

FINANCIAL RESULTS

MANAGEMENT DISCUSSION AND ANALYSIS MARCH 31, 2010

The Management Discussion and Analysis reports on British Columbia Hydro and Power Authority's (the Company) consolidated results and financial position for the year ended March 31, 2010 (fiscal 2010). This discussion should be read in conjunction with the audited consolidated financial statements and related notes of the Company for the years ended March 31, 2010 and 2009. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and are expressed in Canadian dollars. This report contains forward-looking statements, including statements regarding the business and anticipated financial performance of BC Hydro. These statements are subject to a number of risks and uncertainties that may cause actual results to differ from those contemplated in the forward-looking statements.

BC Hydro's results for fiscal 2010 benefited from increased domestic revenues, lower energy costs and lower finance charges, but were adversely impacted by results from energy trading activities, a provision for environmental compliance costs and higher amortization expense compared to the prior year. The majority of these benefits and impacts are transferred to regulatory accounts for inclusion in future rates.

HIGHLIGHTS

- Net income for the year ended March 31, 2010 was \$447 million compared to \$365 million in the prior year and \$5 million below the Service Plan net income forecast.
- Hydro generation levels for the year ended March 31, 2010 were five per cent lower than in the prior year as a result of lower than average system inflows into system reservoirs due to low winter snowpacks and very low precipitation during the first half of fiscal 2010. The impact on results was partially offset by reduced domestic load requirements, primarily as a result of lower sales to large industrial customers impacted by the economic downturn during the year. As a result of reduced load in fiscal 2010, BC Hydro was not required to purchase as much energy from the market, which is more expensive than energy generated from its system, as was required in the previous year which was also a below-average water inflow year.
- Property, plant and equipment expenditures of \$2,406 million are 72 per cent higher than the prior year (\$1,397 million) primarily due to the BC Hydro's acquisition of a one-third interest in Teck Metals Ltd.'s Waneta dam and generating facility in March 2010. Other significant capital expenditures during fiscal 2010 include the Vancouver Island Transmission Reinforcement project, Revelstoke Unit 5 installation and system improvements to the distribution network. This is a very positive result given BC Hydro's significant capital expenditure requirements over the next several years in order to be able to continue to meet load growth requirements and maintain its aging infrastructure.

For the year ended March 31
(in millions)

| | 2010 | 2009 | Change |
|--|-----------|-----------|----------|
| Total Assets | \$ 18,093 | \$ 16,329 | \$ 1,764 |
| Shareholders' Equity | \$ 2,674 | \$ 2,179 | \$ 495 |
| Loss Before Regulatory Accounts | \$ (249) | \$ (73) | \$ (176) |
| Net Income | \$ 447 | \$ 365 | \$ 82 |
| Accrued Payment to the Province | \$ 47 | \$ — | \$ 47 |
| Property, Plant and Equipment Additions | \$ 2,406 | \$ 1,397 | \$ 1,009 |
| Return on Equity, as defined for regulatory purposes | 12.49% | 11.75% | 0.74% |
| Debt to Equity ratio, as defined for regulatory purposes | 80 : 20 | 81 : 19 | — |
| Number of Domestic Customers | 1,830,698 | 1,801,038 | 29,660 |
| GWh Sold (Domestic) | 50,233 | 52,512 | (2,279) |
| Total Reservoir Storage (GWh) | 12,328 | 14,915 | (2,587) |

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CONSOLIDATED RESULTS OF OPERATIONS

BC Hydro reports net income both before and after net changes to regulatory accounts. As a rate-regulated utility, BC Hydro applies various accounting policies that are acceptable under Canadian generally accepted accounting principles (GAAP) for rate-regulated enterprises but differ from enterprises that do not operate in a rate-regulated environment. These policies allow for the deferral of amounts that under GAAP would otherwise be recorded as expenses or income in the current accounting period. The deferred amounts are either recovered or refunded through future rate adjustments.

BC Hydro presents its financial statements on a gross view which shows its results under GAAP in the absence of rate regulation (Income/Loss Before Regulatory Account Transfers) and with rate regulation (Net Income). The net change in regulatory accounts on the income statement includes: variances between planned amounts from the most recent revenue requirements application and actual results for certain costs, including cost of energy, trade income and finance charges; certain amounts incurred in the current period that are deferred for future recovery in rates (such as demand-side management expenditures and liability provisions); interest accrued on regulatory accounts where allowed; and amortization of regulatory accounts. As a result, there can be significant differences between income before regulatory account transfers and net income.

For the year ended March 31, 2010, loss before regulatory account transfers was \$249 million compared to a loss of \$73 million in the previous year. The increase in the loss was a result of lower trade income, recognition of an environmental compliance provision related to polychlorinated biphenyls (PCBs) and higher amortization expense, partially offset by higher domestic gross margin, arising from both higher domestic revenues and lower energy costs and lower finance charges.

Transfers to regulatory accounts for the year were mainly comprised of additions to the Trade Income Deferral Account for differences between actual and planned trade income and transfers for other variances relating to lower interest rates, higher non-current pension costs and higher foreign exchange gains as compared to plan. Expenditures on demand-side management (DSM) and the new provision for future environmental compliance and remediation expenditures were also transferred to regulatory accounts during the year.

Energy trading activities, conducted by BC Hydro's wholly owned subsidiary, Powerex, in both electricity and gas markets, were affected by the weak economic climate in fiscal 2010. The downturn has resulted in substantially lower market prices and significantly lower price spreads compared to the previous year. Spot prices for the year were approximately 30 to 40 per cent lower on average than in the prior year. Natural gas continued to trade significantly lower as well, primarily due to increased supply in North America and lower demand coinciding with the poor economic conditions. The average daily gas price at the B.C. border for the year was down 45 per cent on average from fiscal 2009. The U.S. dollar has also weakened significantly, falling 19 per cent in the current fiscal year, resulting in foreign exchange losses on Powerex's U.S. dollar net asset position, most significantly in the first two quarters of fiscal 2010.

Net income for the year ended March 31, 2010 was \$447 million, compared to \$365 million in the previous year. BC Hydro's net income increased from fiscal 2009 mainly due to higher domestic gross margins partially offset by lower trade income, higher amortization and higher finance charges after regulatory deferrals.

