



T H I R D Q U A R T E R R E P O R T - F I S C A L 2 0 0 7

Financial

MANAGEMENT DISCUSSION AND ANALYSIS

The following section provides a discussion and analysis of BC Hydro's consolidated results and financial position. This section should be read in conjunction with the Management Discussion and Analysis presented in the 2006 Annual Report, 2006 Annual Consolidated Financial Statements of BC Hydro, and the interim consolidated financial statements of BC Hydro for the nine months ended December 31, 2005 and 2006.

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 materially from those contemplated in the forward-looking statements.

Consolidated Results of Operations

BC Hydro's income before regulatory account transfers was \$143 million for the three months ended December 31, 2006 compared to \$149 million in the same period in fiscal 2006. The change was a result of a decrease in trade gross margin, higher operating costs and finance charges partially offset by an increase in domestic gross margin and lower amortization.

The net income for the third quarter was \$176 million compared with \$118 million in the same period in the previous year. The current financial results include the impact of a rate increase for domestic customers of 1.54 per cent effective July 1, 2006 and adjustments to the deferral account transfers to reflect the Fiscal 2007/2008 Revenue Requirements Application (F07/F08 RRA) Negotiated Settlement Agreement (NSA) approved by the British Columbia Utilities Commission (BCUC) during the quarter. In addition, the improved results are also due to lower amortization charges offset by higher operating costs and finance charges.

Income before regulatory account transfers of \$305 million for the nine months ended December 31, 2006, compares with \$286 million for the same period in the previous year. The increase is due to an increase in the trade gross margin, lower operating costs and amortization expense, offset by lower domestic gross margin and higher finance charges.

BC Hydro's net income was \$380 million for the nine months ended December 31, 2006, compared with \$250 million in the same nine-month period in the previous year. The increase is primarily a result of lower operating costs and amortization and trade income in excess of the \$200 million limit for transfers to the deferral account. This increase in net income is partially offset by higher finance charges.

Financial

Revenues

	For the three months ended December 31			
	(in millions)		(gigawatt hours)	
	2006	2005	2006	2005
Domestic:				
Residential	\$ 291	\$ 305	4,834	4,793
Light industrial and commercial	251	246	4,603	4,459
Large industrial	132	149	4,059	4,221
Other energy sales	50	8	638	601
Total Domestic	\$ 724	\$ 708	14,134	14,074
Trade:				
Electricity	\$ 265	\$ 452	6,222	6,689
Gas	123	140	1,425	1,595
Total Trade	\$ 388	\$ 592	7,647	8,284
Total	\$ 1,112	\$ 1,300	21,781	23,358

	For the nine months ended December 31			
	(in millions)		(gigawatt hours)	
	2006	2005	2006	2005
Domestic:				
Residential	\$ 740	\$ 731	11,577	11,316
Light industrial and commercial	749	728	13,431	13,183
Large industrial	400	439	12,038	12,370
Other energy sales	76	137	1,312	1,198
Total Domestic	\$ 1,965	\$ 2,035	38,358	38,067
Trade:				
Electricity	\$ 752	\$ 988	26,052	23,206
Gas	345	297	5,471	4,018
Total Trade	\$ 1,097	\$ 1,285	31,523	27,224
Total	\$ 3,062	\$ 3,320	69,881	65,291

Total revenue during the third quarter of fiscal 2007 was \$1,112 million, a decrease of 14 per cent over the same period last year. Domestic revenues decreased overall as a combination of the accrual for the rate refund for the period from July 1 through September 30, 2006 and a reduction in activity in the large industrial sector, offset by the introduction of new customer rates and increased domestic customer demand in the residential and light industrial and commercial sectors. Trade revenues were lower as a result of the decrease in average commodity prices and a decrease in commodity volumes traded.

Total revenues of \$3,062 million for the nine months ended December 31, 2006 were \$258 million lower than the same period in the previous year. The primary reasons for the decrease are a reduction in electricity trading revenues due to significantly reduced commodity prices, partially offset by increased trade volumes. Domestic revenues for the period included the approved 1.54 per cent customer rate increase, however, this was offset by the customer refund accrual and the impact of the implementation of stepped rates and lower demand in the large industrial sector in this fiscal year.

Financial

Domestic Revenues

The new customer rates approved by the BCUC include a 1.54 per cent increase, effective from July 1, 2006. The interim rate of 4.65 per cent applied during the period from July 1 through September 30, 2006 has been adjusted to reflect the approved rate of 1.54 per cent through the accrual of a customer rate refund to be paid in Spring 2007. The Fiscal 2007 Revenue Deficiency Referral account recorded in the first quarter was reversed this quarter, reducing revenue in the quarter. Further details regarding the impact of the NSA is included in Note 4 of the consolidated financial statements.

Total domestic revenues of \$724 million for the third quarter were \$16 million or two per cent higher than for the same period in the previous year. This is due to the combined effects of the implementation of the newly approved customer rates, customer refund adjustments, and a small growth in consumption for all sectors except for large industrial which reflect lower business activity and the impact of the introduction of stepped rate pricing. Stepped rate pricing enables customers to pay two different prices for their electricity, depending on their historic use of the resource. Stepped rates encourage customers to conserve electricity and/or invest in more efficient equipment. Total sales volumes were comparable to the prior year with 6,343 customers added to the system. The continued decline in revenue levels in the large industrial sector resulted from lower consumption in the pulp and paper industry.

