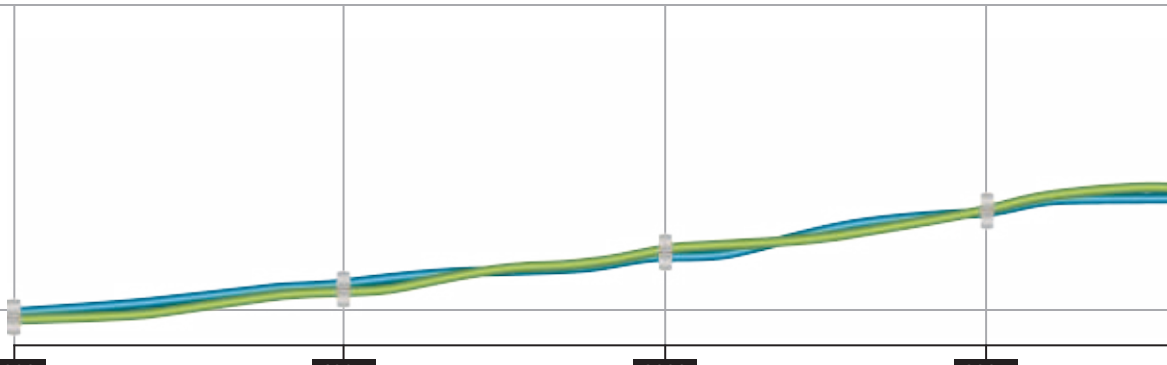
aeso
ALBERTA ELECTRIC SYSTEM OPERATOR

Listening
Balancing
Delivering

2010 Annual Report

In the last 20 years, demand for electricity has increased 88% and Alberta's GDP has risen 94%, yet the grid has not been significantly upgraded in more than two decades.

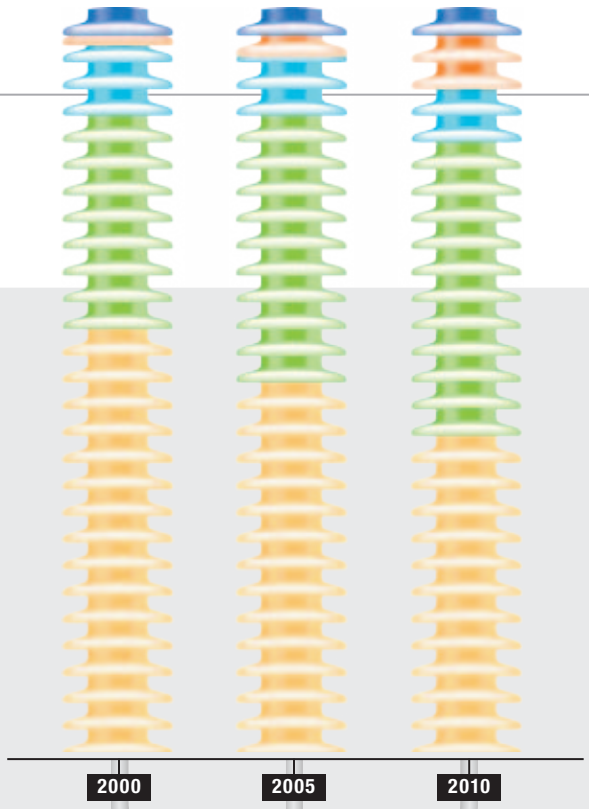
Annual Alberta Electricity Demand and GDP



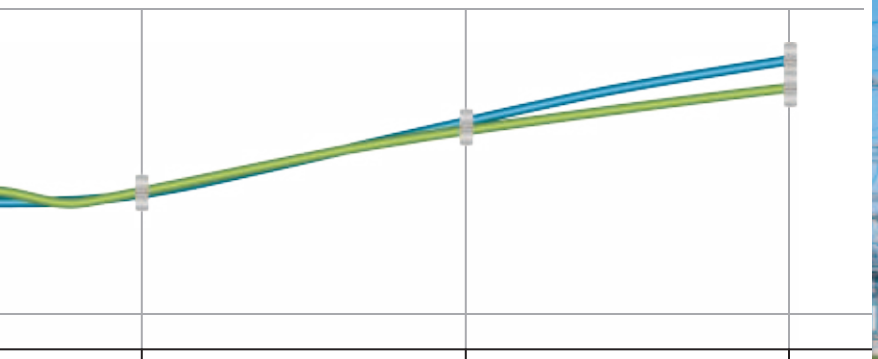
	1990	1995	2000	2005
Alberta GDP *($2002 Millions)*[1]	92,175	110,386	139,172	164,652
Average Hourly Load *(MWh)*	4,352	5,269	6,154	7,565

[1] *Source: Conference Board of Canada: Provincial Outlook 2010 Long-Term Economic Forecast*

Installed Capacity by Fuel Type

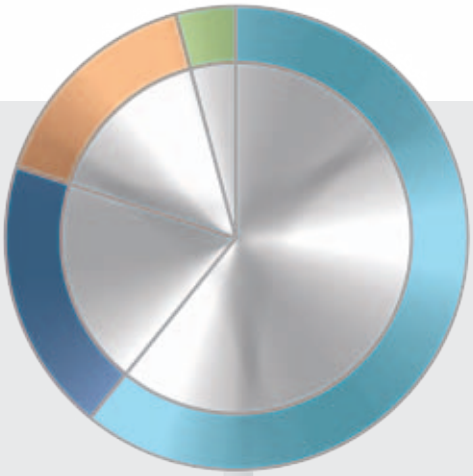


	2000	2005	2010
Other	2%	2%	2%
Wind	<1%	2%	6%
Hydro	9%	8%	7%
Gas	29%	37%	41%
Coal	60%	51%	44%



2010	2015	2020
178,891	220,677	248,334
8,188	10,377	12,368

Allocation of Transmission Costs by Sector



Industrial 61%
Commercial 19%
Residential 16%
Farm 4%

A reliable provincial grid is essential so that electricity finds its way to end-use customers whose livelihood and lifestyle depend on the processes, products and outcomes for which electricity is fundamental.

Albertans can expect the AESO to consult, to consider and to act. We are moving effectively towards delivery of several major projects.

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AESO Vision

The AESO will be seen as a significant contributor to the development of Alberta and the quality of life for Albertans, through our leadership role in the facilitation of competitive electricity markets and the reliable operation and development of the Alberta Interconnected Electric System.

AESO Mission

The AESO facilitates a fair, efficient and openly competitive market for electricity and provides for the safe, reliable and economic operation of the Alberta Interconnected Electric System.

Values

- Integrity
- Leadership
- Innovation
- Collaboration
- Quality

Strategic Objectives

- We will design and operate a competitive, energy-only electricity market where market evolution is driven by participants and the AESO.
- We will lead the development of a reliable transmission system including interties to other jurisdictions, which fully enables operation of the competitive market.
- We will consistently meet or exceed customer expectations in the delivery of system and market access services.
- We will ensure our workforce capacity and skill-sets meet business demand, while making the AESO an exceptional place to work, learn, succeed and make a difference.
- We will leverage leading technologies to improve customer service and the diversity, reliability and efficiency of system and market operations.
- We will build strong public, industry and government support to ensure effective execution of our mandate.

This year again presented its share of challenges and success for the province as well as for the Alberta Electric System Operator. The accomplishments of 2010 and challenging objectives for the upcoming year included in our 2010 annual report provide a sense of the breadth, diversity and complexity of the responsibilities placed upon the AESO.

As we move into 2011, there is reason to be optimistic about the prospects for the future of Alberta and, for the electric industry, a time to be cognizant of the demands renewed growth could place on us all. This optimism and the projections for investment in the energy sector reaffirms the importance of providing new transmission infrastructure to augment our stretched system and reliably deliver electricity which is an essential underpinning to provincial economic development.

At the AESO, we are proud of our role in facilitating the growth of renewable energy that has seen Alberta positioned at the forefront of wind power development and its role in the market. We expect the existing capability of wind will increase by more than 60 per cent in the upcoming year. As we all know, wind requires transmission to deliver the resource from where the wind blows to where the power is consumed. Through the work of AESO personnel and their industry partners, Alberta has gained a reputation as a North American leader in integrating wind resources.

Further development of other renewable resources such as biomass, solar and waste heat will serve an important niche in our electricity supply portfolio and natural gas is expected to play a key role in meeting future requirements. It is important to recognize as Albertans that generation investment is provided by the private sector on a competitive basis and that Albertans do not shoulder any investment debt. Recently, a third party study by The Brattle Group found that our market is sustainable and generally delivers an effective balance of pricing and investment incentives for Alberta.

Activities at the AESO continue to be challenged by increasing demands on many fronts. For example, in 2011 the AESO will be dealing with a substantial increase in customer connection projects. As Albertans, we are fortunate to have a dedicated, talented team of executives, management and employees who address these issues professionally and with integrity in their desire to serve the Alberta public interest. On behalf of our Board, I would like to acknowledge the leadership shown by David Erickson and his team.

"You may find yourself, as I have done, thinking throughout the day of the many things you would be prevented from doing if not for the availability of electricity."

This same dedication and commitment is exhibited at the Board level, and I would like to thank the AESO Board for its support and its role in the continuous improvement of the governance of the AESO. In the upcoming year I expect to execute a mandate and roles agreement with the Minister of Energy which will provide greater visibility and clarity for stakeholders respecting the relationship between the Alberta government and the AESO.

Bill Burch, a Board member since the inception of the AESO in 2003, retired in 2010. On behalf of our Board and all of us at the AESO, I would like to thank Bill for his outstanding contributions to the AESO and the Province of Alberta. I would personally like to express my appreciation to Bill for his sage advice and support over the last several years.

Looking forward, I am confident that, working with stakeholders, the AESO will continue to provide Albertans with exceptional service and effective governance of our electrical system. The AESO will also continue in its role as a not-for-profit organization, acting in the public interest and providing objective information to Albertans.

I invite every Albertan to visit our AESO website **www.aeso.ca** and the Powering Alberta website **www.poweringalberta.com** to gain further insight into this fascinating and complex business of electricity. You may find yourself, as I have done, thinking throughout the day of the many things you would be prevented from doing if not for the availability of electricity. This simply reinforces the importance of what the industry does.

Harry Hobbs
Chairman
April 2011

Message from the President and Chief Executive Officer

I am pleased to report that 2010 was very productive for the AESO, having spent the year consulting with and *listening* to our stakeholders, *balancing* competing views in our efforts to serve all Albertans, and *delivering* or advancing several important initiatives in the fulfillment of the AESO's mandate.

In our continuing efforts to strengthen the reliability of Alberta's electricity grid, 36 transmission needs applications were filed with the Alberta Utilities Commission (Commission). This number represents a significant increase over 2009 and it is expected that an even greater number will be filed in 2011. The approval of these applications will reflect significant progress in upgrading the province's aging transmission infrastructure, although with more than 250 regional transmission and customer connection projects in the planning or implementation phase, there is still a lot of work to be done.

Additionally, we continued to support transmission facility owners as they advanced the Critical Transmission Infrastructure (CTI) projects identified in our 2009 *Long-term Transmission System Plan*. Given the significant need for these projects, it is imperative that they remain on schedule and they are.

Last year we consulted with stakeholders extensively to establish a competitive process to facilitate the building of the Fort McMurray Transmission System Reinforcement Project and any projects designated as CTI in the future, if any. Establishing this process is a complex undertaking with engineering, legal, financial and regulatory implications. Therefore, we are listening carefully to and evaluating all stakeholder feedback to ensure we create a fair, effective and transparent process that will be submitted to the Commission for approval in 2011.

Given the changes that have occurred in Alberta and around the world over the last several years, and those forecasted to occur throughout the balance of this decade, we felt it would be prudent to obtain an independent assessment of the ongoing sustainability of Alberta's energy only market structure. The conclusion drawn by The Brattle Group was that despite challenges, they saw no compelling need for major changes in the market design and that the outlook for new generation to ensure resource adequacy was encouraging. Based on this it is our intention to continue to promote the current market design while focusing on continued enhancements.

In 2010 we began implementation of the first phase of a comprehensive wind integration plan to ensure we are able to effectively integrate alternative sources of energy. We expect up to 1,100 MW of wind generation to be online in Alberta in 2011, nearly double the level of wind on the system in the beginning of 2010. In 2010, we outlined tools and practices the AESO will utilize to enable reliable operation of the system, including initiation of a wind forecasting program, upgrading the technical interconnection rules for wind facilities, and how we will employ wind power management and the use of ancillary services to ensure reliable operation of the system. In 2011, we will continue to work with stakeholders to explore further measures to integrate increasing levels of wind capacity.

"I firmly believe the AESO's ability to deliver high quality services to all Albertans is, in part, a direct result of the wisdom we gain from our stakeholders."

Extensive consultation with stakeholders in 2010 led to the recommendation of a revised intertie framework, as the AESO works to integrate Alberta's first merchant tie to another jurisdiction. The Montana-Alberta Tie Line (MATL) is under construction and expected to energize in late 2011, requiring extensive work by the AESO to update rules, procedures and re-configure systems for full integration. This work advances in 2011, along with continued consultation on the broader framework for interties going forward.

The AESO is also working with stakeholders on demand response initiatives to enable consumers of electricity to play a greater role in maintaining the balance of supply and demand on the system.

With the level of congestion on the electricity grid steadily increasing pending reinforcement of the system, the AESO has been working on parallel initiatives to manage transmission constraints in both real time and the planning domain. A revised rule to manage real time congestion was recently approved by the Commission and we are moving ahead with implementation in 2011. The AESO is also working with stakeholders to clarify our business practices when temporary constraints exist, in order to connect customers until such time as the necessary transmission facilities are in place to alleviate these constraints.

We've also taken steps to strengthen and make our organization more effective and efficient both internally and in our service delivery. Internally, improvements were made in our performance management processes, internal governance and education and awareness programs. In terms of service delivery, we implemented the newly designed connection processes, which will allow us to achieve faster connections while maintaining the same high quality standards for which we are known.

The AESO built significant organizational momentum in 2010, positioning ourselves to execute on a number of key priorities in 2011, including:

- Initiatives to restore intertie capacity and integrate merchant projects, and continued consultation with industry to enhance the intertie framework
- implementation of market enhancements to enable integration of intermittent resources
- release of the updated *Long-term Transmission System Plan*
- delivery of transmission projects and continued refinement of our customer connection and system project management processes
- finalization of the competitive process for CTI projects
- development of an enhanced cost reporting and monitoring strategy
- delivery of exceptional service to our customers

In closing, let me extend my appreciation to the AESO Board for their ongoing support and guidance, as well as our employees for their commitment, focus and integrity in the service of listening, balancing and delivering. I would also like to thank our stakeholders for their valuable input. Although we may not agree on all matters, I firmly believe the AESO's ability to deliver high quality services to all Albertans is, in part, a direct result of the wisdom we gain from our stakeholders. We will continue to employ our expertise and that of our stakeholders to enhance the safe, reliable and economic operation of Alberta's electricity system and the operation of its energy market.