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REVENUES

Revenues are influenced primarily by the volume of energy consumed by customers and market prices of energy. Domestic revenues are influenced by variables such as number of customers, average temperatures during the year, level of economic activity in commercial and industrial sectors, rate increases and mark-to-market gains or losses on forward energy purchase contracts which are recorded in revenues. Trade revenues are influenced by commodity prices and sales volumes for electricity and natural gas.

| | <i>(in millions)</i> | | <i>(gigawatt hours)</i> | |
|--|----------------------|-----------------|-------------------------|----------------|
| | 2010 | 2009 | 2010 | 2009 |
| Domestic | | | | |
| Residential | \$ 1,300 | \$ 1,197 | 17,593 | 17,861 |
| Light industrial and commercial | 1,133 | 1,054 | 17,811 | 18,265 |
| Large industrial | 485 | 481 | 13,020 | 14,303 |
| Other energy sales | 172 | 82 | 1,809 | 2,083 |
| Total Domestic | \$ 3,090 | \$ 2,814 | 50,233 | 52,512 |
| Trade | | | | |
| Electricity – Gross | \$ 1,320 | \$ 2,290 | 28,210 | 32,504 |
| Less: forward electricity purchases ¹ | (756) | (1,125) | — | — |
| Electricity – Net | 564 | 1,165 | — | — |
| Gas – Gross | 789 | 1,175 | 20,632 | 18,295 |
| Less: forward gas purchases ¹ | (621) | (885) | — | — |
| Gas – Net | 168 | 290 | — | — |
| Total Trade | \$ 732 | \$ 1,455 | 48,842 | 50,799 |
| Total | \$ 3,822 | \$ 4,269 | 99,075 | 103,311 |

¹ Forward purchases include derivatives which are deducted from gross sales in accordance with generally accepted accounting principles.

Total revenue for the year ended March 31, 2010 was \$3,822 million, a decrease of 10 per cent from the previous year mainly resulting from lower trade revenues due to lower average commodity prices and lower electricity sales volumes, partially offset by higher trade gas sales volumes. Domestic revenues were higher than the prior year due to higher average customer rates in all classes, partially offset by lower sales volumes to residential customers due to lower consumption and to light industrial and commercial and large industrial customers due to economic conditions throughout the year.

DOMESTIC REVENUES

Total domestic revenues of \$3,090 million for the year ended March 31, 2010 were \$276 million or 10 per cent higher than the previous year. The increase is a result of higher average customer rates in all classes, partially offset by lower consumption in the residential customer class due to warmer weather in the current year, in the light industrial and commercial class due to weak demand in the wood manufacturing industry driven by low housing starts, and in the large industrial class due to lower demand from the pulp and paper industry caused by depressed global markets for pulp and newsprint.

TRADE REVENUES

BC Hydro's electricity system is interconnected with systems in Alberta and the western United States. Interconnection facilitates sales and purchases of electricity outside of British Columbia. Energy trade activities are carried out by Powerex, a wholly owned subsidiary of BC Hydro. Trade activities help BC Hydro balance its system by being able to import energy to meet domestic demand when there is a supply shortage in the system due to such factors as low water inflows. Exports are made only after ensuring domestic demand requirements can be met.

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Gross trade revenue for the year ended March 31, 2010 decreased by \$1,356 million from fiscal 2009 due to a decrease in both electricity sales and gas sales. The decrease in gross electricity revenue of \$970 million was driven by decreases in electricity sales prices of 42 per cent and a 13 per cent decrease in electricity sales volumes. The decrease in gross electricity sales included a decrease in forward electricity transactions of \$369 million, which are reported on a net basis in accordance with GAAP. Electricity sales prices decreased as a result of the current economic downturn coupled with low natural gas prices. Gross gas revenue decreased by \$386 million primarily due to a 41 per cent decrease in gas sales prices driven by oversupply concerns since the beginning of the calendar year. Partially offsetting this decrease was a 13 per cent increase in gas sales volumes reflecting Powerex's strategy to continue to grow its gas business.

ENERGY COSTS

Energy costs are influenced primarily by the volume of energy consumed by customers, the mix of sources of supply and market prices of energy. The mix of sources of supply is influenced by variables such as the current and forecast market prices of energy, water inflows, reservoir levels, energy demand and environmental and social impacts.

Energy costs are comprised of the following sources of supply:

| | <i>(in millions)</i> | | <i>(gigawatt hours)</i> | | <i>(\$ per MWh)</i> | |
|--|----------------------|-----------------|-------------------------|----------------|---------------------|-------------------|
| | 2010 | 2009 | 2010 | 2009 | 2010 ² | 2009 ² |
| Hydroelectric (water rental payments) | \$ 311 | \$ 310 | 42,115 | 44,348 | \$ 7.19 | \$ 7.07 |
| Purchases from Independent Power | | | | | | |
| Producers and other long-term contracts | 568 | 544 | 8,893 | 8,374 | 63.85 | 64.96 |
| Other electricity purchases – Domestic | 80 | 271 | 2,161 | 5,020 | 36.97 | 53.98 |
| Gas for thermal generation | 50 | 58 | 400 | 312 | 125.08 | 185.58 |
| Transmission charges and other expenses | 73 | 79 | 113 | 116 | — | — |
| Allocation to/from trade energy | 68 | (26) | 1,525 | (65) | 36.80 | 79.08 |
| Total Domestic | \$ 1,150 | \$ 1,236 | 55,207 | 58,105 | \$ 20.83 | \$ 21.27 |
| Other electricity purchases – Trade – Gross ¹ | \$ 1,114 | \$ 1,729 | 29,453 | 32,086 | \$ 37.82 | \$ 53.89 |
| Less: forward electricity purchases | (756) | (1,125) | — | — | — | — |
| Other electricity purchases – Trade – Spot | 358 | 604 | — | — | — | — |
| Remarketed gas – Gross | 746 | 1,127 | 21,276 | 18,797 | 35.06 | 59.96 |
| Less: forward gas purchases | (622) | (885) | — | — | — | — |
| Other gas purchases – Trade – Spot | 124 | 242 | — | — | — | — |
| Transmission charges and other expenses | 221 | 285 | — | — | — | — |
| Allocation to/from domestic energy | (68) | 26 | (1,525) | 65 | 36.80 | 79.08 |
| Total Trade | \$ 635 | \$ 1,157 | 49,204 | 50,948 | \$ 28.27 | \$ 44.61 |
| Total Energy Costs | \$ 1,785 | \$ 2,393 | 104,411 | 109,053 | \$ 24.34 | \$ 32.17 |

¹ Other electricity purchases in dollars include purchases for trade activities shown net of derivatives. Gigawatt hours and \$ per MWh are shown at gross cost.

² Total cost per MWh includes other electricity purchases at gross cost.

For the year ended March 31, 2010, total energy costs of \$1,785 million were \$608 million or 25 per cent lower than the previous year primarily as a result of lower market energy purchases for domestic, lower trade electricity purchase volumes and lower prices for both gas and electricity for trade.

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DOMESTIC ENERGY COSTS

Domestic energy costs of \$1,150 million for the year ended March 31, 2010 were \$86 million or seven per cent lower than the prior year. The decrease was primarily due to reduced volume and price of market electricity purchases driven by a reduction in load requirements of 2,279 GWh. Purchases from Independent Power Producers (IPPs) increased mainly due to additional electricity purchases from Alcan that BC Hydro was required to make due to Alcan's reduced smelter load, and from two new bio-energy projects, partially offset by reduced costs from Island Co-Generation (ICG) due to lower purchase volumes and lower gas costs.

