 2005.

Operating income for the first nine months of 2006 was $6.9 million compared to $20.9 million pro forma operating income for the first nine months of 2005, a decrease of $14.0 million, or 67.1%. The decrease was primarily driven from the net effect of 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
Revenues	$ 9,165	$ 23,234	$ 25,718	$ 21,902	$ 21,177
Net income (loss)	$ 510	$ (1,474)	$ (1,316)	$ 1,874	$ (4,175)
Net income (loss) per share	$ 0.02	$ (0.05)	$ (0.04)	$ 0.06	$ (0.14)

Outstanding Share Data

At October 31, 2006, the Company had 30,843,300 EISs outstanding. Each EIS includes one Common Share. In addition, 156,700 Common Shares not associated with EIS's are outstanding.

Earnings per share

Basic earnings per share is computed based on the weighted average number of Common Shares outstanding. During the period ended September 30, 2006, there were no potentially dilutive securities issued and outstanding. Accordingly, diluted earnings per share is equivalent to basic earnings per share.

Liquidity and Capital Resources

The Company believes that available cash reserves inconjunction with cash to be generated from operations and amounts available under the revolving credit facility will be sufficient to meet working capital needs and planned distribution payments in the near term. For the nine months ended September 30, 2006, the Company generated $23.8 million in cash flow from operations. $1.3 million of cash flow from operations is the result of a positive change in working capital for the period. The Company's financing activities for the first nine months of fiscal 2006 resulted in a use of cash of $21.0 million comprised primarily of planned distributions payments.

At September 30, 2006, 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 $86.1 million in Subordinated Notes and Separate Subordinated Notes. The Credit Facility has a maturity date of August 24, 2009, while the Subordinated Notes and Separate Subordinated Notes have a 12-year term and are due and payable on August 24, 2017. The Credit Facility requires the Company to meet certain financial covenants that among other things, requires the Company to maintain certain defined leverage and coverage ratios. As of September 30, 2006, the Company is in compliance with all debt covenant requirements.

The Company determines distribution declarations, which it intends to pay in equal monthly amounts, based on periodic reviews of its estimated annual earnings and related estimated annual cash flows. The Company expects to follow the distribution policy summarized in its Annual Information Form dated March 30, 2006 available on SEDAR at www.sedar.com, after adjustment to reflect the $0.05 increase approved in May 2006.

Distributable Cash Summary

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

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006	Inception to September 30, 2006
Reconciliation of net income (loss) to EBITDA:			
Net income (loss)	$ (4,175)	$ (3,617)	$ (4,581)
Plus:			
Depreciation and Amortization	9,981	29,983	44,388
Interest expense	5,194	15,378	22,589
Unrealized (gain) loss on foreign currency exchange	(23)	3,736	6,046
Unrealized (gain) loss on derivative hedge contracts	2,279	(6,148)	(10,760)
Income tax expense (benefit)	(363)	593	2,518
Non-controlling interest	(1,751)	(4,196)	(5,902)
Distributions on Class B preferred interest	381	1,143	1,680
EBITDA (Note 1)	$ 11,523	$ 36,872	$ 55,978
Less:			
Interest and related charges on new credit facility	2,790	7,916	11,325
Interest on separate subordinated notes	464	1,392	2,051
Distributable Cash (Note 1)	$ 8,269	$ 27,564	$ 42,602
Per Common and equivalent Common Share (Note 2)	$ 0.22	$ 0.74	$ 1.14
Interest on EIS Subordinated Notes	$ 1,944	$ 5,832	$ 8,591
Distributions on Common Shares	5,693	16,601	24,173
Distributions on non-controlling Class B preferred interest	381	1,143	1,680
Distributions on non-controlling Class B common interest	1,164	3,394	4,942
Total distributions (Note 3)	$ 9,182	$ 26,970	$ 39,386
Per Common and equivalent Common Share (Note 2)	$ 0.25	$ 0.72	$ 1.06
Hedge rate (Cdn$ per US$) (Note 4)	$ 1.1671	$ 1.1691	$ 1.1698
Distributable Cash (Cdn$) (Note 1)	$ 9,651	$ 32,225	$ 49,836
Per Common and equivalent Common Share (Cdn$) (Note 2)	$ 0.26	$ 0.86	$ 1.34
Excess (shortfall) distributable cash (Cdn$)	$ (1,066)	$ 694	$ 3,762
Per Common and equivalent Common Share (Cdn$) (Note 2)	$ (0.03)	$ 0.02	$ 0.10

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 interests into equivalent Common Shares. For the three month and nine month periods and for the period from date of inception through September 30, 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.