David Erickson
President & CEO
April 2011

Strategy and Performance at a Glance

Our pride is reflected in not only what we achieve, but how we achieve it.

AESO Principles – What We Value

Credible Character

- We proactively serve the interests of all Albertans. We are objective, focused and dependable.

High Performance

- We deliver high quality work, focus on where we add value and seek to continuously improve. We take pride in effectively executing our mandate.

Service Driven

- We earn the respect and trust of our stakeholders by providing fair, efficient and reliable service and through clear, timely and transparent communication.

Great Teamwork

- We foster an environment of respect, excel at collaboration and have great expectations of one another. Living up to our commitments enables us to be part of a successful team and a great organization.

Strategy	2010 Objectives
Planning and Strategy	▪ Update the *Long-term Transmission System Plan* for 2011 filing with the Alberta Utilities Commission
	▪ Develop new processes for Critical Transmission Infrastructure (CTI)
	▪ Complete a review on the evolution of the wholesale market
Program Delivery and Execution	▪ Effective execution of CTI, system and customer projects
	▪ Effective execution of market and systems operations projects
Effective Business Operations	▪ Operational efficiency and excellence
Sustainable Organization	▪ Improve human resources planning, including performance management
	▪ Improve reputation and brand awareness

2010 Performance Highlights	2011 Objectives
▪ Updated load and generation forecasts based on the evolving economic recovery and dynamic federal policy environment ▪ Transmission review studies completed with a view to filing the updated *Long-term Transmission System Plan* by June 2011	▪ File the updated *Long-term Transmission System Plan* in June 2011 and continue to enhance the system planning process ▪ Develop a transmission cost reporting and monitoring strategy that ensures compliance with all current obligations, clarifies roles of all participants, and enhances ongoing cost control and oversight ▪ Implement a corporate portfolio management process that improves discipline and better integrates strategic planning, project management, budget development, resource planning and performance reporting
▪ Competitive process to procure CTI projects initiated ▪ Discussion paper released and benchmarking with other jurisdictions completed	
▪ Commissioned independent assessment of market sustainability, the results of which will be released in 2011 and will endorse the existing market structure	
▪ Worked with TFOs to advance CTI projects: Heartland and South Calgary facility applications filed; HVDC facility applications on target for Q1 2011; stakeholder input for Fort McMurray competitive process received ▪ Improvements to system and customer connection processes implemented with the commensurate benefits starting to be realized ▪ Heightened focus created on cost reporting and third party validation of estimates provided by transmission facility owners (TFOs) ▪ Five system and 31 customer needs applications filed ▪ Issued notice to file facility applications to TFOs for over 50 regional and customer connection projects	▪ File competitive process application for approval with the Alberta Utilities Commission ▪ Continue to prudently advance CTI, system and customer projects in accordance with the 2011 *Long-term Transmission System Plan* ▪ Provide enhanced cost visibility and reporting ▪ Continue to improve execution of customer connection projects by use of metrics and process streamlining ▪ Advance the evolution of the market by developing and implementing market enhancements to enable the integration of intermittent resources and the continued growth of the market ▪ Continue consultation with industry stakeholders to enhance the intertie framework ▪ Successfully integrate the Montana-Alberta Tie Line to the provincial grid
▪ First phase of a wind integration management plan designed and initiated ▪ Long-term intertie framework developed to facilitate development of new intertie capacity ▪ Initiated consultation on broader intertie framework	
▪ Zero preventable system disturbances and no market suspensions ▪ Complied with all Alberta Reliability Standards, WECC Regional Criteria and Commission and ISO Rules ▪ Transmission Constraints Management (TCM) Rule filed with the Alberta Utilities Commission and approved in early 2011 ▪ Established a replacement plan for disaster recovery facilities ▪ Delivered cost efficiencies and managed the business on budget	▪ Manage the customer relationship model to deliver high-quality services that enable success for our customers ▪ Implement a revised corporate metrics program to facilitate reporting of the AESO's progress against its strategic objectives
▪ Advanced the approaches to performance management, organizational design and human resources planning, including succession, retention and development ▪ Integrated a transparent capital portfolio management process with the Business Review Process	▪ Establish a high-performance workforce by continuing to attract, engage and retain talent ▪ Create effective and efficient communication outreach and awareness programs in support of the industry initiative to increase understanding of the electricity industry
▪ Developed education, awareness and consultation programs resulting in increased public knowledge of the electricity industry	

Getting Regional Advice

Our six Regional Advisors – with their diverse backgrounds in government, industry and academia – augment our direct stakeholder engagement efforts by helping us to stay abreast of local concerns and opportunities.

Regional advisors provide the AESO with feedback and suggestions on our corporate initiatives and insights about how we can improve our efforts to educate and inform Albertans about the electricity industry.

"We can help Albertans see the value of active involvement in our electric system and support the AESO in working with local perspectives."

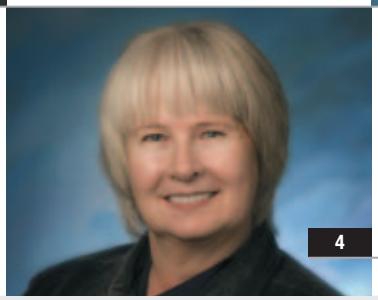
Sandy McDonald

"The AESO listens to Albertans and carefully balances the need for development with the rights of landowners and protection of the environment."

Jim Graham

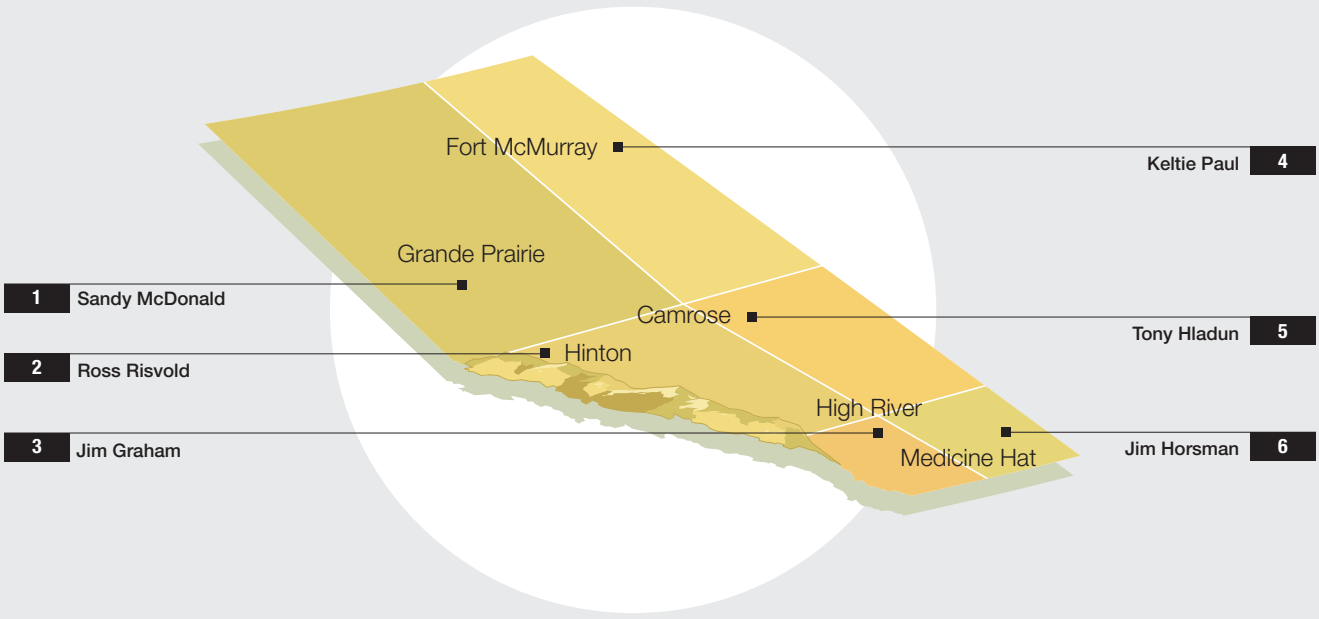
"We bring regional depth to the information the AESO considers and acts upon to provide competitive and reliable electricity to Albertans."

Ross Risvold



"There has been huge growth in the northern region resulting in a strain on infrastructure. We need to make sure that additional electricity capacity is built in a timely way."

Keltie Paul



The six advisors were selected through a public process for their community involvement, their knowledge of regional issues and their diverse experience and expertise.

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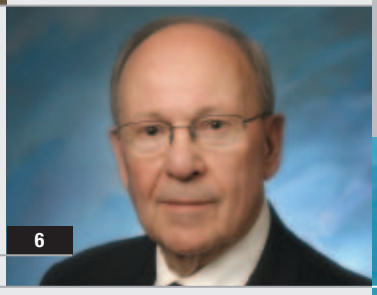
"It's important for the AESO to listen to Albertans, analyze future needs using best industry practices, and act prudently."

Tony Hladun

"Communication is essential because Albertans have rising expectations for secure electricity that are challenged by the need for new generation and transmission."

Jim Horsman



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We have been working successfully with our advisors to incorporate their expertise and knowledge into our outreach programs, consultation processes, communication and organizational initiatives.

Listening Balancing Delivering

The AESO works daily with stakeholders, including landowners, elected officials, industry, First Nations and environmental groups. It is vital for us to pay attention to stakeholder views – wide ranging and often conflicting – and to consider these views carefully in our operations and planning.

Stakeholder relations at the AESO is built on the principle that all stakeholders must have the opportunity to be informed of, and to comment on, the AESO's plans, decisions and actions – in a timely way.

A major assigned accountability of the AESO is balancing. We balance electricity supply and demand in the province, minute by minute, hour by hour, every day and night of the year. And we balance our imperative to act decisively and in a timely manner with our commitment to transparent, thorough consultation and review processes.

Balancing is a big part of what the AESO was created to do, and it continues to be central to what we do today.

It is not enough for the AESO to listen to stakeholders and undertake to balance their interests; the AESO must act. It must implement decisions, procedures and projects. Delivering in a clear, decisive and timely manner – and to high standards – is an important measure of the AESO's value in the Alberta electric industry.

We know we cannot act alone, without consulting stakeholders. The consultation process invariably leads to better results. But we also know that it will never be possible to satisfy all stakeholders – some of whom have openly competing interests. In 2011 and beyond, Albertans can expect the AESO to focus on delivery of the projects we have been consulting thoroughly about in recent years.

"We focus on delivering timely results – rules, procedures, IT solutions and connections – while ensuring that the long-term strategic needs of Albertans are met."

Sandra Scott, Senior Vice-President, Corporate Services and Chief Information Officer

Key Initiatives

"Employees take great pride in carrying out our mandate every day on behalf of all Albertans – with objectivity, focus and integrity."

Cliff Monar, Senior Vice-President

The AESO continuously assesses the needs of the transmission system to continue to meet reliability standards and requirements. In compliance with the *Electric Utilities Act* and the *Transmission Regulation*, we plan the development of the grid to ensure transmission is in place ahead of load growth and generation development to facilitate a competitive marketplace for electricity in Alberta.

We have more than 250 significant transmission system reinforcement projects in progress – under construction, approved for construction, pending regulatory approval or under development. We will continue to purposefully advance Critical Transmission Infrastructure (CTI), regional and customer projects. Transmission planning is an ongoing process however, thus we will continue to refine our plans as future events unfold.

Progress on CTI Projects

Steady progress was made on all CTI projects identified in the AESO's 2009 *Long-term Transmission System Plan*.

South Calgary

In 2010, ENMAX filed a facility application to construct the proposed ENMAX No. 65 substation. The substation will improve capacity and reliability, and ensure the transmission system can meet current and future demand for electricity in south Calgary. In 2011, AltaLink will file a facility application for a new transmission line to connect the new substation to one of its existing lines.

Heartland

The Heartland Transmission Project will form the foundation for the supply of electricity into all of northeast Alberta. It will support oilsands development, local demand in the Heartland area and will strengthen the entire provincial network, benefitting all Albertans.

A joint AltaLink/EPCOR facilities application was filed with the Commission in September 2010 and a Commission hearing commenced in April 2011.

Edmonton to Calgary HVDC

Two high voltage direct current lines between Edmonton and Calgary are required to address issues with reliability, maximize efficiency, accommodate long-term growth and lead generation decisions. Reinforcement also is needed to restore capacity on the B.C. intertie to its full design capacity.

Two TFOs have been assigned to these important projects – AltaLink and ATCO. AltaLink will build one line located in the west/central portion of the province, connecting the existing Wabamun Lake hub west of Edmonton to the Calgary-area hub near Langdon. ATCO will build one line located on the eastern side of the province connecting the Heartland hub northeast of Edmonton to a southern hub in the Brooks area. Facility applications for both lines were filed in the first quarter of 2011.

Fort McMurray

The expected growth of the oilsands industry is the primary driver for additional transmission infrastructure in the northeastern part of the province. This project will be the first CTI project to adhere to the Competitive Process currently being developed by the AESO.

Regional Projects Update

Of equal importance to CTI projects, more than 250 regional and customer connection projects are currently underway. The year 2010 saw significant progress on a number of key projects, including:

Hanna Region Transmission Reinforcement Project

The need for the Hanna Region Transmission Reinforcement Project was approved by the Commission in April 2010. This $1-billion staged project will meet expected oil and gas pipeline loads and provide access to market for about 700 MW of expected wind development by 2017. A subsequent amended Needs Identification Document (NID) was approved by the Commission in early 2011, together with AltaLink's permit and license application, resulting in the near-term construction of a new substation.

Yellowhead Area Transmission Development

This project to upgrade transmission in the Yellowhead region received needs approval by the Commission in June 2010. An in-service date of 2011 is expected.

Central East Region Transmission Development

The AESO filed a NID in May 2010 to upgrade transmission in the Central East region. This staged project will connect load and generation, meet growing demand from oilsands developments and pipelines, and interconnect proposed gas-fired generation and wind farms in the area.

"Sound and transparent budgeting, financial management processes and reporting are hallmarks of the AESO."

Todd Fior, Vice-President, Finance

Competitive Process

In October 2010, the government amended the *Transmission Regulation* to provide the AESO with, among other things, the ability to implement a competitive process. Specifically, the AESO must develop a competitive process for the construction or operation, or both, of the Edmonton to Fort McMurray CTI project and future CTI projects, including interties. This process will enable all qualified bidders to compete in a fair, transparent and open environment for the right to build, own and operate or transfer specific elements of transmission infrastructure.