TRADE ENERGY COSTS

Gross trade energy costs for the year ended March 31, 2010 decreased by \$1,154 million from fiscal 2009 primarily due to a \$615 million decrease in electricity purchases for trade and a \$381 million decrease in remarketed gas purchases. The decrease in electricity purchases for trade included a decrease in forward electricity purchases of \$369 million, which are netted in revenue in accordance with GAAP, and a decrease of \$246 million in spot electricity purchases. Gross electricity purchases for the year reflect a 30 per cent decrease in average electricity purchase prices and an eight per cent decrease in electricity purchase volumes. The purchase price decrease was driven by the current economic downturn and low natural gas prices. Remarketed gas purchase costs decreased by \$381 million driven by a 42 per cent decrease in the average gas purchase price partially offset by a 13 per cent increase in gross gas purchase volumes. As with gas sales, gas purchase volume increases reflect Powerex's strategy to grow its gas business, while the lower gas purchase prices reflect the oversupply concerns since the beginning of the year.

WATER INFLOWS

Water inflows into BC Hydro's reservoirs were 87 per cent of average in fiscal 2010, compared to 96 per cent of average in fiscal 2009. This resulted in a decrease in the volume of low-cost hydro generation.

The BC Hydro reservoirs have been managed such that the combined storage in BC Hydro reservoirs at March 31, 2010 was 94 per cent of average, compared to 114 per cent of average at March 31, 2009 (average storage levels relate to the average from 1986–2009), with the Williston reservoir on the Peace River system at 87 per cent of average (fiscal 2009—106 per cent), and the Kinbasket reservoir on the Columbia River system at 110 per cent of average (fiscal 2009—145 per cent).

The decision to purchase energy instead of utilizing hydro generation is based on many factors, such as the forecast market price of energy in future periods relative to the current period, current reservoir levels and future demand requirements. Operating constraints related to legal and regulatory obligations such as minimum reservoir levels and stream flow requirements also affect the decision to import energy.

OPERATING COSTS

Operations costs for the year ended March 31, 2010 were comparable with the previous year. Higher expenditures on DSM, which support energy conservation, were partially offset by lower First Nations negotiation and settlement costs. Both of these costs are transferred to regulatory accounts and do not impact current year net income. Excluding the costs that were transferred to regulatory accounts, operations costs were consistent with the previous year.

Maintenance costs for the year ended March 31, 2010 were \$275 million higher than the previous year. The increase was primarily the result of a \$289 million provision made in the current year for future environmental compliance and remediation expenditures mainly related to changes in legislation related to PCBs and for environmental impact study expenditures related to the Northern Transmission Line project, partially offset by lower expenditures on mountain pine beetle and hazardous vegetation maintenance. In addition, expenditures on generation asset maintenance were lower in the current year due to the GM Shrum turbine failure in fiscal 2009 which caused significant unplanned maintenance of \$20 million in that year. Both the environmental compliance provision in the current year

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and the GM Shrum repair costs in the previous year were transferred to regulatory accounts and did not impact net income in either year. Excluding the costs that were transferred to regulatory accounts, maintenance costs were \$11 higher in the current year largely due to unplanned transmission system projects.

General and administrative costs were \$58 million higher than the previous year. The increase is primarily the result of higher net benefit costs, mainly related to an increase in non-current pension costs of \$78 million due to the net actuarial loss experienced by the BC Hydro pension plan in fiscal 2009, partially offset by lower expenditures on the procurement enhancement initiative in the current fiscal year. Excluding costs that were transferred to regulatory accounts, general and administrative costs were \$17 million lower than the prior year primarily due to lower net benefit costs after deferral.

AMORTIZATION EXPENSE

Amortization expense for the year ended March 31, 2010, was \$50 million higher than the previous year. The increase is primarily due to higher assets in service in the current year related to BC Hydro's capital expenditure program and to a \$31 million charge to depreciation expense for future environmental remediation costs related to assets that were fully depreciated in prior periods. This charge was transferred to the regulatory account for environmental compliance and did not impact current year net income.

FINANCE CHARGES

Finance charges for the year ended March 31, 2010, were \$53 million lower than the previous year. The decrease was due to foreign exchange translation gains on net unhedged U.S. dollar exposures as a result of the strengthening of the Canadian dollar as compared to the U.S. dollar in the current year as compared with a significant weakening in the prior year, lower short-term interest rates and higher capitalized interest related to higher capital expenditures. These positive variances were partially offset by a higher average volume of debt, lower sinking fund income as the Canadian sinking funds were liquidated in June 2008, and higher other finance charges as the result of a payment to the Province for the carrying cost related to Provincial warehoused debt borrowings.

RETURN ON EQUITY AND PAYMENT TO THE PROVINCE

| <i>(dollar amounts in millions)</i> | 2010 | 2009 |
|---------------------------------------|--------|--------|
| Actual return on equity ¹ | 12.49% | 11.75% |
| Allowed return on equity ² | 13.05% | 11.78% |
| Payment to the Province | \$ 47 | — |

¹ Based on equity as defined for regulatory purposes and adjusted for the unplanned impact of the Waneta transaction.

² BC Hydro's allowed return on equity for F09 and F10 were set by the Commission via BCUC Orders G-16-09 dated March 13, 2009 and BCUC Letter No. L-55-08 dated November 20, 2008.

Under a Special Directive from the Province, BC Hydro is required to make an annual Payment to the Province (the Payment) on or before June 30 of each year. The Payment is equal to 85 per cent of BC Hydro's distributable surplus for the most recently completed fiscal year assuming that the debt to equity ratio, as defined by the Province, after deducting the Payment, is not greater than 80:20. If the Payment would result in a debt to equity ratio exceeding 80:20, then the Payment will be based on the greatest amount that can be paid without causing the debt to equity ratio to exceed 80:20. The Payment accrued as at March 31, 2010, is \$47 million which is below 85 per cent of the distributable surplus due to the 80:20 cap.

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LIQUIDITY AND CAPITAL RESOURCES

Cash flow provided by operating activities for the year ended March 31, 2010, was \$373 million, compared with \$254 million for the prior year. The primary reason that cash flow provided by operating activities increased in fiscal 2010 was an increase in net income.

The long-term debt balance net of sinking funds at March 31, 2010 was \$10,705 million, compared with \$9,325 million at March 31, 2009. The increase was mainly as a result of net long-term bond issues totaling \$1,438 million, an increase in revolving borrowings of \$233 million and an increase of \$34 million for the net premium on new debt issues less amortization, offset by a decrease of \$49 million in debt due to fair value hedge accounting and net foreign exchange revaluation gains of \$276 million. Cash flow generated in the current year and proceeds from debt issues were used primarily to fund property, plant and equipment expenditures, including the \$841 million acquisition of the one-third interest in the Waneta dam and generating facility.