For the nine months ended September 30, 2006, the Company generated Cdn$32.2 million of Distributable Cash and distributed Cdn$31.5 million for a payout ratio of 97.9%. The Board of Directors monitors the distribution policy with respect to excess cash, forecasted cash flows, debt levels and spending plans and is prepared to adjust payout levels to balance desired distributions with the need to retain appropriate capital for business operations.

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006	Inception to September 30, 2006
Reconciliation of cash flows from operating activities to distributable cash:			
Cash provided by operating acttivities	$ 979	$ 23,842	$ 32,780
Interest on EIS Subordinated Notes	1,944	5,832	8,591
Accrued interest income	(316)	(696)	(751)
Accretion of asset retirement obligations	(50)	(151)	(218)
Changes in working captial	5,712	(1,263)	2,200
Distributable Cash	$ 8,269	$ 27,564	$ 42,602

Foreign Currency Exchange Contracts

The Company has entered into forward contracts to purchase Canadian dollars sufficient to make monthly distributions through September 2010 at the current 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 nine month period ended September 30, 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 $5.9 million. The fair value of these agreements was a net amount of $9.8 million of which, $1.9 million is recorded in current assets.

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 New 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 nine month period ended September 30, 2006, the net impact of the exchange in the fair value of the agreements resulted in an unrealized gain of $0.2 million. The fair value of these agreements was a net amount of $0.9 million as at September 30, 2006, of which $0.4 million is recorded in current assets.

Commitments and Contractual Obligations

The following table reflects the Company's contractual obligations and commitments related to outstanding indebtedness as of September 30, 2006 and the required payment by period due.

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

	September 30, 2006 Balance	2006	2007	2008	2009	2010	Thereafter
Notes Payable	$ 135,000	$ -	$ -	$ -	$ 135,000	$ -	$ -
Subordinated debt	86,075	-	-	-	-	-	86,075
Total	$ 221,075	$ -	$ -	$ -	$ 135,000	$ -	$ 86,075

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.

Transactions with Related Parties

Primary Energy Ventures LLC (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.

During the term of the Management Agreement, if the Manager decides to sell or otherwise alienate any Right of First Offer Project ("ROFO Project") (as defined in the prospectus), it will first provide an offer to the Company in respect thereof (an "Offer"). The Offer will set out a cash price for the ROFO Project and the proposed terms of sale. The Company will have 90 days after receipt of the Offer to accept such Offer or negotiate alternate terms of sale acceptable to the Company. If the Company agrees with the terms of sale for the ROFO Project prior to the end of the 90 day negotiation period, the Manager and the Company shall enter into definitive documentation to effect such transfer, which shall be accepted within 30 days thereafter or such longer period up to a maximum of 90 days as may be necessary to complete a shareholder vote by the Company (if required) or a financing (if required). If within the 90 day negotiation period the Offer is not accepted and the parties cannot agree on other terms then thereafter the Manager may sell the ROFO Project (subject to any changes in form or condition, financial or otherwise, which in the reasonable opinion of the Manager are not material taken as a whole) to a third party dealing at arm's length with the Manager at a price and on terms and conditions that, taken as a whole, in the reasonable opinion of the Manager are not more favorable to the third party than those contained in the Offer. To clarify, the Manager would be permitted to sell to the third party at a lower price than as set out in the Offer if one or more other terms and conditions of the transaction are more attractive than those contained in the Offer.

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 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. Energy Service revenue represents the revenue earned based on measurements of services performed each period. The Company provides estimates for doubtful accounts it deemed necessary based on the aging category and specific knowledge of the customers ability to pay. No such allowances were recorded at September 30, 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 30, 2006, which factors are incorporated at this time by reference which can be found on SEDAR at www.sedar.com, for a full description of the Company's risk factors. There were no changes during the quarter.

Recent Canadian Accounting and Related 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 make use of "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 a required disclosure under the new standard. These standards are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006 and are not expected to have a material impact on the consolidated financial statements.

Subsequent Event
On November 1, 2006, the Manager was acquired by EPCOR Power L. P., a Canadian Public Company. In connection with the acquisition, there were changes made to the Designated Employees of the Manager and the Company made certain changes to the composition of the Board of Directors. The Manager will continue to provide management services to the Company under its

existing management agreement. As a result of this transaction, the deferred tax liability of approximately $50.0 million ascribed to the non-controlling interest as described in Note 7 will be written off to non-controlling interest on the balance sheet by recording a tax benefit and a corresponding specific allocation to non-controlling interest in the consolidated statement of operations. The Company has filed a Material Change Report dated November 1, 2006 on SEDAR at www.sedar.com that provides additional disclosure related to the transaction.

Additional Information

Additional information relating to the Company, including the unaudited interim consolidated financial statements for the three months and nine months ended September 30, 2006 and the Company's Annual Information Form dated March 30, 2006, is available on SEDAR at www.sedar.com.