The AESO is committed to developing a fair competitive procurement process that encompasses input and support from stakeholders. Consultation began in 2010 and will continue in 2011 as we work towards establishing a timely and cost-effective process, while maintaining the integrity of the transmission system as a whole.

Transmission Facilities Cost Monitoring Committee

The *Transmission Regulation* clarified the roles of industry participants on the Transmission Facilities Cost Monitoring Committee to provide consumers with increased transparency on costs for large projects. The AESO facilitates the provision of project records to the Committee. Representatives from the AESO, nine consumer and business groups and two independent members comprise this committee.

Wind Integration

In January 2010, the AESO signed a two year contract with Denmark-based wind forecasting company WEPROG to provide centralized wind power forecasts for Alberta. WEPROG's service will provide wind power forecasts ranging from 10 minutes to 144 hours ahead, which will enable our system operators to better anticipate the amount and timing of wind available to the grid.

We developed the first phase of a wind integration framework in 2010 to safely integrate 1,100 megawatts (MW) of additional wind power by the end of 2011. We also released a recommendation paper and began consultation on the implementation of the second phase of the plan to integrate increasing wind capacity beyond 2011.

"The AESO balances competing interests through the lens of the public interest – both short and long-term."

Shan Bhattacharya, Vice-President, Transmission

Needs Identification Documents Filed and Approved

In 2010 the AESO filed 36 Needs Identification Documents (NIDs) with the Alberta Utilities Commission. This represents a significant increase over 2009 and it is expected that an even greater number will be filed in 2011. In 2010, two system NIDs and 17 customer connection NIDs have been approved by the Commission. The remaining are still under review.

Long-term Transmission System Plan

The AESO's *Long-term Transmission System Plan* provides market participants, customers, government and interested stakeholders a view of the proposed development of Alberta's transmission system over the next 10 to 20 years. The plan is a blueprint for ensuring a robust transmission system that will provide reliable service to Albertans for years to come. It facilitates a competitive marketplace that recognizes investment in new load and required generation depends on access to an unconstrained and efficient transmission system.

The plan is developed in consultation with stakeholders and filed for information with the Commission every two years. We are in the process of updating the plan and will file it with the regulator in June 2011.

"We will earn the respect and trust of our stakeholders by continuing to provide fair, efficient and reliable services."

Kelly Gunsch, Vice-President, Market Services

Improved Business Processes and Operations

Internally, we are working to establish a more highly disciplined business planning process that integrates strategic planning, project management, budget development, resource planning and performance measures.

System and Customer Connection Improvements

In 2010, the AESO introduced fundamental changes in the organizational structure of our Transmission business unit. To deliver on our commitment to enhance our project delivery and execution capabilities, project delivery teams were aligned geographically by the formation of a north team and a south team. Project delivery teams are responsible for both system development and customer connection projects.

The success of this organizational change is evident. Following several months of stakeholder consultation, the AESO implemented a new customer connection process in April 2010 with the objective of having a more effective and efficient process to connect customers to the grid. This improved process will lead to improvements in NID preparation practices, including the ability to delegate NID preparation to TFOs where efficiencies can be gained.

"In addition to the AESO's consultation activities, Alberta's regulatory process offers parties impacted by our proposals opportunities to influence them."

Heidi Kirrmaier, Vice-President, Regulatory

Transition of Authoritative Documents

In order to carry out our responsibilities, the AESO is given authority through legislation to make Independent System Operator (ISO) Rules, adopt or make Reliability Standards and to prepare an ISO Tariff. These documents are referred to as the AESO's authoritative documents.

Authoritative documents are used by the AESO to communicate binding and legal rights, requirements and obligations of market participants and the AESO. Compliance with the requirements set out in authoritative documents is mandatory. We have been working with stakeholders since 2009 to transition these documents to a consistent format and structure and eliminate duplication among documents. Many documents were transitioned in 2010 and we expect the project to be completed in 2012.

Reliability Standards

The AESO continues to review North American Electric Reliability Council (NERC) reliability standards and following consultation with stakeholders, the AESO filed six Alberta Reliability Standards for approval with the Commission in 2010. A total of 34 standards have been approved since the initiative began in 2009, and another 37 standards are in various stages of consultation.

Tariff

Following more than a year of stakeholder consultation, the AESO filed the 2010 General Tariff Application with the Commission in March 2010. This filing was the culmination of work by the AESO's Regulatory team, including upwards of 40 meetings with more than 50 stakeholders from across the industry.

The Commission approved most of the AESO's proposed tariff changes in Decision 2010-606, issued on December 22, 2010. The AESO submitted a compliance filing on February 6, 2011 in response to directions in the decision, and expects the approved tariff to become effective on July 1, 2011.

Demand Response

The AESO engaged the Brattle Group in late 2010 to assess potential demand response opportunities in Alberta. The Brattle Group has a wide range of experience in developing demand response programs and has provided an independent assessment of the potential for demand response in Alberta. The AESO will be exploring The Brattle Group's recommendations with stakeholders in 2011.

"We excel at the implementation of innovative solutions to complex grid and market challenges to ensure the safe, reliable operation of the Alberta Interconnected Electric System."

Mike Law, Vice-President, Operations

Transmission Constraints Management and Remedial Action Schemes

The AESO has been engaging with stakeholders to develop rules for constraints management since 2008. With congestion levels steadily increasing, we are working on parallel initiatives to manage constraints on the system in both real time and planning domains. A revised Transmission Constraints Management (TCM) Rule was filed in 2010 in compliance with the Commission's decision, and it was approved in early 2011. We also completed consultation on a draft Remedial Action Scheme Rule to clarify our business practices when temporary constraints exist, in order to connect customers until such time as the necessary transmission facilities are in place.

Interties

Last year we released discussion and recommendation papers on the restoration of intertie capacity as well as a long-term intertie framework for the province. This includes recommendations intended to achieve successful integration of the Montana-Alberta Tie Line into the Alberta grid. We will continue to seek stakeholder input in 2011 as we draft new ISO Rules for available transfer capacity for all interties bordering Alberta.

Additionally, in 2010 we released an Expression of Interest for a Load Shed Service for Imports (LSSi), a reliability product to help increase import levels through our interties. Implementation of this product is scheduled for the second quarter of 2011.

Information Technology Improvements

In June 2010, the AESO upgraded the Dispatch Tool (DT) and the Automated Dispatch and Messaging System (ADaMS) to improve reliability, stability, and sustainability of these system coordination computer systems, primarily through strengthening the underlying technical architecture.

We used the real-time operations planning capabilities of our newly upgraded Energy Management System to deliver increased system visibility and maximize transmission capabilities in congested environments.

Public Education and Engagement

The AESO's public engagement efforts continued last year as we contributed to increased knowledge and understanding of electricity among Albertans with our education, awareness-building and consultation programs.

From 2007 to 2010, the AESO hosted or supported 247 open houses about transmission projects, attended 283 meetings with municipalities or small stakeholder groups, and interacted directly with more than 13,250 people face-to-face.

Our commitment to energy literacy continued last year with the fifth publication of *Powering Albertans* magazine. This issue was delivered to approximately 1.3 million Alberta households through mail and newspaper insert delivery.

We will continue to engage with our stakeholders, customers and the public. Plans for 2011 include two issues of Powering Albertans, continued stakeholder consultation and participation in energy literacy initiatives.

Corporate Governance

Governance is a philosophy, an approach and a process. The AESO's governance structure, policies and practices are driven by the vision, mission and values of the organization.

Fundamental to governance is the clarity it brings to accountability and the roles of the AESO Board, AESO executive, management and employees.

The AESO's structure provides for a strong governance model. The AESO's governance model promotes best practices, ethical behaviours, accountability and transparency to stakeholders (internal and external) in its business dealings.

AESO Board

The Independent System Operator, operating as the Alberta Electric System Operator (AESO), is a statutory corporation established on June 1, 2003 under the *Electric Utilities Act* (EUA) of the Province of Alberta. The AESO is governed by its legislative mandate and by its Board (AESO Board), which consists of Members appointed by Alberta's Minister of Energy (Minister) under Section 8 of the EUA.

The AESO Board is responsible for overseeing the business and affairs of the AESO. The AESO Board is actively involved with the AESO executive in the strategic planning process, and discusses and approves the AESO's strategic plan. On an ongoing basis, the AESO Board conducts financial oversight of all corporate operations, including cost and risk management. How the AESO Board conducts its affairs is contained in the AESO Bylaws. A copy of the AESO Bylaws can be found at **www.aeso.ca/bylaws**

In accordance with the EUA and the AESO Bylaws, the AESO Board must recommend to the Minister individuals to be appointed as members of the AESO (Members) and may recommend to the Minister an individual to be designated as Chair. There are a maximum of nine Members on the AESO Board. The AESO Board, its Committees and Task Force have the authority to independently obtain and retain consultants or other advisors.

In addition, the *Alberta Public Agencies Governance Act* will provide guidance to assist the effectiveness of the AESO. The AESO is developing documentation to meet certain requirements of this legislation, including a mandate and roles document.

AESO Board, Committees and Task Force

The AESO Board has established three standing Committees and one standing Task Force. Each operates in accordance with its own AESO Board-approved charter and with a view to following best practices.

Audit Committee (AC)

The AC provides consultation, advice and recommendations to the AESO Board on financial reporting matters, systems of internal controls, systems for managing risk, the external and internal audit processes and the AESO's process for monitoring compliance with laws and regulations.

Human Resources, Compensation and Nominations Committee (HRCNC)

The HRCNC provides consultation, advice and recommendations to the AESO Board with respect to human resources, compensation and Member nomination matters. This includes AESO executive compensation levels, AESO President and Chief Executive Officer's (AESO CEO) performance, the AESO's performance, officer selection, executive succession planning, human resources programs (including salary planning, benefits and incentive design), and human resources practices.

Corporate Governance Committee (CGC)

The CGC provides consultation, advice and recommendations to the AESO Board on corporate governance matters. This includes maintaining and enhancing the AESO's corporate governance practices. It also includes identifying and recommending the criteria and processes for a number of AESO Board practices in meeting its statutory duties and responsibilities.

Transmission Advisory Task Force (TATF)

The TATF provides the AESO Board with assistance and recommendations in fulfilling certain of the AESO Board's governance and oversight responsibilities related to the planning and development of the Alberta Interconnected Electric System, otherwise referred to as the transmission system.

Members

The Members have extensive knowledge and experience in various industries, including energy, utilities, technology and government. The following are Members who served during 2010:

Member	Member Since	Current AESO Board Position	Committee/Task Force Member
Harry Hobbs	2004	Board Chair	Audit; CGC; HRCNC; TATF
Bill Burch[1]	2003	Vice-Chair	Audit; HRCNC
Nancy Laird	2003	Member	Chair CGC; HRCNC
Hugh Fergusson	2007	Member	Chair HRCNC; CGC
Robert McClinton	2007	Member	Chair Audit; HRCNC
Jan Carr	2009	Member	Audit; TATF
Gordon Ulrich[2]	2009	Vice-Chair	Chair TATF; Audit
Paul McMillan[3]	2010	Member	Audit; TATF
Linda Chambers[3]	2010	Member	CGC; TATF
J.D. Hole[4]	2010	Member	HRCNC; TATF

[1] *Term ended effective August 31, 2010.*

[2] *Appointed Vice-Chair effective September 1, 2010.*

[3] *Appointed April 21, 2010.*

[4] *Appointed December 1, 2010.*

AESO Board Effectiveness

AESO Board Evaluation

The AESO Board, its Committees and Task Force have self-evaluation processes in place. The self-evaluation is performed on an annual basis.

Meeting Attendance and Remuneration

In 2010, the attendance of the Members at AESO Board, Committee and Task Force meetings was as follows:

AESO Board	AESO Board	AC	HRCNC	CGC	TATF	Meeting Attendance	Per cent Attendance	2010 Total Remuneration
Harry Hobbs	9 of 9	4 of 4	5 of 5	3 of 3	4 of 4	25 of 25	100%	$ 125,584
Bill Burch[1]	5 of 5	1 of 2	2 of 2	N/A	N/A	8 of 9	89%	$ 32,611
Nancy Laird[2]	8 of 9	N/A	5 of 5	3 of 3	N/A	16 of 17	94%	$ 54,584
Jan Carr[2]	8 of 9	4 of 4	N/A	N/A	4 of 4	16 of 17	94%	$ 47,424
Hugh Fergusson	9 of 9	N/A	5 of 5	3 of 3	N/A	17 of 17	100%	$ 53,592
Robert McClinton	9 of 9	4 of 4	3 of 3	N/A	N/A	16 of 16	100%	$ 55,584
Gordon Ulrich[3]	9 of 9	4 of 4	N/A	N/A	4 of 4	17 of 17	100%	$ 55,427
Paul McMillan[4]	7 of 7	3 of 3	N/A	N/A	4 of 4	14 of 14	100%	$ 35,410
Linda Chambers[4]	7 of 7	N/A	N/A	3 of 3	4 of 4	14 of 14	100%	$ 19,723
J.D. Hole[5]	1 of 1	N/A	1 of 1	N/A	N/A	2 of 2	100%	$ 4,535
Attendance	72 of 74	20 of 21	21 of 21	12 of 12	20 of 20	147 of 150	N/A	
% Attendance	97%	95%	100%	100%	100%	98%	N/A	

[1] *Term ended effective August 31, 2010.*

[2] *Unable to attend a non-regularly scheduled AESO Board meeting.*

[3] *Appointed Vice-Chair effective September 1, 2010.*

[4] *Appointed April 21, 2010.*

[5] *Appointed December 1, 2010.*

Remuneration of Members

A summary of remuneration Members are eligible to receive is as follows:

Chair – retainer	$90,000/year
Member – retainer	$25,000/year
Committee and Task Force Chair – retainer	$5,000/year
AESO Board, Committee and Task Force meetings	$1,000/meeting
Additional AESO business	$1,000/day

Benefits

Members are eligible to receive certain health and insurance benefits.[1]

The total remuneration provided to the Members in 2010 was $484,474.00.

AESO Executive Compensation

Program Objectives

The AESO compensation program (Program) is an integrated program designed to attract, retain and motivate the caliber of executives required to support the achievement of our statutory mandate, corporate vision and business objectives. Accordingly, the compensation philosophy and programs have been built on the following objectives:

- to focus executives on the AESO's business objectives;
- to attract and retain qualified and talented executives to carry out the AESO's mandate; and
- to reward a combination of demonstrated results and competencies.

The philosophy underlying these objectives is that total compensation for the AESO executive must be competitive with industry comparators to attract and retain the skills and competencies necessary to fulfill the AESO's mandate.