All derivative financial instruments are required to be carried on the balance sheet at fair value. As at March 31, 2010, BC Hydro recorded a net derivative financial instrument liability of \$97 million (\$520 million asset less \$617 million liability) compared with a net financial instrument asset of \$95 million (\$1,167 million asset less \$1,072 million liability) in the prior year. The change resulted from significant losses on foreign currency contracts due to the strengthening of the Canadian dollar as compared to the U.S. dollar in the current year in contrast to the prior year when the weakening of the Canadian dollar resulted in significant gains, and from the decline in value of interest rate swaps as some swaps matured or were unwound while others were impacted by rising interest rates, partially offset by an increase in the value of commodity derivatives as a result of a net short position and a decrease in market prices during fiscal 2010.

PROPERTY, PLANT AND EQUIPMENT EXPENDITURES

Property, plant and equipment expenditures were as follows:

| <i>(in millions)</i> | 2010 | 2009 | Change |
|--|-----------------|-----------------|-----------------|
| Distribution improvements and expansion | \$ 425 | \$ 399 | \$ 26 |
| Generation replacements and expansion | 461 | 349 | 112 |
| Waneta dam and generating facility – one-third interest | 841 | — | 841 |
| Transmission lines and substation replacements & expansion | 389 | 474 | (85) |
| General, including computers and vehicles | 290 | 175 | 115 |
| Total Property, Plant and Equipment Expenditures | \$ 2,406 | \$ 1,397 | \$ 1,009 |

For the year ended March 31, 2010, Distribution capital expenditures increased by \$26 million over the prior year primarily due to higher levels of work on recurring distribution system projects, partially offset by lower customer-driven projects.

Generation replacements and expansion expenditures for the year ended March 31, 2010 increased by \$953 million over the prior year. The increase was primarily due to the purchase of one-third ownership interest of the Waneta dam and generating facility. Higher current year expenditures on other projects included the Revelstoke Unit 5 Installation, the GM Shrum Station Service Replacement, the Terzaghi Spillway Gate Reliability project, the Fort Nelson Resource Smart Upgrade and the Mica Gas Insulated Switchgear (GIS) Replacement, partially offset by lower expenditures on the Aberfeldie Redevelopment that went into service in the first quarter of fiscal 2010.

Transmission capital expenditures, planned and completed by British Columbia Transmission Corporation (BCTC) and owned by BC Hydro, decreased by \$85 million for the year ended March 31, 2010 compared with the prior year. The decrease was primarily due to the substantial completion of the Vancouver Island Transmission Reinforcement project in fiscal 2009, the cancellation in fiscal 2010 of two projects under the Canadian Hydro Blue River IPP project that had been active in fiscal 2009 and lower expenditures on the Dokie Wind Farm IPP project. The decrease was partially offset by increased expenditures on the Central Vancouver Island Reinforcement project, the Vancouver City Central Transmission projects and the East Toba and Montrose IPP.

General capital expenditures increased by \$115 million for the year ended March 31, 2010 compared with the prior year. The majority of the increase was due to current year expenditures for the Home Purchase Offer Program in Tsawwassen, various IT&T transformational and foundational initiatives and vehicle purchases.

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COMPARISON WITH SERVICE PLAN

The *Budget Transparency and Accountability Act* requires that BC Hydro file a Service Plan each February. BC Hydro's Service Plan filed in February 2009 and in August 2009 both forecast net income at \$452 million.

Domestic gross margin was lower than forecast due to lower domestic revenues, particularly in the light industrial and commercial and large industrial sectors which were impacted by weakness in the wood manufacturing and pulp and paper sectors due to economic conditions during the year.

Net trade margins were comparable to the August 2009 Service Plan Update forecast. However, energy trading results reflect a combination of lower revenues due to significantly reduced price spreads for both electricity and gas offset by lower energy purchase costs due to lower commodity prices.

Operating costs increased by \$252 million from the August 2009 Service Plan Update largely due to a provision for future environmental compliance and remediation costs, partially offset by lower operating costs as a result of lower non-current pension costs, lower expenditures on mountain pine beetle and hazardous vegetation maintenance, and lower salaries and benefits due to higher than planned vacancies.

Amortization expense was \$11 million higher than forecast due to an unplanned charge to depreciation for future environmental remediation costs related to assets that were fully depreciated in prior periods, partially offset by gains on asset disposals and lower than forecast dismantling costs.

Finance charges were \$17 million higher than forecast, primarily due to an unplanned payment to the Province for the carrying costs of Provincial warehouse debt borrowings, partially offset by foreign exchange gains due to the higher than planned strengthening of the Canadian dollar as compared with the U.S. dollar during the year.

The majority of these variances to forecast were transferred to regulatory accounts. As a result, the actual net income of \$447 million was \$5 million lower than the August 2009 Service Plan Update.

The table below provides an overview of BC Hydro's financial performance relative to its 2010 to 2011 Service Plan Update (August 2009). The results and forecasts form the basis upon which key performance targets are set.

| <i>(in millions)</i> | Actual | | | Service Plan | 2010 |
|--|----------|----------|----------|--------------|----------|
| | 2008 | 2009 | 2010 | Forecast | Variance |
| | | | | 2010 | |
| Revenues | | | | | |
| Total Domestic | \$ 2,944 | \$ 2,814 | \$ 3,090 | \$ 3,107 | \$ (17) |
| Trade | 1,266 | 1,455 | 732 | 1,280 | (548) |
| | 4,210 | 4,269 | 3,822 | 4,387 | (565) |
| Expenses | | | | | |
| Energy costs | 2,057 | 2,393 | 1,785 | 2,302 | 517 |
| Operating costs | 942 | 915 | 1,249 | 997 | (252) |
| Taxes | 153 | 167 | 173 | 173 | — |
| Amortization | 368 | 395 | 445 | 434 | (11) |
| | 3,520 | 3,870 | 3,652 | 3,906 | 254 |
| Operating Income | 690 | 399 | 170 | 481 | (311) |
| Finance Charges | 463 | 472 | 419 | 402 | (17) |
| Income (Loss) Before Regulatory Account Transfers | 227 | (73) | (249) | 79 | (328) |
| Net Change in Regulatory Accounts | 142 | 438 | 696 | 373 | 323 |
| Net Income | \$ 369 | \$ 365 | \$ 447 | \$ 452 | \$ (5) |

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ADOPTION OF NEW ACCOUNTING STANDARDS

Effective April 1, 2009, BC Hydro adopted the following changes to standards issued by the Canadian Institute of Chartered Accountants (CICA).

(a) Goodwill and Intangible Assets

BC Hydro adopted new CICA Handbook Section 3064, *Goodwill and Intangible Assets*. This section replaced CICA Handbook Section 3062, *Goodwill and Intangible Assets*, and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets.