Program Governance

The AESO Board delegates the responsibility of Program governance to the HRCNC. The HRCNC reviews compensation objectives, policies and programs and makes recommendations to the full AESO Board.

[1] *Benefits include dental, health, life insurance and accidental death & dismemberment insurance.*

The AESO Board and HRCNC, in carrying out their respective mandates, have access to AESO management's perspectives as well as those of expert consultants. Executive compensation is reviewed annually with respect to Program design, industry compensation trends, internal compensation and external market relativities.

Market Comparisons

The AESO regularly benchmarks compensation to similar positions in Canadian industry. The peer group comparators include a mixture of utilities, energy companies and public sector organizations.

Market data is compared with respect to base pay, total cash compensation (base salary and short-term incentive), and total direct compensation (base salary, short-term incentive, perquisites and long-term incentives). Base compensation is targeted at the 50th percentile[2] of market. There is no long-term incentive plan in place at the AESO.

In addition to the comparisons outlined above, the AESO Board reviews available compensation data for other North American Independent System Operators to determine if broader North American trends should be considered.

Program Description – Roles

The AESO's total compensation program includes base pay, a short-term incentive plan, a flexible benefits program, and a group retirement and savings program. For analysis and advice on industry comparators, compensation trends and comparator information, the HRCNC obtains the services of an independent expert. The HRCNC reviews the information and confers with the AESO CEO. Pay for performance adjustment recommendations are based on demonstrated results and competencies and are then put forward to the AESO Board for review and approval.

Program Description – Base Pay

Base pay is individually determined for each executive position based on comparative market. Base pay increases are based on individual performance on key accountabilities, achievement on business objectives and demonstration of competencies, as recommended by the HRCNC and approved by the AESO Board.

[2] *The 50th percentile is the benchmark most commonly used by peer group comparators.*

Program Description – Short-Term Incentive Plan

The short-term incentive plan (STIP) is an annual program available to all AESO employees and subject to the discretion of the AESO Board. Subject to AESO Board approval, the STIP is a lump sum cash award based on two components: corporate performance and individual performance.

The corporate component achievement is recommended by the HRCNC and is subject to approval by the AESO Board. The individual component achievement is recommended by the HRCNC and is factored in to the total incentive payment. In the event a corporate component is awarded by the AESO Board, both components are used to determine resulting incentive payments.

The AESO CEO's target STIP is 50 per cent of base pay earnings, with the ability to earn up to 100 per cent of earnings; the Senior Vice-Presidents' target STIP is 35 per cent of earnings with the ability to earn up to 70 per cent; and the Vice-Presidents' target STIP is 25 per cent of earnings with the ability to earn up to 50 per cent.

Program Description – Flexible Benefits

The flexible benefits program provides for life insurance, dependent life insurance, accidental death and dismemberment, sick leave and short-term disability, group and individual long-term disability, critical illness, dental and health care benefits, as well as a health spending account for additional relevant expenses. Perquisites such as parking and fitness allowance are provided.

Program Description – Registered Retirement and Group Savings Plans

A group plan is provided in which the AESO contributes 6 per cent of base salary to a registered retirement or non-registered savings account. In addition, the AESO will match up to 3 per cent of salary for any voluntary contributions made. This can result in a total retirement savings contribution of 9 per cent of base salary by the AESO.

Other Considerations

Employment agreements outlining severance provisions for termination without cause are in place for two executives.

AESO Executive Compensation

The table below details the total compensation for the year ended December 31, 2010 for the executive officers listed.

Position	Name	Year	Base Salary	STIP	Perquisites[1]	Benefits & Savings[2]	Other[3]
President & CEO	David Erickson	2010	399,999.84	281,999.89	12,420.00	45,975.00	–
SVP Corporate Services & CIO	Sandra Scott	2010	285,600.00	144,942.00	5,570.00	35,679.00	–
SVP	Cliff Monar	2010	253,174.79	115,194.53	7,293.60	32,760.82	–
VP Operations	Mike Law[4]	2010	224,772.64	81,480.08	6,750.00	30,204.54	75,000.00
VP Finance	Todd Fior	2010	208,353.82	70,319.41	6,262.50	28,726.72	–

[1] *Perquisites include parking and fitness allowance.*

[2] *Benefits & Savings include group savings, dental, health, life insurance, accidental death & dismemberment and critical illness insurance.*

[3] *Signing bonus.*

[4] *Mike Law joined the AESO in January 2010. This amount represents his compensation from his start date through to the end of 2010.*

Governance Practices

The AESO looks to private, public and not-for-profit sectors of industry to provide best business practices. The following are some pertinent governance practices the AESO utilizes to provide sound corporate governance within the organization.

AESO Codes of Conduct

The AESO maintains codes of conduct applicable to the AESO Members, officers, employees and contractors, which serve as frameworks for these individuals when they are faced with difficult situations where laws and regulations may not provide sufficient direction and assistance. These codes of conduct form part of the AESO Bylaws.

The AESO's Code of Conduct – Officers, Employees and Contractors is a policy all new employees are required to review and agree to abide by from their first day of employment. All employees must, at least annually, review, confirm compliance/non-compliance with and agree to abide by it. Similarly, each AESO Member is bound by the AESO Members' Code of Conduct.

Strategic Planning and Budget Development

The strategic plan, budget and business plans are key to the AESO's operations.

The strategic plan provides organizational direction for the development of corporate, departmental and individual plans and goals for the current and future years and links the AESO's vision, objectives, strategies and initiatives to day-to-day operations. The strategic plan is reviewed and approved by the AESO Board and forms the foundation for which the AESO's annual business priorities and budgets are established. Individual goals and departmental plans are established and approved by the AESO executive and management. The AESO CEO's goals are approved by the AESO Board.

As a part of the AESO's development of its business priorities, budgets and forecast costs, the AESO undertakes a consultation process with stakeholders which is referred to as the Budget Review Process (BRP).

The BRP is an open and transparent process that allows stakeholders the opportunity to provide input into the AESO's business priorities, budgets and forecast costs. The BRP's primary objective is to work with stakeholders to develop a comprehensive business planning document that provides a common understanding of expected deliverables and related costs. Stakeholder input can be provided in a number of ways including submitting written comments on the proposed business priorities, budgets and forecast costs, and meeting with the AESO Board to further explain those comments. At the conclusion of the process, the AESO Board issues a decision on the AESO's business priorities, budgets and forecast costs.

Performance Management

The AESO's salary administration process is pay for performance and is designed to meet, align with and attain the goals to be achieved at the corporate level. The corporate goals are initially developed by the AESO executive based on business priorities set out in the strategic plan and the business plan. The AESO Board provides oversight and approves annual corporate goals.

Department plans and individual goals, which are developed annually, are designed with a view to support achievement of the corporate goals and advance the Strategic Plan.

Performance Reporting

The AESO executive updates the status of attaining corporate goals on a regular basis and reports to the AESO Board. Based on its review, the AESO executive can determine which goals are on target to be met and those that are at risk of not being achieved. For those goals at risk of not being met, strategies are developed or altered to better achieve the desired goal, including re-prioritizing of the corporate goals.

Risk Management

The AESO has established a Security Policy and Risk Committee, which is an AESO executive committee responsible for development, implementation and ongoing management of the organization's enterprise risk management and corporate security programs. This committee has regularly scheduled meetings.

Regular reports are provided to the Security Policy and Risk Committee, senior management and the AESO Board's Audit Committee, which detail identified risks, their status and related mitigation strategies.

The AESO prioritizes its risks and incorporates them into the annual goal-setting process. Risk mitigation includes development and implementation of appropriate corporate policies, including various financial policies. These policies are communicated to employees and are accessible by employees at all times.

Internal Controls

Internal controls have been designed and implemented by the AESO's management. These controls, except those delegated to the AESO CEO, are approved by the AESO Board and its Committees – utilizing policy approval processes, to provide reasonable assurance of achieving the following objectives:

- effectiveness and efficiency of operations;
- reliability of financial reporting; and
- compliance with laws and regulations.

External Audits/Reviews/Procedures

Operating audits/reviews/procedures are performed to determine the existence and effectiveness of internal controls as they relate to the AESO's operations and compliance with laws and regulations. This includes the annual financial statement audit performed by an independent audit firm.

Internal Audits

In 2010, the Controls & Audit Services group was established at the AESO. This function is a component of the AESO's governance framework and will evaluate the organization's governance, risk management and control processes, as designed and represented by the AESO's management, to determine they are functioning and adequate.

AESO Executive

The AESO Board is responsible for appointing the AESO CEO pursuant to the EUA, and in accordance with the AESO Bylaws, such other officers as are necessary, whose duties and functions are prescribed by in the AESO Bylaws or by the AESO CEO.

The AESO CEO leads an executive team that operates the day-to-day business and affairs of the AESO, including running the business and developing corporate practices, such as governance practices, required to meet best business practices.

The current executive team is as follows:

David Erickson
President and Chief Executive Officer

Cliff Monar
Senior Vice-President

Sandra Scott
Senior Vice-President, Corporate Services and Chief Information Officer

Shan Bhattacharya
Vice-President, Transmission
(effective January 2010)

Todd Fior
Vice-President, Finance

Kelly Gunsch
Vice-President, Market Services

Heidi Kirrmaier
Vice-President, Regulatory

Mike Law
Vice-President, Operations
(effective January 2010)

Larry D. Kram
General Counsel and Corporate Secretary

AESO Board Members

The AESO's Board Members are independent of market participants and have expertise in several business disciplines, including technology, finance and stakeholder relations as well as business experience in energy industries.

The Board's objective is to provide effective governance for the AESO organization to achieve its strategic goals and objectives. This includes balancing the interests of a diverse set of stakeholders and fulfilling its public interest mandate.

Seated left to right: Gord Ulrich, Harry Hobbs

Standing left to right: Nancy Laird, Robert McClinton, J.D. Hole, Jan Carr, Paul McMillan, Hugh Fergusson, Linda Chambers

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

This management's discussion and analysis of financial condition and results of operations (MD&A) should be read in conjunction with the Alberta Electric System Operator's (AESO) audited financial statements for the years ended December 31, 2010 and 2009 and accompanying notes. The MD&A and financial statements are reviewed and approved by the AESO Board. The AESO's financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and are expressed in Canadian dollars.

The AESO is responsible for the operation of Alberta's competitive power pool; determining the order of dispatch of electric energy and ancillary services; providing system access service on the electric transmission grid; directing the safe, reliable and economic operation of the interconnected electric system; planning the capability of the transmission system to meet future needs; and administering load settlement.

Summary Annual Highlights

The AESO, a not-for-profit statutory corporation, recovers its operating, intangible and capital asset costs through three separate revenue sources, each of which is designed to recover the costs directly related to the provision of a specific service, as well as a portion of the shared corporate services costs.

($ Millions) Years ended December 31	**2010**	2009	Change	% Change
Collections	**1,046.7**	929.1	117.6	13
Revenue/(deferred revenue)	**8.3**	(2.4)	10.7	(446)
Other revenue	**1.0**	1.4	(0.4)	(29)
Total revenue	**1,056.0**	928.1	127.9	14
Transmission operating costs	**944.4**	824.2	120.2	15
Other industry costs	**22.0**	21.4	0.6	3
General & administrative costs	**73.6**	71.6	2.0	3
Interest costs	**2.3**	1.3	1.0	77
Amortization	**13.7**	9.6	4.1	43
Total costs	**1,056.0**	928.1	127.9	14

Total Costs

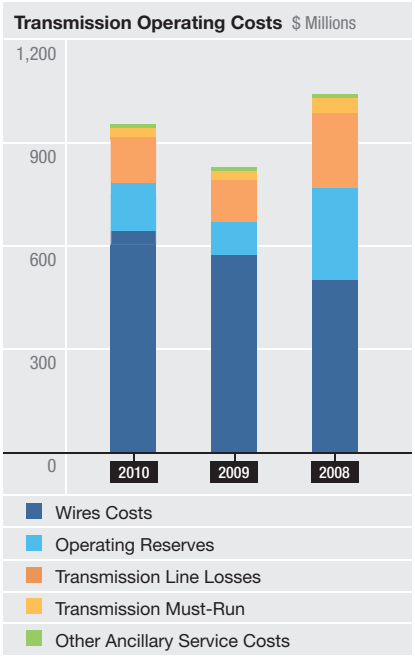
Transmission Operating Costs

Transmission operating costs represent wires, transmission line losses and ancillary services costs. In 2010, transmission operating costs are $944.4 million, which is $120.2 million or 15 per cent higher than the 2009 costs of $824.2 million. This variance is attributable to changes in wires costs due primarily to Alberta Utilities Commission (Commission) decisions on regulated rates charged by the owners of transmission facilities (TFOs) and operating reserves costs resulting from high pool prices in May 2010.

($ Millions) Years ended December 31	**2010**	2009	Change	% Change
Wires costs	**640.9**	566.8	74.1	13
Operating reserves	**135.7**	101.9	33.8	33
Transmission line losses	**130.5**	123.1	7.4	6
Transmission must-run	**28.3**	26.0	2.3	9
Other ancillary service costs	**9.0**	6.4	2.6	41
Transmission operating costs	**944.4**	824.2	120.2	15

Wires Costs

Wires costs represent the amounts paid primarily to TFOs in accordance with their Commission-approved tariffs and are not controllable costs of the AESO. Wires costs in 2010 are $640.9 million which is $74.1 million or 13 per cent higher than the 2009 costs of $566.8 million due to changes in the regulated rates charged by the TFOs.



Operating Reserves

Operating reserves are comprised of three types of active reserves, with the minimum levels of operating reserves based on standards established by the Western Electricity Coordinating Council (WECC):

- **Regulating reserves –** The provision of generation and load response capability, including capacity, energy and maneuverability, which respond to the AESO's automatic generation control (AGC) system.
- **Spinning reserves –** Unloaded generation that is synchronized to the system, automatically responsive to frequency deviation and ready to serve additional demand following an AESO system controller directive. A supplier offering spinning reserves must be able to ramp up their generator within 10 minutes in response to a system controller directive due to a system contingency.
- **Supplemental reserves –** Similar to spinning reserves except supplemental reserves are not required to respond to frequency deviations; therefore, they include load and generators.

The AESO purchases operating reserves from the ancillary services exchange and through over-the-counter contracts with suppliers. Operating reserves are generating capacity or load that is held in reserve and made available to the system operator to manage the transmission system supply-demand balance in real time. Operating reserve prices are indexed to the hourly pool price.

Operating reserve costs in 2010 are $135.7 million, which is $33.8 million or 33 per cent higher than the 2009 costs of $101.9 million primarily due to high pool prices in May 2010. As a result of the transmission constraints that occurred in relation to the May storms resulting in high pool prices, the costs for operating reserves in that one month represented over 30 per cent, or approximately $46.0 million, of the annual operating reserve costs in 2010 and account for the increase in costs compared to 2009.

The average hourly pool price, at which operating reserve prices are indexed, is $51 per megawatt hour (MWh) in 2010 compared to $48 per MWh in 2009, representing an increase of six per cent. Operating reserve volumes are 8,152 gigawatt hours (GWh) in 2010 compared to 8,116 GWh in 2009.

Transmission Line Losses

Transmission line losses represent the amount of energy that is 'lost' as a result of electrical resistance on the transmission lines. Volumes associated with line losses are determined through the energy market settlement as the difference between generation and import volumes less consumption and export volumes. The hourly volumes of line losses vary based on load and export levels, generation (baseload, peaking units and import) available to serve load, weather conditions and changes in the transmission topology. System maintenance schedules, unexpected failures, dispatch decisions on the Alberta Interconnected Electric System (AIES) and short-term system measures (such as demand response) may also affect the volume of losses. The value of line losses is calculated at the hourly pool price.

The costs of line losses in 2010 are $130.5 million, which is $7.4 million or six per cent higher than the 2009 costs of $123.1 million due to the combined impact of higher pool prices in 2010 and higher volumes of line losses. The average hourly pool price, at which losses are valued, is $51 per MWh in 2010 compared to $48 per MWh in 2009, representing an increase of six per cent in 2010. The volumes of line losses in 2010 are 2,696 GWh, which is 183 GWh or seven per cent higher than the 2009 volumes of 2,513 GWh.

Transmission Must-Run

Transmission must-run (TMR) is generation required to be online and operating to assure reliability in specific areas of the AIES with insufficient transmission capacity to guarantee system reliability. This service is typically procured through commercial contracts between the AESO and suppliers.

The costs of TMR services are dependent primarily upon natural gas prices and pool prices. Since TMR services are provided by gas-fired generators, the underlying cost of the service is dependent on the price of natural gas. In addition, the determination to dispatch a generator to provide TMR service is based on local demand and local transmission constraints.

TMR costs in 2010 are $28.3 million, which is $2.3 million or nine per cent higher than the 2009 costs of $26.0 million due primarily to the need for unforeseeable TMR during 2010 to ensure system reliability during unanticipated transmission outages.

Other Ancillary Services

Other ancillary services include the remaining services that the AESO procures for the secure and reliable operation of the AIES such as load shed services and black start services. These services are procured through bilateral contracts with suppliers. In 2010, other ancillary services costs are $9.0 million which is $2.6 million or 41 per cent higher than the 2009 costs of $6.4 million due to additional contracted volumes for load shed service to meet operational requirements.

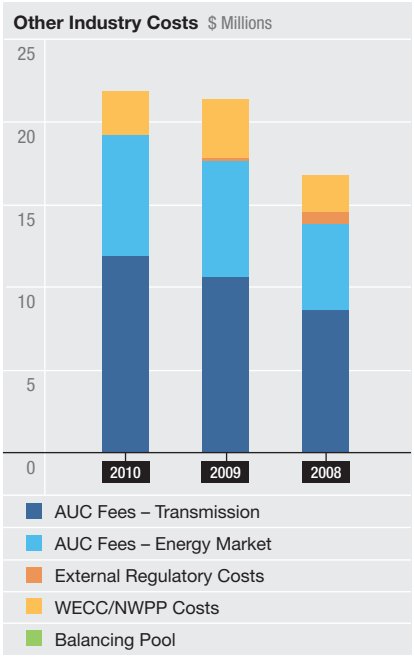
Other Industry Costs

($ Millions) Years ended December 31	**2010**	2009	Change	% Change
Commission fees – Transmission	**12.1**	10.5	1.6	15
Commission fees – Energy Market	**6.9**	7.1	(0.2)	(3)
WECC/NWPP costs	**3.0**	3.6	(0.6)	(17)
External regulatory costs	**0.0**	0.2	(0.2)	(100)
Balancing Pool	**–**	–	–	–
Other industry costs	**22.0**	21.4	0.6	3

Other industry costs represent fees or costs paid based on regulatory requirements or membership fees for industry organizations. These amounts are not under the AESO's control and relate to the annual administration fees for the Commission, the AESO's share of WECC and Northwest Power Pool (NWPP) membership fees and external regulatory costs for the cost awards to interveners related to the AESO's regulatory proceedings.

Other industry costs in 2010 are $22.0 million, which is $0.6 million or three per cent higher than the 2009 costs of $21.4 million due mainly to an increase in Commission administrative fees in 2010 offset by lower WECC costs.

Under the provision of the *Alberta Utilities Commission Act* (effective January 1, 2008), Commission operating and capital costs are recovered from natural gas and electricity market participants under its jurisdiction or any person to whom the Commission provides services. Accordingly, the Commission apportions its costs related to its electricity transmission and wholesale electric market activities to the AESO as a Commission administration fee. The Commission levies two separate administration fees to the AESO: a transmission fee that is recovered through the transmission tariff and an energy market fee that is recovered from market participants through the AESO's energy market trading charge on a per MWh traded basis.



The AESO's share of the WECC membership fees in 2010 is $2.9 million, which is $0.6 million or 17 per cent less than the 2009 fees of $3.5 million. While the annual WECC fees, payable in US dollars, have remained consistent during these years, the strengthening of the Canadian dollar has resulted in a cost decrease for the AESO in 2010.

General and Administrative Costs

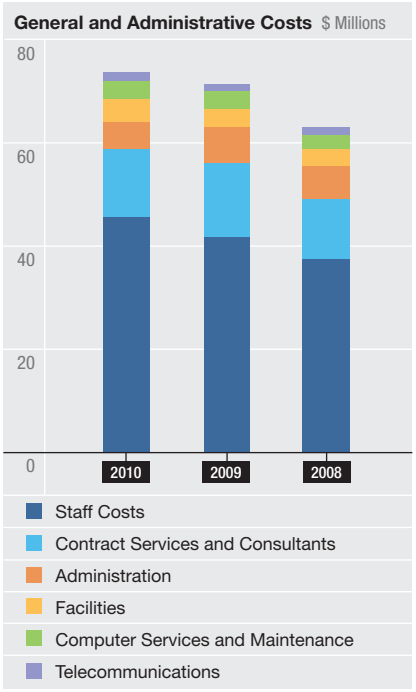
General and administrative costs in 2010 are $73.6 million, which is $2.0 million or three per cent higher than the 2009 costs of $71.6 million. This variance is primarily attributable to increased staff and facility costs, partially offset by a decrease in administration and consulting costs.

($ Millions) Years ended December 31	**2010**	2009	Change	% Change
Staff costs	**45.6**	41.5	4.1	10
Contract services and consultants	**13.3**	14.7	(1.4)	(10)
Administration	**5.0**	7.0	(2.0)	(29)
Facilities	**4.7**	3.6	1.1	31
Computer services and maintenance	**3.6**	3.5	0.1	3
Telecommunications	**1.4**	1.3	0.1	8
General and administrative costs	**73.6**	71.6	2.0	3

Staff Costs

Staff resources continue to be the foundation for the AESO's operations, with ongoing management to assure that the right people with the right skill sets work to achieve the corporate objectives. This requires the organization to focus on attracting and retaining qualified staff. Two factors key to achieving this are maintaining a competitive compensation package and ensuring sufficient resources are available (permanent staff and contractors).

In 2010, staff costs are $45.6 million, which is $4.1 million or 10 per cent higher than the 2009 costs of $41.5 million. This is attributable to the increase in the AESO staff complement (2010 – 334, 2009 – 319) combined with a lower vacancy rate in 2010.



Contract Services and Consultants

In 2010, contractor and consultant costs are $13.3 million, which is $1.4 million or 10 per cent lower than the 2009 costs of $14.7 million primarily as a result of the postponement or deferral of planned work initiatives. There were several areas of focus in 2010 that required additional resourcing: preparation of connection proposals and overall project management, consultation and drafting of authoritative documents, advancement of market services initiatives including the assessment of the sustainability of the Alberta market design and preparation of Need Identification Document (NID) applications. The AESO continues to utilize contracted services for certain corporate information technology (IT) support and technical expertise.

Administration

Administration costs include corporate communications, recruiting, travel and training, AESO Board fees and office costs. In 2010, administration costs are $5.0 million, which is $2.0 million or 29 per cent lower than the 2009 costs of $7.0 million. This is attributable to lower costs in 2010 associated with a change to the AESO's transmission project open houses and public outreach/education program, recruiting, and travel and training costs.

Facilities

In 2010, facilities costs are $4.7 million, which is $1.1 million or 31 per cent higher than the 2009 costs of $3.6 million. This increase is attributable to a reclassification of costs associated with the AESO's back-up facility from the computer services and maintenance to the facilities cost category; overall facility costs in 2010 have remained consistent with 2009.

Computer Services and Maintenance

As the AESO invests in IT infrastructure to support the organization's business operations, ongoing costs are incurred to purchase annual software operating licenses and maintenance agreements.

In 2010, computer services and maintenance costs are $3.6 million, which is $0.1 million or three per cent higher than the 2009 costs of $3.5 million. As previously stated, the costs associated with the AESO's back-up facility have been reclassified from the computer services and maintenance to the facilities cost category; in the absence of this reclassification, computer services and maintenance costs would be $4.5 million in 2010. The increase in costs is associated with additional maintenance and support agreements required to support the systems due to new applications and user growth.

Telecommunications

The AESO incurs costs for the support of real-time operations and the network systems and telecommunications to support general business operations. The strategy for developing and maintaining the telecommunication infrastructure is based on the requirement for high availability, which necessitates redundancies of services and equipment.

In 2010, telecommunication costs are $1.4 million, which is $0.1 million or eight per cent higher than the 2009 costs of $1.3 million.

Interest and Amortization

($ Millions) Years ended December 31	**2010**	2009	Change	% Change
Interest costs	**2.3**	1.3	1.0	77
Amortization of intangible and capital assets	**13.7**	9.6	4.1	43

Interest

Interest is incurred as a result of bank debt held throughout the year and the associated borrowing rate. Bank debt is issued to fund intangible and capital asset purchases and working capital deficiencies due to timing differences in the collection of revenues and payment of expenses. Intangible and capital assets are financed through the AESO's credit facilities and recovered over the useful life of the assets (included in amortization).

In 2010, interest costs are $2.3 million, which is $1.0 million or 77 per cent higher than the 2009 costs of $1.3 million. This is the result of higher borrowing amounts combined with gradually increasing market interest rates throughout 2010. In 2009, the economic landscape led to significantly lower market interest rates and working capital surpluses reduced the required borrowing amounts.

Amortization of Intangible and Capital Assets

Intangible and capital assets are amortized over their estimated useful lives in accordance with GAAP and reviewed on an annual basis. Intangible assets include the AESO's computer software purchase and development costs.

In 2010, amortization of intangible and capital assets is $13.7 million, which is $4.1 million or 43 per cent higher than the 2009 amortization of $9.6 million primarily due to $21.5 million in software additions commissioned in 2010.

Intangible and Capital Assets

Intangible and capital expenditures totaled $23.1 million in 2010 compared to $21.5 million in 2009. The AESO's development and acquisition of intangible and capital assets, most significantly the investment in IT infrastructure, is a key component of the business operations. As with all IT-intensive organizations, the AESO's challenge is to find the appropriate balance between implementing technology advancements, determining the level of IT development that can be supported by business operations and validating the overall financial requirement. To address these challenges, a vetting and prioritization process has been implemented and continues to be enhanced to assure intangible and capital asset expenditures achieve the most beneficial and cost-effective results to continue to meet operating requirements.

In 2010, the investment in intangible and capital assets of $23.1 million continued to support software development and upgrades to critical operational systems in addition to base system application infrastructure. Resources were focused on the Dispatch Tool (DT) to improve the reliability, stability and sustainability of the system, an upgrade to the database management infrastructure, additional data warehouse capacity and strategic storage applications.

In 2009, the intangible and capital asset expenditures of $21.5 million related primarily to the system coordination computer systems, in addition to software development for critical operational systems such as upgrades to the DT and the Automated Dispatch and Messaging System (ADaMS).

The AESO's net book value for intangible and capital assets totaled $76.9 million in 2010 compared to $67.4 million in 2009. As of December 31, 2010, approximately 78 per cent of the net book value relates to computer infrastructure with the remaining value associated with the system coordination facility.

Service Area Cost Detail

Allocation of Costs for Revenue Requirements

The AESO recovers its operating, intangible and capital costs through three separate revenue sources. Each is designed to recover the costs directly related to a specific service as well as a portion of the shared corporate services costs. The majority of revenues the AESO collects relate to the recovery of transmission operating costs (wires, line losses and ancillary services costs). The remaining costs (other industry, general and administrative, interest and amortization costs) are recovered through a methodology intended to relate the cost to the specific service that it supports (transmission, energy market or load settlement).

The allocation of costs to one of the AESO's three services is based on the direct or indirect relationship the cost has to one of the services. If an operating cost is directly associated with a service, the cost will be assigned directly to that service (i.e., a consultant cost in the Transmission group would be assigned 100 per cent to transmission and recovered through the transmission tariff). Alternatively, if the operating cost is not directly associated with any one service (typical for corporate service areas), the cost will be allocated to all services based on the directly assigned costs. This methodology assumes that the service with the higher direct costs would contribute to a higher demand for general costs (such as corporate services) and therefore be assigned a higher percentage allocation.

There are a few exceptions to this general methodology for IT, rent, intangible and capital costs. IT costs are allocated based on an activity-based analysis to better reflect the nature of the underlying costs. Rent costs are allocated based on the staff associated with the three services. Intangible and capital purchases made to support one service are recovered from that service or alternatively from multiple services based on management judgment, taking into consideration the business/operating activities that will be supported by the systems (hardware and software).

Allocation and Cost Classifications

		AESO Services *(%)*		
Cost Categories	General Classification	Transmission	Energy Market	Load Settlement
Wires	Operating	100	–	–
Line losses	Operating	100	–	–
Operating reserves	Operating	100	–	–
Transmission must-run	Operating	100	–	–
Other ancillary services	Operating	100	–	–
Other industry costs	Non-operating	All other costs	Commission-related administration fee	–
General and administration	Non-operating	Costs allocated based on an established methodology		
Interest	Non-operating	Costs allocated based on an established methodology		
Amortization of intangible/capital assets	Non-operating	Costs allocated based on an established methodology		

	General and Administrative		Amortization		Interest		Total	
($ Millions) Years ended December 31	**2010**	2009	**2010**	2009	**2010**	2009	**2010**	2009
Transmission	**52.1**	52.2	**7.2**	5.0	**1.6**	0.8	**60.9**	58.0
Energy market	**19.6**	17.1	**4.8**	3.0	**0.6**	0.4	**25.0**	20.5
Load settlement	**1.9**	2.3	**1.7**	1.6	**0.1**	0.1	**3.7**	4.0
Total	**73.6**	71.6	**13.7**	9.6	**2.3**	1.3	**89.6**	82.5

General and Administrative

The results of the allocation of general and administrative costs between the three services based on the detailed allocation methodology produces no material change in percentages from 2009 to 2010; 71 per cent to transmission, 27 per cent to energy market and two per cent to load settlement.