As a result of adopting this new standard, the Company has retroactively revised the comparative statements for amounts that no longer qualify for capitalization. The effect of the change reduced opening retained earnings by \$10 million, which is the amount of the adjustment related to periods prior to April 1, 2009. To reflect the write-off of amounts previously capitalized in the prior period but which no longer meet the criteria for capitalization, intangible assets decreased by \$8 million and other long-term liabilities increased by \$2 million, with the corresponding amount being charged to income in the prior periods. An adjustment of \$1 million was also made to other long-term liabilities, with the corresponding amount being reflected in property, plant and equipment.

The Company also reclassified \$118 million of clearing costs from intangible assets to lines within property, plant and equipment.

(b) Accounting for Rate-Regulated Operations

Effective April 1, 2009, the Canadian Accounting Standards Board (AcSB) removed the temporary exemption in Section 1100, *Generally Accepted Accounting Principles*, pertaining to the application of that Section to the recognition and measurement of assets and liabilities arising from rate regulation. The removal of the exemption requires the Company to now apply Section 1100 to the recognition of assets and liabilities arising from rate regulation. In applying Section 1100, the Company may consult other sources, including pronouncements issued by bodies authorized to issue accounting standards in other jurisdictions. Consequently, the Company has consulted and applied *Accounting Standards Codification (ASC) 980, "Regulated Operations"*, (previously Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation*) as issued by the U.S. Financial Accounting Standards Board to its rate-regulated operations and has determined that all regulatory assets and liabilities continue to qualify for recognition under Canadian GAAP. As a result, the removal of the temporary exemption under Section 1100 did not impact the Company's consolidated financial statements.

(c) Financial Instruments

For the year ended March 31, 2010, BC Hydro adopted the amendments to CICA Handbook Section 3862—*Financial Instruments—Disclosures*. The amendments require the classification and disclosure of fair value measurements using a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. The amendments affected disclosure only and did not impact BC Hydro's accounting for financial instruments. These disclosures have been included in Note 13 to the Company's financial statements.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

On February 13, 2008, the Canadian Accounting Standards Board confirmed the adoption of IFRS in place of Canadian GAAP for publicly accountable enterprises. The new requirements are effective for interim and annual reporting periods beginning on or after January 1, 2011.

In October 2009, the Canadian Public Sector Accounting Board (PSAB) confirmed the existing guidance whereby Government Business Enterprises (GBEs), which BC Hydro is classified as, adhere to standards for publicly accountable enterprises in the private sector. The Company is currently evaluating the impact of the transition to IFRS on its consolidated financial statements.

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Areas with significant differences between IFRS and Canadian GAAP that would impact BC Hydro include: Regulatory Accounting, Property, Plant & Equipment, Provisions and Contingent Liabilities, Employee Benefits, and the overall presentation of financial statements. The initial adoption of IFRS under IFRS 1, *First-time Adoption of International Financial Reporting Standards*, would also result in a number of significant changes.

Regulatory Accounting is currently under consideration by the International Accounting Standards Board (IASB) and further guidance is expected in 2010.

REGULATION

REGULATORY ACCOUNTS

BC Hydro has various regulatory accounts which were established with the approval of the BCUC. Regulatory accounts allow BC Hydro to defer certain types of revenue and cost variances through transfers to and from the accounts which has the effect of adjusting net income. The deferred amounts are then included in customer rates in future periods, subject to approval by the BCUC.

For the year ended March 31, 2010, BC Hydro transferred, on a net basis, \$696 million of costs to regulatory accounts compared with \$438 million during the previous year. The majority of the transfers relate to the cost of energy deferral to the Trade Income Deferral Account (TIDA), DSM expenditures and environmental compliance costs. The net balance of the regulatory asset and liability accounts as at March 31, 2010, was a \$1,713 million asset compared to a \$1,018 million asset at March 31, 2009. The significant increase in transfers to TIDA primarily reflect the lower than planned energy trading results in the current year as a result of significantly lower price spreads due to lower commodity prices for electricity and natural gas. The net balance in the energy deferral accounts (Heritage Deferral Account (HDA), Non-Heritage Deferral Account (NHDA), TIDA and BCTC Deferral Account (BCTCDA)) as at March 31, 2010 were a \$585 million asset compared to a \$332 million asset as at March 31, 2009. These energy deferral accounts are recovered through the rate rider.

REVENUE REQUIREMENTS APPLICATION

In regulating and setting rates for BC Hydro, the BCUC must ensure that the rates are sufficient to allow BC Hydro to provide reliable electricity service, meet its financial obligations, comply with government policy and achieve an annual rate of return on equity based on forecast consolidated net income. The annual rate of return on equity is equal to the pre-income tax annual rate of return allowed by the BCUC to the most comparable investor-owned energy utility regulated under the *Utilities Commission Act*. The allowed annual rate of return on equity (ROE) calculated based on equity as defined for regulatory purposes for fiscal 2010 was 13.05 per cent (fiscal 2009—11.78 per cent). The actual rate of return in fiscal 2010 was 12.49 per cent after adjusting for the impact of the Waneta Dam and generating facility acquisition.

BC Hydro's F2011 Revenue Requirement Application (RRA) was filed with the BCUC on March 3, 2010 requesting a 6.11 per cent increase to current rates. The allowed annual ROE for fiscal 2011 is 14.37 per cent. The increase over the prior year's ROE is due to the higher rate of return allowed for Terasen Gas Inc., upon which BC Hydro's ROE is based. The rate increase is attributable to the ongoing implementation of a significant capital program to refurbish BC Hydro's aging assets, an increase in the return on equity earned by government, higher costs associated with BC Hydro's pension plan reflecting the impact of market conditions on the valuation of plan assets, and expected lower trade income due to weaker export market conditions. BC Hydro also requested that the rate rider increase by three per cent to partly recover the energy deferral accounts which increased during fiscal 2010 as a result of lower trade income. The rate increases were approved by the BCUC on an interim basis on March 15, 2010 effective April 1, 2010. The RRA review process is underway and is expected to continue to the fall of 2010.

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WANETA TRANSACTION

On September 23, 2009, BC Hydro and Teck Metals Ltd. (Teck) signed an Asset Purchase Agreement for the acquisition by BC Hydro of a one-third interest in Teck's Waneta dam and generating facility near Trail, B.C., for \$825 million. BC Hydro applied to the BCUC for acceptance that expenditures associated with the proposed acquisition (\$825 million payment to Teck Metals Ltd. plus transaction costs) are in the public interest. A written regulatory review process was held from July to December 2009 and the BCUC acceptance of the transaction was received on February 3, 2010. BC Hydro and Teck closed the transaction on March 5, 2010.

GORDON M. SHRUM (GMS) TURBINE REPLACEMENT PROJECT

On August 5, 2009, BC Hydro filed an application with the BCUC for the expenditures associated with the Gordon M. Shrum (GMS) Units 1 to 5 Turbine Replacement Project. GMS Units 1 to 5 are late 1960's vintage turbines that have reached their end of life and require replacement. A written regulatory review process was completed in December and a decision was issued by the BCUC on January 5, 2010, accepting the \$260 million project as being in the public interest.