Amortization

The allocation of the 2010 commissioned assets produces a higher percentage of overall amortization allocated to the energy market. The significant assets commissioned during the year, most notably the Dispatch Tool, support the operation of the energy market. The offset to the increase in the energy market allocation is a reduction in the load settlement allocation.

Interest

Taking into consideration the business requirements associated with the credit facility borrowings in 2010, the allocation of interest costs between the three services resulted in an increase in the allocation to transmission with a corresponding decrease in the allocations to energy market and load settlement.

Total Revenues

The *Electric Utilities Act* (EUA) requires that the AESO operates so that no profit or loss results on an annual basis from its operations. To achieve this, revenue is recognized to the extent of annual operating costs, including the amortization of intangible and capital assets. When the annual sum of collections differs from the annual operating costs, the difference is recorded as revenue or deferred revenue and recognized in the deferral accounts. The AESO's three revenue sources are transmission, energy market and load settlement.

TOTAL REVENUE

($ Millions) Years ended December 31	**2010**	2009	Change	% Change
Revenue collections				
Transmission	**1,011.1**	900.9	110.2	12
Energy market	**32.5**	27.2	5.3	19
Load settlement	**4.1**	2.4	1.7	71
Total collections	**1,047.7**	930.5	117.2	13
Revenue/(deferred revenue)				
Transmission	**9.3**	(4.4)	13.7	(311)
Energy market	**(0.7)**	0.4	(1.1)	(275)
Load settlement	**(0.3)**	1.6	(1.9)	(119)
Total revenue/(deferred revenue)	**8.3**	(2.4)	10.7	(446)
Total revenue	**1,056.0**	928.1	127.9	14

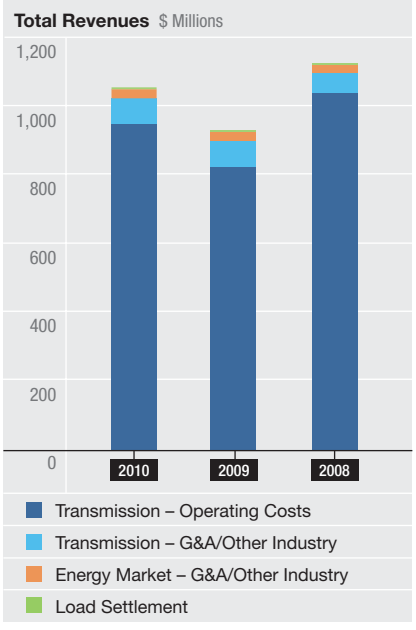
Transmission

The AESO is responsible for paying all of the costs of managing the provincial transmission system and recovering the costs through a tariff approved by the Commission. The transmission tariff is designed to allocate the costs to all users of the transmission system based on their level of usage.

On a monthly basis, the AESO invoices its market participants for transmission system access services based on approved tariff rates. The AESO also pays for costs associated with providing system access services. The monthly differences in the revenues collected and the costs incurred are accumulated in the AESO's transmission deferral account and can be attributed to several factors:

- Timing of revenues and costs (monthly fluctuations);
- Forecast variances (pool price volatility, meter volumes and regulatory decisions); and
- Any misalignment of approved rates and the current year revenue requirement (delays in having the current year rates approved).

In circumstances where collections are in excess of the transmission costs, the excess amount is recognized in the deferral accounts and refunded to market participants in future periods. In circumstances where collections are less than the transmission costs, the shortfall is recorded as revenue, recognized in the deferral accounts and recovered from market participants in future periods.



TRANSMISSION DEFERRAL SUMMARY

($ Millions) Years ended December 31	**2010**	2009
Collections	**1,011.1**	900.9
Costs	**1,020.4**	896.5
Transmission revenue (deferred revenue)	**9.3**	(4.4)
Deferral account (payable) receivable, beginning of year	**(0.1)**	10.7
Disbursement (collection) of the Deferral Account Reconciliation Applications		
2010	**1.8**	
2009		(6.4)
Deferral account receivable (payable), end of year	**11.0**	(0.1)

As part of the transmission tariff, Deferral Account Adjustment Rider C is intended to bring the transmission deferral account balance for non-transmission line losses rate categories to zero during the following calendar quarter. It is a dollar per MWh collection or payment by rate class and rate component. Losses Calibration Factor Rider E is intended to bring the transmission line losses deferral account balance to zero during the remainder of the calendar year. Rate Rider E is a percentage adjustment to all location-specific loss factors.

For non-transmission line losses rate categories, the AESO files a retrospective deferral account reconciliation application with the Commission for approval of the final settlement amounts. The final reconciliation process associates all revenue and cost adjustments by rate category to the appropriate production month and allocates the corresponding charges and refunds to market participants. For transmission line losses, Rate Rider E is a prospective adjustment for the reconciliation of deferral account balances.

The transmission deferral account balance changed from a payable of $0.1 million to market participants at December 31, 2009 to a receivable of $11.0 million from market participants at December 31, 2010. This change is due to 2010 transmission costs exceeding collections combined with the refund to market participants in 2010 related to the 2009 Deferral Account Reconciliation Application.

Energy Market

The AESO recovers the costs of operating the real-time energy market through an energy market trading charge on all MWh traded. The energy market trading charge is set to recover the operating costs and the amortization of intangible and capital assets and the Commission administrative fee during the period. For 2010, the AESO's component of the energy market trading charge is 27.2 cents per MWh to cover operating, intangible and capital costs (21.1 cents per MWh) and the Commission administrative fee (6.1 cents per MWh). For 2009, the AESO's component of the energy market trading charge was 23.2 cents per MWh to cover operating, intangible and capital costs (13.1 cents per MWh) and the Commission administrative fee (10.1 cents per MWh). There is also a component in the energy market trading charge that relates to the operations of the Market Surveillance Administrator (MSA), which is independent of the AESO's operations.

Energy market collections are dependent on the energy market trading charge and the volume of energy traded through the power pool.

In circumstances where annual collections are in excess of energy market costs, the excess amount is recognized in the deferral accounts and incorporated into a reduction in the following year's required energy market trading charge. In circumstances where annual collections are less than the energy market costs, the shortfall is recorded as revenue, recognized in the deferral accounts and collected in the following year.

The energy market deferral account is the accumulated difference between revenues collected and costs paid that is receivable from, or payable to, market participants.

ENERGY MARKET DEFERRAL SUMMARY

($ Millions) Years ended December 31	**2010**	2009
Collections	**32.5**	27.2
Costs	**31.8**	27.6
Energy market (deferred revenue) revenue	**(0.7)**	0.4
Deferral account receivable, beginning of year	**3.2**	2.8
Deferral account receivable, end of year	**2.5**	3.2

The energy market deferral account at December 31, 2010 is a $2.5 million receivable compared to a $3.2 million receivable at the end of 2009. The change of $0.7 million during 2010 is the result of energy market collections exceeding costs.

Market Surveillance Administrator Charge

A portion of the energy market trading charge collected by the AESO is remitted to the MSA for its revenue requirement in accordance with the EUA. The AESO facilitates the cash collection process for the funding of the MSA through a per MWh addition to the AESO's energy market trading charge. In 2010, the MSA's portion of the total energy market trading charge is 2.6 cents per MWh, which compares to an MSA charge of 2.5 cents per MWh in 2009.

The MSA's revenue and costs are separate and independent of the AESO's financial records. The AESO records the difference between the payments made to the MSA and the collections on behalf of the MSA as a separate deferral account. At the end of 2010, the difference between MSA collections and payments is less than $0.1 million.

Load Settlement

Expenses that are incurred to provide services related to administering provincial load settlement are charged to the owners of electric distribution systems and wires service providers conducting load settlement under ISO rules. The costs associated with load settlement include direct service costs, an allocation of the AESO's corporate shared services and an allocation of amortization for the recovery of intangible and capital assets.

The difference in the annual revenue collections and costs incurred associated with load settlement is recorded in the deferral accounts. Load settlement collections are dependent upon the AESO's annual forecast of load settlement costs. On an annual basis, the load settlement deferral account is charged or refunded to the owners of electric distribution systems and wires service providers.

LOAD SETTLEMENT DEFERRAL SUMMARY

($ Millions) Years ended December 31	**2010**	2009
Collections	**4.1**	2.4
Costs	**3.8**	4.0
Load settlement (deferred revenue) revenue	**(0.3)**	1.6
Deferral account payable, beginning of year	**(0.2)**	(1.8)
Deferral account payable, end of year	**(0.5)**	(0.2)

Financial Position and Liquidity

($ Millions) Years ended December 31	**2010**	2009
Cash, beginning of year	**40.2**	12.8
Operating activities	**64.5**	18.4
Investing activities	**(23.1)**	(21.5)
Financing activities	**(34.1)**	30.5
Cash, end of year	**47.5**	40.2

The cash balance as at December 31, 2010 is $47.5 million compared to $40.2 million at December 31, 2009. The increase is primarily the result of the following:

- **Operating activities** provided cash of $64.5 million in 2010 (2009 – $18.4 million). The increase is mainly attributed to a change in non-cash working capital of $50.8 million (2009 – $8.8 million).
  - Accounts receivable balance at December 31, 2010 is $100.2 million compared to $113.2 million at December 31, 2009, a decrease of $13.0 million.
  - Accounts payable balance at December 31, 2010 is $140.0 million compared to $113.6 million at December 31, 2009, an increase of $26.4 million.
  - Security deposits at December 31, 2010 are $9.1 million compared to $1.8 million at December 31, 2009, an increase of $7.3 million.
- **Investing activities** used cash of $23.1 million (2009 – $21.5 million) for intangible and capital asset purchases.
- **Financing activities** used cash of $34.1 million in 2010 (2009 – provided cash of $30.5 million). The primary financing activities are a decrease in bank debt of $23.9 million and an increase in deferral accounts receivable from market participants of $10.1 million.

As at December 31, 2010, the AESO had the following credit facilities available to fund general operating and intangible and capital purchasing activities:

($ Millions) Year ended December 31, 2010	Total	Available	**Used**
Demand revolving facility	160.0	60.2	**99.8**
Demand treasury risk management facility	9.0	9.0	**–**

The demand revolving facility includes a $10 million letter of credit at December 31, 2010 and 2009, which is issued as security for the AESO's procurement of operating reserves.

Future Outlook

Cost recovery for the AESO's operations is approved on an annual basis by the AESO Board, and for transmission-related wires costs through TFO tariffs approved by the Commission under section 37 of the EUA.

For transmission-related activities in 2011, the AESO established a revenue requirement of $1,027.8 million through the 2011 Budget Review Process for costs related to wires, ancillary services, line losses, other industry, general and administrative, amortization and interest costs. The total transmission revenue requirement in 2011 is $7.4 million or one per cent higher than the 2010 actual costs of $1,020.4 million.

For energy market activities, the annual costs are forecast to increase to $37.8 million in 2011 from 2010 actual costs of $31.8 million, a $6.0 million or 19 per cent increase. This forecast increase results from increases in general and administrative costs, most notably related to staff and consultant resources and amortization. With the combination of this forecast cost increase and the 2010 deferral account balance, the AESO's portion of the 2011 energy market trading charge will increase to 23.7 cents per MWh in 2011 compared to 21.1 cents per MWh in 2010, an increase of 2.6 cents per MWh. In 2011, the total energy market trading charge, which also includes an MSA component, will be 31.9 cents per MWh, a change from the 2010 charge of 29.8 cents per MWh.

Timely approval and implementation of proposed transmission upgrades remain as priorities for the AESO to meet future reliability needs and to connect new load and generation. In the upcoming 24-month period, transmission upgrades are expected to reduce the need for TMR generation. The levels of generation constraints will depend on both unplanned outages as well as the coordination of planned transmission and generator outages. The AIES currently meets the industry reliability requirements; however, with increasing loads and generation requests in the queue, the level of congestion on the system is expected to increase until more transmission is built. Generation constraints are increasing in the Keephills-Ellerslie-Genesee (KEG), southwest and northeast areas. The northwest area continues to rely on TMR generation. In the operations of the system, some generation constraints will be unavoidable.

The AIES supply margins appear adequate during the next two years as Alberta's economy recovers from the recent economic downturn that slowed load growth. Market forces continue to govern generation development in accordance with expected load growth as evidenced by the volume of generation queuing to arrange for connection to the system. The AESO will continue to focus on rules, procedures and system analysis along with the continued emphasis on training and information technology development to equip the AESO's system controllers to manage the reliability of the Alberta system.

The AESO, in support of a sustainable, energy-only market design in Alberta, is continuing to focus on the development and implementation of enhancements to the market rules. In 2011, this includes the review of recommendations from an independent analysis of the sustainability of the Alberta market design. Through the next several years, the AESO will also continue to focus on market design initiatives such as wind integration, interties, demand response, transmission constraint management and operating reserve market redesign. Many of these projects will require capital investment for new computer systems and applications. A replacement of the existing market IT systems will be assessed in 2011. If this assessment indicates the need for new systems or major upgrades, implementation would begin no earlier than 2012.

Preparation of the updated Long-term Transmission System Plan, which will be filed with the Commission in the first half of 2011, is ongoing. The AESO is refining its processes with respect to the load and generation forecasting, system studies and scenario development. Consultation on the Long-term Transmission System Plan will continue with stakeholders as it is developed.

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed that effective January 1, 2011, Canadian GAAP for publicly accountable entities will be replaced in full with International Financial Reporting Standards (IFRS) as promulgated by the International Accounting Standards Board (IASB). While the requirement to transition to the new accounting standards does not include not-for-profit entities such as the AESO, the AESO may elect to adopt IFRS.

In September 2010, the AcSB approved an optional deferral of one year to the mandatory date for adoption of IFRS by qualifying entities with rate-regulated activities to January 1, 2012. This deferral is limited to entities that have activities subject to cost-based regulation and that recognize regulatory assets and regulatory liabilities. This deferral resulted from the AcSB's recognition that the IFRS currently do not provide specific guidance on rate-regulated activities.