MICA GAS INSULATED SWITCHGEAR (GIS) PROJECT

On August 5, 2009, BC Hydro filed an application with the BCUC for the expenditures associated with the Mica Gas Insulated Switchgear (GIS) Project. The existing GIS is more than 30 years old, and poses the risk of forced outage to BC Hydro. The Project will replace, with modern GIS technology, all the existing GIS at Mica. A written regulatory process was completed in December 2009. The BCUC issued its decision on March 16, 2010, declining to accept the project as being in the public interest.

LARGE GENERAL SERVICE (LGS)

An application to re-design the Large General Service (LGS) rate to provide new conservation rates for BC Hydro's Large General Service customer class was filed with the BCUC on October 16, 2009. If approved, the existing LGS rate class will be split into two new customer classes: a new large general service customer class and a new medium general service customer class. A Negotiated Settlement Process between BC Hydro and customer intervenors is currently underway. Further rate structures will be designed over the next few years to help BC Hydro meet its conservation targets.

STAVE FALLS SPILLWAY GATES REPLACEMENT PROJECT

On December 23, 2009, BC Hydro filed an application with the BCUC for acceptance of an estimated \$61.5 million of expenditures associated with the Stave Falls Spillway Gates Replacement Project. The existing gates at the Stave Falls facility were installed in the 1920s and are at end of life. Their replacement will reduce dam safety risks associated with any potential operational failure of the Stave Falls dam during high flood conditions. A written process to review the application was completed at the end of April 2010.

SOUTHERN ST'AT'IMC COMMUNITIES ELECTRIFICATION PROJECT

On December 1, 2009, BC Hydro filed an application with the BCUC for acceptance of the expenditures to provide electric service to the Southern St'at'imc Communities. This is the first application for a First Nation community under BC Hydro's Remote Community Electrification program. While the total estimated cost of the project is about \$30 million, BC Hydro is seeking acceptance of only \$12 million of expenditures from the BCUC; the remaining expenditures are to be funded by contributions from Indian and Northern Affairs Canada and the St'at'imc. A written process to review the application concluded in February. On April 13, 2010, the BCUC determined that the project is in the public interest.

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LEGAL PROCEEDINGS

Since 2000, Powerex has been named, along with other energy providers, in lawsuits and U.S. federal regulatory proceedings which seek refunds, damages and/or contract rescissions based on allegations that, during part of 2000 and 2001, the California wholesale electricity markets were unlawfully manipulated and energy prices were not just and reasonable. At March 31, 2010, Powerex was owed US \$265 million (CDN \$269 million) by the California Power Exchange and the California Independent System Operator related to Powerex's trade activities in California during the period covered by the lawsuits. It is expected those receivables will be offset against any refunds that Powerex is required to pay.

Due to the ongoing nature of the regulatory and legal proceedings against Powerex, management cannot predict the outcomes of the claims against Powerex. Powerex has recorded provisions for uncollectible amounts and legal costs associated with the California energy crisis. These provisions are based on management's best estimates, and are intended to adequately provide for any exposure. However, the amounts that are ultimately collected or paid may differ from management's current estimates. Management has not disclosed the provision amounts or ranges of expected outcomes due to the potentially adverse effect on the process.

Due to the size, complexity and nature of BC Hydro's operations, various other legal matters are pending. It is not possible at this time to predict with any certainty the outcome of such litigation. Management believes that any settlements related to these matters will not have a material effect on BC Hydro's consolidated financial position or results of operations.

RISK MANAGEMENT

BC Hydro faces risks to its business that could significantly impact its ability to achieve its short- and long-term financial, social and environmental goals. The goal of risk management is not to eliminate risks, but rather to mitigate them to acceptable levels which are commensurate with potential benefits to be derived. BC Hydro's strategies aim to minimize or mitigate risks with a consistent risk management process that is applied to day-to-day business activities as well as to specific projects and initiatives. BC Hydro's Chief Risk Officer is responsible for supporting this risk management process and ensuring strong oversight of significant risks by the BC Hydro Risk Management Committee. BC Hydro's Board of Directors also plays a key role in the oversight of risk management, as the Board must understand the risks being taken by BC Hydro and ensure that processes are in place to appropriately manage the risks. BC Hydro's operations involve a broad spectrum of risks ranging from those commonly associated with any business to catastrophic societal loss risks that would have severe effects on entire regions. The key risks BC Hydro faces are divided into eight categories for management purposes: employee, public and dam safety; reliability; financial performance; regulatory; First Nations; organization risk; environmental and social performance; and market dynamics

EMPLOYEE, PUBLIC AND DAM SAFETY

The generation and distribution of electricity inherently results in certain safety risks to both BC Hydro workers and the public. Safety risks to the public exist due to the multiple uses of water for electricity generation, recreation and waterways. Risks can also result from potential contact with transmission and distribution equipment located in communities. To manage the public safety risk, BC Hydro relies on safe design, construction and operating standards and practices, signage, consultation with other agencies and stakeholder groups, and public education. BC Hydro also prepares emergency response plans to limit injury and loss of life and to restore electric service.

Many of BC Hydro's employees face the risk of serious injury or death by the nature of their jobs in dealing with electrical and other high risk hazards. To mitigate these inherent risks, BC Hydro has a comprehensive safety management system that includes employee involvement, communication, training, resources, policies and safety practice regulations.

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The large dams represent a catastrophic loss risk (low probability but high consequence) to BC Hydro in terms of life, safety, financial, environmental and reputation. This dam failure risk is managed through a comprehensive dam safety management system involving dam safety professionals and experts. The system incorporates dam surveillance and monitoring, periodic independent reviews of dam performance, dam investigations and analysis. Dam upgrades may be required due to changes in knowledge, standards or extreme event parameters (for earthquake, floods, landslides). BC Hydro follows the B.C. Dam Safety Regulation, participates in the Canadian Dam Association and the International Commission on Large Dams, and engages panels of international experts for independent advice on the management and control of these risks.

RELIABILITY

The most significant risks to the reliability of BC Hydro's system are aging infrastructure and the impact of weather. As BC Hydro's facilities approach end of life they require increased maintenance and capital investment. Other factors such as changing operating demands and increased use can also affect the health of the equipment. With BC Hydro's large service territory, there is significant exposure to trees, terrain and diverse weather patterns. BC Hydro mitigates the likelihood and consequence of such impacts through effective design, construction, operations, maintenance and response. Additionally, a five-year System Resiliency Program is in progress which increases the ability of the system to withstand interruptions caused by adverse weather. In managing these risks, BC Hydro balances customers' expectations and cost considerations. Reliability risks could also result from either a lack of available generation supply or the associated transmission capacity to meet customer demand. BC Hydro must meet government—permitting requirements to operate its facilities and build new infrastructure, which can have an impact on project lead times. Delays in obtaining appropriate permits and consent could adversely impact reliability.