Management continues to assess the areas of difference between Canadian GAAP and IFRS. As the IASB continues to deliberate IFRS with regards to rate-regulated activities, the AESO will analyze the potential impact resulting from the IASB's decision (i.e., the ability to recognize regulatory assets and liabilities) on the AESO's financial statements. The results of management's assessment and analysis will be reviewed with the advising public accounting firm. The Audit Committee and the AESO Board are provided with regular updates, as management continues to deliberate on the adoption of IFRS and related timing of a potential future transition.

Risk Management

Similar to other electric system operators and wholesale market facilitators, the AESO is exposed to various risks and uncertainties in the normal course of business. The risk management processes the AESO has developed are designed to identify the risks confronting the AESO, assess the impact and likelihood of those risks occurring and determine mitigation strategies to be taken. AESO management is responsible for the ongoing operations of the organization including its risk management programs. Regular reports are provided to the Audit Committee and the AESO Board detailing the status of the risks identified and related mitigation strategies. The AESO prioritizes the risks identified and incorporates this information into the organization's corporate strategies and annual goals and objectives.

While many of the risks identified by the AESO's risk management processes are not directly within the control of the AESO, it has adopted several strategies to reduce and mitigate the effects of those risks that are within its control. The key features of the AESO's internal control environment, which facilitate the AESO's risk management processes, are as follows:

- The AESO is governed by members of the AESO (Members) who are individuals appointed by the Alberta Minister of Energy. The Members function within the AESO as a Board of Directors (AESO Board). Each Member and the AESO Board act in the public interest and independently from any person or entity having a material interest in the electricity industry.
- The *Alberta Public Agencies Governance Act*[1] clarifies the role of the AESO as a public agency subject to government policies applicable to it, or its activities or functions. The AESO will comply with this legislation, including the execution of a document describing relevant roles and mandates of both the AESO and the Minister of Energy.
- Corporate policies are developed and approved by the AESO Board or the President and Chief Executive Officer as delegated by the AESO Board. Corporate policies are communicated to employees regularly and are accessible by employees at all times.
- The AESO, led by the President and Chief Executive Officer, is committed to maintaining a high level of ethics and integrity. Management fosters this culture throughout the organization.

[1] *Assented to on June 4, 2009; in effect on proclamation.*

- The AESO maintains codes of conduct applicable to its Members and officers, employees and contractors, which serve as frameworks for these individuals when they are faced with difficult situations where laws and regulations may not provide sufficient direction and assistance. The AESO's Code of Conduct – Officers, Employees and Contractors is a policy that all employees must agree to when hired, review at least annually to confirm compliance/non-compliance, and affirm their agreement to abide by the policy. Contractors of the AESO have similar requirements, as appropriate, given the nature of their work for the AESO. Each Member of the AESO Board is bound by the AESO Members' Code of Conduct and similarly provides an annual confirmation of their compliance/non-compliance.
- The AESO's management is responsible for establishing and maintaining adequate internal controls over financial reporting. These controls are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Internal controls over financial reporting, no matter how well designed, have inherent limitations and provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements.

  The AESO conducts an annual assessment of the design and effectiveness of its internal controls over financial reporting based on an accepted industry framework. The framework adopted by the AESO for this assessment is the *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management concludes that, as of December 31, 2010, the AESO maintains effective internal control over financial reporting.
- The Audit Committee reviews and monitors the system of internal controls, the systems for managing risk, the external audit process, and the AESO's process for monitoring compliance with laws and regulations, with a view to adopt best practices as appropriate.
- In 2010, the AESO established an internal audit function to provide the organization with an objective and independent assessment of internal controls, risk management activities and governance mechanisms.
- Risk assessment is a continuous process undertaken by management. The AESO's management is committed to proactively addressing potential risks identified and implementing appropriate mitigation action plans.
- The AESO reports its significant risks to the Audit Committee on a regular basis and provides updates on the implementation of mitigation strategies that are undertaken.
- The AESO, its Members, its employees and its contractors are extended a degree of statutory liability protection consistent with the AESO's public interest mandate.
- The AESO carries insurance coverage that is deemed to be appropriate by the AESO Board. The insurance coverage may not be adequate to cover all possible risks and the proceeds of any insurance claim may not be adequate to cover all potential losses.

Forward-Looking Statements

This MD&A contains forward-looking statements that are subject to certain assumptions and risks that create uncertainties. These assumptions and risks could cause actual results to differ materially from results anticipated by the forward-looking statements.

Additional Information

Additional information relating to the AESO can be found on the corporate website at **www.aeso.ca**

Financial Statements and Notes

Management's Responsibility for Financial Reporting

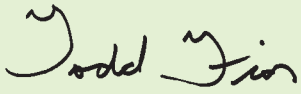
The financial statements of the Alberta Electric System Operator (AESO) are the responsibility of management and have been approved by the AESO Board. These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles, and include the use of estimates and assumptions that have been made using management's best judgment. Financial information contained elsewhere in this annual report is consistent with that in the financial statements.

To discharge its responsibility for financial reporting, management maintains a system of internal controls designed to provide reasonable assurance that the AESO's assets are safeguarded, that transactions are properly authorized and that financial information is relevant, accurate and available on a timely basis. Internal controls are reinforced through the AESO's Codes of Conduct, which set forth the AESO's commitment to conduct business with integrity, and within both the letter and the spirit of the law.

The AESO Board, through the Audit Committee, is responsible for ensuring management fulfils its responsibility for financial reporting and internal controls. The Audit Committee meets regularly with management and the external auditors to discuss any significant accounting, internal control and auditing matters to determine that management is carrying out its responsibilities and to review and approve the financial statements.

The financial statements have been examined by Deloitte & Touche LLP, the AESO's external independent auditors who are engaged by the AESO Board. The responsibility of these external auditors is to examine the financial statements and express their opinion on the fairness of the financial statements in accordance with Canadian generally accepted accounting principles. The auditors' report outlines the scope of their examination and states their opinion. The auditors have access to the Audit Committee, with and without the presence of management.

David Erickson, CA
President & Chief Executive Officer



Todd D. Fior, CA
Vice-President, Finance

To the Members of the Alberta Electric System Operator Board

We have audited the accompanying financial statements of the Alberta Electric System Operator (AESO) which comprise the balance sheet as at December 31, 2010 and 2009, and the statements of operations and comprehensive income and cash flows for the years then ended, and the notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Alberta Electric System Operator at December 31, 2010 and 2009, and its financial performance and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Independent Chartered Accountants
Calgary, Alberta

February 16, 2011

Balance Sheet

As at December 31 (in thousands of Canadian dollars)	**2010**	2009
Assets		
Current assets		
Cash	**$ 47,503**	$ 40,191
Accounts receivable *(note 4)*	**100,163**	113,231
Prepaid expenses and deposits	**2,362**	6,502
MSA deferral account receivable	**59**	42
AESO deferral account receivable *(notes 3 and 8)*	**12,967**	2,918
	163,054	162,884
Intangible assets *(note 5)*	**47,816**	40,583
Capital assets *(note 6)*	**29,075**	26,859
	$ 239,945	$ 230,326
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities *(note 7)*	**$ 139,950**	$ 113,581
Security deposits *(note 14)*	**9,080**	1,811
Bank debt *(note 9)*	**89,800**	113,650
	238,830	229,042
Deferred rent	**1,115**	1,284
Equity *(note 1)*	**–**	–
	$ 239,945	$ 230,326
Asset retirement obligation *(note 11)*		
Contingencies and commitments *(note 12)*		

On behalf of the AESO Board:

Harry Hobbs
AESO Board Chairman

Robert McClinton, CA
Audit Committee Chair

See accompanying notes

Statement of Operations and Comprehensive Income

For the year ended December 31 (in thousands of Canadian dollars)	**2010**	2009
Revenue		
Transmission tariff	**$ 1,019,706**	$ 895,267
Energy market charge	**31,520**	27,307
Load settlement charge	**3,734**	4,026
Interest and other	**996**	1,464
	1,055,956	928,064
Operating costs and expenses		
Wires costs	**640,884**	566,800
Ancillary services costs	**173,005**	134,301
Line losses	**130,550**	123,083
General and administrative	**73,557**	71,564
Other industry costs	**21,977**	21,374
Amortization *(notes 5 and 6)*	**13,698**	9,625
Interest expense *(note 9)*	**2,285**	1,317
	1,055,956	928,064
Net income and comprehensive income	**$ –**	$ –

See accompanying notes

Statement of Cash Flows

For the year ended December 31 (in thousands of Canadian dollars)	**2010**	2009
Operating activities		
Net income	**$ –**	$ –
Amortization	**13,698**	9,625
Changes in non-cash working capital*	**50,846**	8,805
Net cash provided by operating activities	**64,544**	18,430
Investing activities		
Intangible asset additions	**(16,909)**	(18,627)
Capital asset additions	**(6,238)**	(2,838)
Net cash used in investing activities	**(23,147)**	(21,465)
Financing activities		
(Decrease) increase in bank debt	**(23,850)**	22,050
(Decrease) increase in AESO deferral accounts	**(10,049)**	8,781
Decrease in deferred rent	**(169)**	(145)
Decrease in MSA deferral account	**(17)**	(206)
Net cash (used in) provided by financing activities	**(34,085)**	30,480
Increase in cash	**7,312**	27,445
Cash, beginning of year	**40,191**	12,746
Cash, end of year	**$ 47,503**	$ 40,191
Cash interest paid	**$ 2,445**	$ 1,294

** Consists of changes in accounts receivable, prepaid expenses and deposits, accounts payable and accrued liabilities, and security deposits.*

See accompanying notes

December 31, 2010 and 2009

(All amounts are in thousands of Canadian dollars unless otherwise indicated)

1. Nature of Operations

The Independent System Operator (ISO), operating as the Alberta Electric System Operator (AESO), is a statutory corporation established on June 1, 2003 under the *Electric Utilities Act* (EUA) of the Province of Alberta.

Effective June 1, 2003, the AESO assumed responsibility for operating and promoting a fair, efficient and openly competitive energy-only wholesale market for electricity; determining the order of dispatch of electric energy and ancillary services; providing system access service on the electric transmission grid; directing the safe, reliable and economic operation of the interconnected electric system; planning the capability of the transmission system to meet future needs; and administering load settlement.

The AESO is governed by members of the AESO (Members) who are individuals appointed by the Alberta Minister of Energy. The Members function within the AESO as a Board of Directors (AESO Board). Each Member and the AESO Board act in the public interest and independently from any person or entity having a material interest in the electricity industry. The AESO Board has three committees and one task force: Audit Committee; Human Resources, Compensation and Nominations Committee; Corporate Governance Committee; and Transmission Advisory Task Force.

The EUA requires that charges to industry, including the transmission tariff, energy market charge and load settlement charge, be set to recover the costs required to operate the AESO, and that the AESO be operated so no profit or loss results on an annual basis from its operations. The AESO has no equity.

The AESO's transmission-related financial activities are regulated by the Commission or Regulator and approved based upon the AESO's tariff applications.

Management views the operations of the AESO as one fully integrated operation; therefore, segmented information is not applicable.

2. Summary of Significant Accounting Policies

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP).

USE OF ESTIMATES – Preparation of these financial statements requires estimates and assumptions that affect the amounts reported and disclosed in the financial statements and related notes. These estimates and assumptions include information, regulatory decisions and other matters that are periodically influenced by third parties that may impact the timing of revenue and/or expense recognition. Actual results may differ from those estimates and assumptions due to factors such as the useful lives and impairment of intangible assets, capital assets, accrued liabilities, settlement of an asset retirement obligation and regulatory decisions. Any changes from current estimates or assumptions are accounted for in the period that they are determined.

CHANGE IN ACCOUNTING ESTIMATE – During the year ended December 31, 2010, the estimate for the useful life of a class of capital assets was increased. The change in estimate was due to a reassessment of the period in which facility infrastructure assets would be available and used in the AESO's operations. These assets were combined with the system coordination facility assets, with the useful life extended from a 10-year to a 20-year amortization period ending in July 2025. The impact of this change on 2010 amortization is a decrease of $0.1 million.

DEFERRALS – The AESO utilizes deferral accounts to facilitate a matching of revenues and costs. On an individual basis for the transmission, energy market and load settlement operations, in circumstances where annual collections are in excess of the costs, the excess amount is recognized in the deferral accounts and refunded in the subsequent year. In circumstances where annual collections are less than the costs, the shortfall is recorded as revenue, recognized in the deferral accounts and collected in the subsequent year.

A portion of the energy market charge collected by the AESO is remitted to the Market Surveillance Administrator (MSA), a separate statutory corporation, according to its revenue requirement as provided in the EUA. When the annual revenue collected on behalf of the MSA through the energy market charge collection process is different than the funding payments made to the MSA, the difference is recognized in the deferral account and is incorporated into the estimated per megawatt hour charge for the following year.

INTANGIBLE ASSETS – Intangible assets include computer software and are stated at cost less accumulated amortization. These assets are amortized on a straight-line basis over their estimated useful life as follows:

Software development	5 to 7 years; or Over the term of the license agreement for customization of Software as a Service
System coordination computer systems	7 years

Interest costs attributable to and incurred during the development phase of large projects are capitalized. Capitalization ceases when the projects are substantially complete and ready for productive use. Payroll and payroll-related costs associated with staff directly involved in software development are capitalized as intangible assets.

CAPITAL ASSETS – Capital assets are stated at cost less accumulated amortization. These assets are amortized on a straight-line basis over their estimated useful life as follows:

Computer hardware, furniture and office equipment	3 to 5 years
System coordination computer systems	7 years
System coordination facility	Over the land lease term ending in 2025
Leasehold improvements	Over the lease term ending in 2014

Interest costs attributable to and incurred during the development phase of large capital projects are capitalized. Capitalization ceases when the projects are substantially complete and ready for productive use. Payroll and payroll-related costs associated with staff directly involved in hardware set-up and installation are capitalized.

REVENUE RECOGNITION – The AESO's revenue is primarily derived through three separate charges: (i) the transmission tariff; (ii) the energy market charge; and (iii) the load settlement charge. Each of these charges is set to recover those costs directly attributable to one of the AESO's main functions as well as a portion of shared corporate services costs. Consistent with the requirements of the EUA, which requires the AESO to operate with no annual profit or loss, revenue is recognized equivalent to the aggregate of annual operating costs on a function-by-function basis.

The EUA requires the AESO to provide funding for the MSA with the amount to be recovered through the energy market charge. The energy market charge included in the AESO's statement of operations and comprehensive income does not include amounts recovered related to the MSA's funding requirements and the AESO's costs do not include amounts related to the operations of the MSA. The difference in the revenue collections and the monthly payments associated with the MSA are recorded in the MSA deferral account.

DEFERRED RENT – The lease costs associated with the 10-month, rent-free period will be recognized over the 10-year lease term.