BC Hydro manages these risks through long-term planning, asset maintenance and replacement programs, working with BCTC to mitigate transmission and substation outages, reliance on a diverse supply of energy options, and through cooperative support arrangements with neighbouring utilities.

FINANCIAL PERFORMANCE

In meeting its financial performance targets, BC Hydro faces many risks including challenging economic conditions, energy costs, energy demand, interest and foreign exchange rates, pension obligations, and energy trading. Of these, risks associated with energy costs—specifically water inflows and energy market prices—are the largest. Tariff rates are set based upon BC Hydro's cost forecast and allowed return on deemed equity. Many risks (difference between forecast and actual costs) associated with uncontrollable costs are mitigated through regulatory deferral accounts. The major cost components susceptible to variation included in the regulatory deferral accounts are water inflows, energy prices including thermal fuel costs, finance charges and trade income. In addition, the return on pension fund assets and the market discount rate at year end can have a significant impact on the cost of providing employee future benefits.

Increasing costs due to aging infrastructure, the modernization and refurbishment of the electricity system, the need for new supply and the need to manage environmental impacts create challenges for BC Hydro in maintaining the low electricity cost advantage the province enjoys. A low water year and the impacts associated with the economic downturn also create challenges in maintaining a cost advantage. How BC Hydro manages tradeoffs between these competing objectives will be important to its financial performance and its ability to make the required infrastructure investment. External long-term costs of environmental and social impacts need to be factored into decision-making today to ensure the right business decisions are made for the long-term.

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CREDIT RISK

Customer and supplier credit risk remains elevated as a result of the recent volatile economic and market conditions.

ENERGY COST

Energy cost risk is the most significant financial risk to BC Hydro and arises when BC Hydro is required to purchase electricity and/or natural gas from the markets. It can also result from changing market prices for electricity and natural gas. Overall BC Hydro system inflows during fiscal 2010 were well below average, at 87 per cent of normal. As a result, in fiscal 2010 BC Hydro was a net buyer of market electricity for the ninth year in the last ten years. The amount of energy stored in BC Hydro system reservoirs is now below the historic average for this time of year, and about 2,700 GWh lower than the system storage level last year at this time. Due to low snowpacks during the past winter, the forecast for system inflow energy in fiscal 2011 is also below average, at about 90 per cent of normal. The impact of these successive years of below-average system inflows is partially offset by reduced domestic loads due to the current economic conditions. However, even with the reduced loads and an increase in other domestic resources the system is forecast to be in a significant net deficit energy position for fiscal 2011.

Furthermore, several factors constrain BC Hydro's ability to use its stored system energy to meet load throughout the year. These factors include generating unit outages at major plants (forced outages and capital projects) as well as water management constraints which limit generation at the major plants during some periods. As a result, while the majority of the market electricity purchases can be made on a "discretionary" basis (i.e. at times of low prices), some purchases will also be required during constrained periods of the year when market prices are likely higher. The cost of all of these market purchases is subject to market price risk.

BC Hydro manages its energy cost risk through its flexible hydroelectric system, which allows water to be stored in large reservoirs and used when it is most economic, and by hedging the cost of imported electricity. This risk is also mitigated through regulatory deferral accounts which allow BC Hydro to recover its energy costs in rates provided they have been prudently incurred.

ENERGY DEMAND

Electricity demand is increasing as B.C.'s population increases and its economy grows. However, this demand can be volatile, particularly from larger customers whose consumption is often driven by export markets and world commodity prices. The forestry sector has taken a series of indefinite and permanent shutdowns which have resulted in a reduction in current and forecasted electricity demand. There are indications of an economic recovery which could lead to increased customer loads due to a combination of increased general economic activity, and the restarting of currently idled industrial capacity.

BC Hydro's risk mitigation strategy is to achieve energy security from domestic sources. BC Hydro's first and best choice for energy security is through energy conservation and efficiency. Additional choices include reinvesting in assets to prolong their life and, where possible, adding additional energy and capacity. BC Hydro is also examining the potential of new hydro generation facilities and will continue to purchase clean and renewable power from IPPs.

INTEREST RATES AND FOREIGN EXCHANGE RATES

Changes in interest and foreign exchange rates can significantly impact BC Hydro's finance charges. BC Hydro debt management and risk management strategies include limiting the allowable percentage range of variable interest rate debt and closely monitoring settlement and counterparty credit risks associated with derivative financial instruments. Interest and foreign exchange rate changes can also influence the performance and cost of BC Hydro's employee benefit and pension plans.

Interest rate risk is managed within Board approved limits and policies, which require the debt portfolio to be managed using an appropriate blend of fixed and variable rate debt, as well as by managing the term to maturity of its debt portfolio to manage exposure to interest rate movements in the future. BC Hydro utilizes financial instruments, including interest rate swaps and options, to adjust the balance of fixed and variable rate debt, and to reduce its overall cost of borrowing.

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Falling interest rates resulting from the global financial turmoil have allowed BC Hydro to take advantage of the low rates for long-term debt. BC Hydro has increased its long-term fixed rate debt and has reduced its proportion of variable interest rate exposure.

BC Hydro is exposed to foreign exchange rate risk through its U.S. dollar denominated debt issues and debt servicing, U.S. dollar denominated sinking fund investments, the purchase of U.S. dollar priced electricity and natural gas, from Powerex through its U.S. trade activities, and from U.S. dollar capital equipment purchases. Foreign exchange risk is managed within Board approved limits and policies. BC Hydro utilizes financial instruments, including cross currency swaps and foreign exchange rate forward contracts, to manage its foreign exchange exposure. Both foreign exchange and interest rate risks are monitored and reported on a monthly basis.

ENERGY TRADING

BC Hydro's energy trading subsidiary, Powerex, is exposed to the risk of variable market prices and counterparties who might not meet their obligations. Powerex manages these risks by operating through defined limits that are regularly reviewed by both the Powerex and BC Hydro Boards of Directors. Powerex primarily focuses on near-mid-term trading positions, backing forward commitments with the physical supply capability of the BC Hydro System, the Canadian Entitlement, and other supply contracts, while operating within Board approved market and credit limits. Longer-term positions are reviewed in the context of the overall energy trading portfolio. Lower market electricity and gas prices have led to a contraction in locational and seasonal price spreads, lessening the potential for profit from trading activities.

Powerex is exposed to the risk of litigation, such as the potential liabilities from the California power crisis. The conduct of Powerex employees is governed by its Trading Code of Conduct and Compliance policies and procedures. Powerex also adheres to the Electric Power Supply Association's Code of Ethics and Sound Trading Practices for Electric Power Suppliers to guide its trading activities.