EMPLOYEE FUTURE BENEFITS – The AESO's employee future benefit program consists of a defined contribution plan. The AESO's contributions to employee future benefit plans are expensed as incurred.

FINANCIAL INSTRUMENTS – The AESO has evaluated the five classifications of financial instruments, namely i) held for trading, ii) available for sale, iii) held to maturity, iv) loans and receivables and v)other financial liabilities, and designated its financial instruments.

COMPREHENSIVE INCOME – As the AESO does not have any other comprehensive income, net income equals comprehensive income.

RECENT ACCOUNTING PRONOUNCEMENTS ADOPTED –

Business Combinations, Consolidated Financial Statements and Non-controlling Interests

In January 2009, the Canadian Institute of Chartered Accountants (CICA) issued section 1582 "Business Combinations", section 1601 "Consolidated Financial Statements" and section 1602 "Non-controlling Interests", which replace the former section 1581 "Business Combinations" and section 1600 "Consolidated Financial Statements". Section 1582 establishes standards for the accounting for a business combination. Section 1601 together with section 1602 establishes standards for the preparation of consolidated financial statements. These sections apply prospectively for annual reporting periods beginning on or after January 1, 2011. Early adoption is permitted.

Effective January 1, 2010, the AESO early-adopted section 1582, section 1601 and section 1602. The adoption of these standards did not have an impact on the AESO's results of operations, financial position or cash flows.

RECENT ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED –

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed that effective January 1, 2011, Canadian GAAP for publicly accountable entities will be replaced in full with International Financial Reporting Standards (IFRS) as promulgated by the AcSB. In September 2010, the AcSB approved an optional deferral of one year to the mandatory date for adoption of IFRS by qualifying entities with rate-regulated activities to January 1, 2012. This deferral applies only to entities subject to cost-based regulation. This deferral resulted from the AcSB's recognition that the IFRS currently do not provide specific guidance on rate-regulated activities.

As the AESO is not a publicly accountable entity, there is no requirement for the AESO to transition to IFRS. Should the AESO opt to transition to IFRS, the adoption of these standards would have an impact on the presentation of the AESO's results of operations, financial position, cash flows and accompanying notes. The impact has not been estimated at this time.

3. Financial Statement Effects of Rate Regulation

Regulatory assets represent certain costs incurred in the current period or in prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions of revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process.

As of December 31,	**2010**	2009
Regulatory assets		
Transmission deferral	**$ 11,038**	$ –
Regulatory liabilities		
Transmission deferral	**$ –**	$ 66

At December 31, 2010, the transmission deferral asset was $11.0 million based upon an accumulation of variances between transmission revenue collections and costs incurred in 2010 and prior years. The AESO applies to the Regulator for the approval and settlement of deferral balances. The transmission deferral balance is a regulatory asset or liability, based upon the expectation that amounts accumulated from one year to the next will be approved for collection from, or refund to, customers in a subsequent year. In the absence of rate regulation, GAAP would require that such balances be included in operating results in the year in which they are incurred. The regulatory asset is included in the AESO's net deferral accounts receivable on the balance sheet at December 31, 2010 (Note 8).

All transmission-related financial activities of the AESO are subject to the Regulator's approval, thus the recovery of transmission costs through the transmission tariff is subject to regulatory approval. With the formation of the AESO through the EUA, the AESO must be managed so no profit or loss results on an annual basis from its operations. Management believes that the ultimate recovery is assured due to the not-for-profit status of the AESO.

4. Accounts Receivable

As of December 31,	**2010**	2009
Transmission settlement	**$ 92,019**	$ 100,493
Energy market settlement	**3,270**	2,784
Trade	**4,874**	9,954
	$ 100,163	$ 113,231

5. Intangible Assets

	Cost	Accumulated Amortization	**2010 Net Book Value**
Software development	$ 52,530	$ 22,681	**$ 29,849**
System coordination computer systems	15,848	2,641	**13,207**
Work in progress	4,760	–	**4,760**
	$ 73,138	$ 25,322	**$ 47,816**

	Cost	Accumulated Amortization	2009 Net Book Value
Software development	$ 33,229	$ 18,352	$ 14,877
System coordination computer systems	15,848	378	15,470
Work in progress	10,236	–	10,236
	$ 59,313	$ 18,730	$ 40,583

Work in progress relates to intangible assets associated with various software development projects that were not commissioned or operational by the end of the year.

For the 12 months ended December 31, 2010, $2.0 million of payroll and payroll-related costs associated with staff directly involved in software development have been capitalized (2009 – $2.4 million) and interest costs of $0.2 million were capitalized in 2010 during the design and development phases of a software project (2009 – $0.2 million during the design and development phases of the system coordination computer systems project).

6. Capital Assets

	Cost	Accumulated Amortization	**2010 Net Book Value**
System coordination facility	$ 21,807	$ 5,088	**$ 16,719**
Computer hardware, furniture and office equipment	8,604	4,132	**4,472**
System coordination computer systems	2,392	399	**1,993**
Leasehold improvements	4,185	2,290	**1,895**
Work in progress	3,996	–	**3,996**
	$ 40,984	$ 11,909	**$ 29,075**

	Cost	Accumulated Amortization	2009 Net Book Value
System coordination facility	$ 21,800	$ 3,942	$ 17,858
Computer hardware, furniture and office equipment	5,941	3,837	2,104
System coordination computer systems	2,392	57	2,335
Leasehold improvements	4,081	1,812	2,269
Work in progress	2,293	–	2,293
	$ 36,507	$ 9,648	$ 26,859

Work in progress relates to capital assets associated with hardware that were not commissioned or operational by the end of the year.

For the 12 months ended December 31, 2010, $0.2 million of payroll and payroll-related costs associated with staff directly involved in hardware development have been capitalized (2009 – $0.2 million) and no interest costs were capitalized in 2010 (2009 – $0.03 million during the design and development phases of the system coordination computer systems project).

7. Accounts Payable and Accrued Liabilities

As of December 31,	**2010**	2009
Transmission settlement	**$ 92,022**	$ 68,665
Trade	**41,429**	38,782
Accrued liabilities	**6,499**	6,134
	$ 139,950	$ 113,581

The accounts payable trade balance includes flow-through customer contribution amounts of $1.6 million in 2010 (2009 – $0.3 million).

8. AESO Deferral Accounts Receivable (Payable)

	Transmission	Energy Market	Load Settlement	Total
Opening balance, January 1, 2009	$ 10,720	$ 2,829	$ (1,850)	$ 11,699
2009 Operations	(4,410)	361	1,644	(2,405)
Collection of the 2008 Deferral Account Reconciliation Application	(6,376)	–	–	(6,376)
Closing balance, December 31, 2009	(66)	3,190	(206)	2,918
2010 Operations	9,333	(718)	(337)	8,278
Distribution of the 2009 Deferral Account Reconciliation Application	1,771	–	–	1,771
Closing balance, December 31, 2010	**$ 11,038**	**$ 2,472**	**$ (543)**	**$ 12,967**

9. Credit Facilities

The AESO has credit facilities of $160.0 million in demand revolving loan facilities. The facilities provide that the borrowings may be made by way of fixed rate offer loans, prime loans or bankers' acceptances, which bear interest at the rates specified in fixed rate offer loans, at the bank's prime rates, or at bankers' acceptance rates plus a stamping fee. There is an option to request letters of credit under the credit facilities.

In addition to the credit facilities, a demand treasury risk management facility of $9.0 million in deemed risk content is available to provide for interest swaps for up to $35.0 million in notional debt. This facility was not used in 2010 and 2009.

At December 31, 2010, $89.8 million (2009 – $113.7 million) was drawn on the facilities and a $10.0 million letter of credit was issued as security for operating reserve procurement.

The amount of interest paid during 2010 was $2.4 million (2009 – $1.3 million) at an average interest rate of 0.7 per cent.

10. Capital Disclosure

In managing capital, the AESO reviews its cash flows from operations, including the transmission tariff, energy market charge and load settlement charge, to determine whether there are sufficient funds to cover its operating costs and pay for intangible and capital purchases. To the extent that the cash flows are not sufficient to cover these expenditures, the AESO utilizes debt financing. The AESO has no equity or externally imposed capitalization requirements.

As of December 31,	**2010**	2009
Bank debt	**$ 89,800**	$ 113,650

11. Asset Retirement Obligation

The system coordination facility is located on leased land. Under the terms of the lease agreement, the AESO is obligated, at the request of the landlord, to complete site restoration upon termination of the lease. The landlord's intentions are not determinable at this time. As the fair value of the obligation cannot be reasonably estimated due to the broad range of settlement dates and cash flows, any potential liability has not been recognized. Amounts will be accounted for in the period they are determined.

12. Contingencies and Commitments

(i) The AESO leases office space, data processing equipment and land under various operating leases. The minimum lease payments associated with these leases are as follows:

Year	Amount *($ Million)*
2011	3.9
2012	3.4
2013	3.3
2014	3.1
2015	0.1
Thereafter	1.0

(ii) To fulfill the duties of the AESO in accordance with the EUA, the AESO manages the procurement of ancillary services through contracts with third-party suppliers. These ancillary services include operating reserves, transmission must-run, load shed and system restoration. The contracts are for generation capacity and load reduction capabilities ranging in contract duration from one day to 20 years. The amount to be paid under each contract is dependent upon fixed and variable terms. The variable terms are based upon commodity prices, dispatch volumes and frequency.

(iii) As a result of events that have occurred, the AESO may become party to a claim or legal action arising in the normal course of business. While the outcome of these matters is uncertain, the AESO does not currently believe that the outcome related to these matters or any amount that the AESO may be required to pay would have a materially adverse effect on the AESO as a whole.

(iv) The EUA requires the AESO to provide funding for the MSA with the amount to be recovered through the energy market charge. In 2010, $3.1 million was paid to the MSA (2009 – $3.1 million).

(v) The *Alberta Utilities Commission Act* requires the AESO to provide funding for the Commission with the amounts to be recovered through the transmission tariff and the energy market charge. In 2010, $19.0 million was paid to the Commission (2009 – $17.7 million).

13. Employee Future Benefits

The contributions to the defined contribution plan are based on a percentage of an employee's salary with the AESO matching employee contributions to a maximum percentage. There is no unfunded obligation related to the plan as contributions are paid to employees when earned. Total expense for the defined contribution plan was $3.0 million in 2010 (2009 – $2.7 million).

14. Security Deposits

Security requirements for market participant financial obligations in excess of their unsecured credit limits are met with cash deposits and letters of credit. All market participants who have financial obligations to the AESO must adhere to the ISO rules and transmission tariff terms and conditions regarding security requirements. Unsecured credit is granted by the AESO to organizations (or guarantors) with an acceptable credit rating from an AESO recognized bond rating agency, to organizations that do not have a credit rating if they qualify for an AESO determined proxy credit rating, and to organizations that have an exempt status as determined through government legislation. The unsecured credit granted by the AESO to an organization is limited based on the AESO's assessment of the organization's credit worthiness.

15. Financial Instruments

Financial Instrument	Designated Category	Measurement Basis	Associated Risks	Fair Value at December 31, 2010
Cash	Held for trading	Fair value	Liquidity risk	Carrying value approximates fair value due to short-term nature
Accounts receivable AESO deferral accounts receivable MSA deferral account receivable	Loans and receivables	Initially at fair value and subsequently at amortized cost	Credit risk	Carrying value approximates fair value due to short-term nature
Accounts payable and accrued liabilities	Other financial liabilities	Initially at fair value and subsequently at amortized cost	Liquidity risk Market risk	Carrying value approximates fair value due to short-term nature
Security deposits	Other financial liabilities	Initially at fair value and subsequently at amortized cost	Liquidity risk	Carrying value approximates fair value due to short-term nature
Bank Debt	Other financial liabilities	Initially at fair value and subsequently at amortized cost	Liquidity risk Market risk	Carrying value approximates fair value due to short-term nature and variable interest rates

Nature and Extent of Risks Arising From Financial Instruments

The AESO is exposed to the following types of risks in relation to its financial instruments:

a) **CREDIT RISK –** The risk that a counterparty may default on their financial obligations to the AESO. Due to the EUA requirement that the AESO be operated with no profit or loss from its operations, credit risk is ultimately borne by market participants, though managed by the AESO.

   Counterparties are granted certain levels of unsecured credit with the AESO based on their long-term unsecured debt rating provided by a major reputable corporate rating service satisfactory to the AESO or, in the absence of the availability of such ratings, the AESO has satisfactorily reviewed the counterparty for creditworthiness as appropriate. Letters of credit, cash on deposit and legally enforceable right to set off are used to mitigate risk where appropriate. As at December 31, 2010, the amount of financial assets that were past due was not material (2009 – not material) and there were no uncollectible receivable balances (2009 – nil).

b) **MARKET RISK –** The risk of a potential negative impact on the balance sheet and/or statement of operations and comprehensive income resulting from adverse changes in the value of financial instruments as a result of changes in certain market variables. This includes interest rate price and foreign exchange risks.

   The AESO's bank debt is comprised of short-term bankers' acceptances that bear interest at market rates. Accordingly, the exposure to interest rate price risk in relation to the bank debt at the balance sheet date is not material.

   The AESO conducts slightly over one per cent of its business in U.S. dollars and accordingly is subject to currency risk associated with changes in foreign exchange rates in relation to payables. The AESO monitors its exposure to currency risk and reviews whether the use of derivative financial instruments is appropriate to manage potential fluctuations in foreign exchange rates. The AESO has not entered into any derivative instruments with respect to currency risk.

c) **LIQUIDITY RISK –** The risk that the AESO will not be able to meet its obligations associated with financial liabilities. The AESO does not consider this to be a significant risk as the available credit facilities provide financial flexibility to allow the AESO to meet its obligations as they come due. The AESO does not consider there to be a present risk in relation to funds availability to the AESO under the existing credit facilities.

Summarized Quantitative Data Associated with the Above Risks

a) **CREDIT RISK –** At December 31, 2010, the AESO's maximum exposure to receivable credit risk was $113.1 million, which is the aggregate of accounts receivable and AESO deferral accounts receivable.

The AESO's receivables are due from counterparties that have provided security to the AESO or have been granted unsecured credit based on satisfactory credit ratings. As at December 31, 2010, the amount of financial assets that were past due was not material.

b) **MARKET RISK –** The AESO is exposed to currency risk on $0.7 million of U.S. dollar denominated financial liabilities at December 31, 2010.

If the Canadian dollar increases (decreases) against the U.S. dollar by five per cent prior to the payment by the AESO, operating costs would decrease (increase) by less than $0.1 million and intangible asset costs would decrease (increase) by less than $0.1 million.

c) **LIQUIDITY RISK –** The AESO's bank debt and accounts payable and accrued liabilities generally have contractual maturities of six months or less.

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