REGULATORY RISK

BC Hydro's proposals on revenue requirements, rate designs, long-term planning, power procurement, and major capital projects are subject to review and approval or acceptance by BCUC. Depending on the outcome of these reviews, BC Hydro may not be able to undertake some of these initiatives or certain costs incurred by BC Hydro may not be recoverable in rates. Adding to this prevalence of regulatory uncertainty is the impact of the economy on BC Hydro's revenues and costs. The BCUC established a number of regulatory accounts to deal with economic uncertainty and lessen the financial risk to BC Hydro. BC Hydro manages this regulatory risk by working to maintain positive relationships with its intervenors, stakeholders and the BCUC and ensures that its proposals and applications are well-justified and in the interests of its ratepayers.

FIRST NATIONS

First Nation consultation obligations on new projects, legal challenge from First Nations on the adequacy of consultation and alleged infringements of aboriginal rights on existing projects continue to pose risks to regulatory processes and service reliability. These risks are managed through a comprehensive and proactive Aboriginal Relations program. The long-term goal of further building business relationships with First Nations is intended to go beyond addressing the impact of BC Hydro facilities, capital projects and power acquisitions on First Nations and reducing the associated financial, legal and operating risks, to having a more proactive, mutually beneficial approach to working together.

ORGANIZATIONAL RISK

Ensuring the appropriate supply of labour in both the short- and long-term is a challenging issue for BC Hydro as well as for other utilities and businesses across North America. While the current global economic slowdown has eased some of the pressures within the external labour market and improved the attraction and retention of our workforce, certain occupation groups such as technical workers,

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operational managers and qualified trades people remain in limited supply across the local and broader employment marketplace. The economic downturn has had the effect of delaying employee retirements. This may result in a sudden surge of retirements in the future with shorter notice periods. While apprentice and job-sharing programs partially mitigate this risk, there remains the potential for some concern. The cost of living in many British Columbia communities continues to pose a challenge to the attraction and retention of employees as does the geographic isolation of some BC Hydro work locations. A moderately reduced attrition rate has also kept BC Hydro's retirement eligibility rate high with around 25 per cent of our current staff eligible to retire within the next 4 years. Failing to maintain and develop BC Hydro's people capacity presents risk to the ability to execute our operational and capital plans.

ENVIRONMENTAL AND SOCIAL PERFORMANCE

Areas where BC Hydro is exposed to the risk of non-compliance with environmental regulations include the release of hazardous materials into the environment and endangerment of wildlife and their habitats. Although the B.C. Government has set aggressive targets for reducing GHG emissions, significant uncertainty remains around climate change-related regulations. Efforts to limit GHGs are expected to significantly affect the costs, market value and risks associated with the evaluation of electricity generation resource options by utilities. BC Hydro also faces physical risks associated with climate change including effects on water supply, infrastructure and emergency planning. To mitigate these risks BC Hydro monitors development in GHG policy and regulation. Our climate change strategy also helps BC Hydro mitigate GHG emissions, manage regulatory risk and meet compliance requirements, as well as adapt to the potential effects of climate change. BC Hydro's environmental responsibility policy states that BC Hydro will meet or exceed environmental regulations defined by legislation, regulation, government directives and guidelines, as well as its commitments and agreements. Even if there is no environmental or social regulation, BC Hydro can face risks. These risks are managed through environmental management systems and risk mitigation strategies. BC Hydro's Board approved a corporate social responsibility policy in 2004. Voluntary action is taken with a view to managing long-term risk and for cost controls.

MARKET DYNAMICS

The dynamics among participants in BC Hydro's industry appear to be changing. Emerging business opportunities in power generation and clean energy technologies are leading to our own customers looking to play a larger role in providing electricity. We may also see an increase in fuel switching between electricity and natural gas. Risks of competition exist, however they are balanced with opportunities for collaboration and BC Hydro is taking action to establish or strengthen existing relationships with communities, technology providers, other utilities and BC Hydro customers to develop these opportunities.

FUTURE OUTLOOK

The *Budget Transparency and Accountability Act* requires that BC Hydro file a Service Plan each year. BC Hydro's Service Plan filed in early March 2010 forecasts net income for fiscal 2011 at \$609 million. The Service Plan includes a 6.11 per cent interim rate increase for fiscal 2011 which was approved by the BCUC on an interim basis. BC Hydro is currently going through its revenue requirement process and the final rate increases approved by the BCUC may differ from the interim rate increase. Any difference between the final and interim rate increase will be adjusted on customer bills accordingly.

BC Hydro's results can fluctuate significantly due to various non-controllable factors such as the level of water inflows, customer load, market prices for electricity and natural gas, weather, temperatures, interest rates and foreign exchange rates. The impact to net income of these non-controllable factors is largely mitigated through the use of regulatory accounts. The Service Plan forecast assumes average water inflows for fiscal 2011, customer load of 51,550 GWh, average market energy prices of CDN \$36.80/MWh, short-term interest rates of 1.02 per cent and a U.S. dollar exchange rate of US \$0.9611, an allowed return on equity of 14.37 per cent, and an interim rate increase of 6.11 per cent for fiscal 2011.

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EARNINGS SENSITIVITY

The following table shows the effect on earnings of changes in some key variables. The analysis is based on business conditions and production volumes forecast for fiscal 2011. Each separate item in the sensitivity analysis assumes the others are held constant. While these sensitivities are applicable to the period and magnitude of changes on which they are based, they may not be applicable in other periods, under other economic circumstances or greater magnitude of changes.

The volatility between BC Hydro's plan and actual results are mostly mitigated through the use of BCUC-approved regulatory deferral accounts.

| Factor | Change | Approximate change in earnings before regulatory deferral account transfers (in millions) | 5 year high | 5 year low |
|-------------------------------|--|---|---------------------|----------------------|
| Hydro generation ¹ | 1,000 GWh | \$ 40 | 52,140 GWh | 43,208 GWh |
| Electricity trade margins | \$1/MWh | 35 | n/a | n/a |
| Interest rates | +/- 1% | 40 | 4.50% ² | 0.45% ² |
| Exchange rates (US/ CDN) | \$0.01 | 5 | \$0.97 ³ | \$0.84 ³ |
| Weather | 1°C change in average temperature | 15 | 1.0°C ⁴ | -1.5 °C ⁴ |
| Pension costs | 1% change in the expected return of 7.3% on pension assets ⁵ | 5 | 18.8% | -23.3% |

¹ Assumes change in hydro generation is offset by corresponding change in energy imports (i.e. increase in hydro generation is offset by decrease in energy imports).

² Interest rates are the average Canadian short-term interest rates (3 month Canadian Dollar Offered Rate).

³ Exchange rates are the average US Dollar noon rates for fiscal 2006 to fiscal 2010.

⁴ Weather high and low numbers represents the variance in degrees Celsius from the normal temperatures over the winter months November to March from 2005/06 to 2009/10. [-1.5 degrees lower than normal to 0.4 degrees higher than normal—normal is the 10-year rolling average].

⁵ The impact of this change affects earnings in the subsequent year.