Total domestic revenues of \$1,965 million for the nine months ended December 31, 2006 were \$70 million or three per cent lower than for the same period in the previous year. Total domestic sales volumes increased by one per cent as a result of 29,887 customers added to the system, and an increase in average consumption in the residential and light industrial and commercial sectors. The decline in revenue levels in the large industrial sector resulted from lower volumes in the pulp and paper industry and the introduction of stepped rate pricing. The year-to-date results also benefited from the implementation of the recently approved customer rates.

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.

Total trade revenues for the third quarter were \$388 million, a decrease of 35 per cent compared to \$592 million in the prior year. Trade sales volumes of 7,647 GWh decreased by eight per cent from 8,284 GWh in the third quarter of the prior year both from electricity and gas trading activities. The volume of electricity traded during the quarter was 6,222 GWh compared to 6,689 GWh in the third quarter of fiscal 2006 and average sales prices for electricity were 27 per cent lower at a gross price of \$72/MWh (Fiscal 2006 - \$98/MWh). The volume of gas sales decreased to 1,425 GWh during the third quarter from 1,595 GWh in the prior year with a 21 per cent lower average sales price at a gross price of 76/MWh (Fiscal 2006 - \$96/MWh).

Electricity market prices were lower in the third quarter of fiscal 2007 compared to the same period last year, as a result of relatively warmer temperatures which reduced demand and higher gas storage levels which increased supply compared to the prior year. Gas prices in the third quarter of fiscal 2006 were high due to a continued shortage of gas supply as a result of severe hurricanes in the Gulf of Mexico earlier in the year. Trade revenues for the nine months ended December 31, 2006 were \$1,097 million compared to \$1,285 million in the same period last year. There was a 16 per cent increase in total gas and electricity sales volumes, however, this was offset by a significant decrease in average sales prices for both gas at \$61/MWh (F2006 - \$77/MWh) and electricity at \$64/MWh (F2006 - \$80/MWh) as discussed above.

Financial

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 made up of the following sources of supply:

	For the three months ended December 31					
	(in millions)		(gigawatt hours)		(\$ per MWh)	
	2006	2005 ¹	2006	2005 ¹	2006	2005 ¹
Hydro ²	\$ 71	\$ 79	12,453	13,703	\$ 5.77	\$ 5.72
Purchases from Independent Power Producers and other long-term contracts	68	128	1,635	2,329	41.59	54.96
Other commodity purchases - Domestic (net) ³	61	13	1,114	241	54.76	53.94
Thermal	29	18	384	103	75.52	174.76
Transmission charges and other	3	21	32	30	-	-
Total Domestic	\$ 232	\$ 259	15,618	16,406	\$ 14.85	\$ 15.79
Other electricity purchases – Trade	\$ 153	\$ 290	6,722	6,517	\$ 55.98	\$ 82.88
Remarketed Gas	105	150	1,496	1,673	70.19	89.66
Transmission charges and other	47	57	-	-	-	-
Total Trade	\$ 305	\$ 497	8,218	8,190	\$ 64.29	\$ 91.23
Total Energy Costs⁴	\$ 537	\$ 756	23,836	24,596	\$ 31.90	\$ 40.91

	For the nine months ended December 31					
	(in millions)		(gigawatt hours)		(\$ per MWh)	
	2006	2005 ¹	2006	2005 ¹	2006	2005 ¹
Hydro ²	\$ 181	\$ 206	31,251	35,516	\$ 5.87	\$ 5.76
Purchases from Independent Power Producers and other long-term contracts	266	347	5,988	6,935	44.42	50.04
Other commodity purchases - Domestic (net) ³	193	135	4,706	2,593	41.01	52.06
Thermal	68	45	919	294	73.99	153.06
Transmission charges and other	33	60	79	77	-	-
Total Domestic	\$ 741	\$ 793	42,943	45,415	\$ 17.26	\$ 17.46
Other electricity purchases – Trade	\$ 299	\$ 539	26,385	21,320	\$ 49.64	\$ 65.80
Remarketed Gas	319	312	5,758	4,208	55.40	74.14
Transmission charges and other expenses	176	168	-	-	-	-
Total Trade	\$ 794	\$ 1,019	32,143	25,528	\$ 56.15	\$ 73.76
Total Energy Costs⁴	\$ 1,535	\$ 1,812	75,086	70,943	\$ 33.91	\$ 37.72

1. Prior year has been restated to reflect split between domestic and trade activities.

2. Includes net storage exchange due to Non-Treaty Storage Agreement with Bonneville Power Administration, Canal Plant Agreement with FortisBC Inc, Teck-Cominco Metals Ltd, and power subsidiaries of Columbia Power Corporation (CPC) and the Columbia Basin Trust (CBT), and Keenleyside Entitlement Agreement with Arrow Lakes Power Corporation (a subsidiary of CPC and CBT). Price per MWh excludes net storage exchange.

3. Other commodity purchases – Domestic is offset with revenue earned for energy generated for trade.

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

Financial

For the third quarter of fiscal 2007 total energy costs of \$537 million were \$219 million or 29 per cent lower than the third quarter last year. This is the result of a decrease in average prices, a decrease in the total volume of energy supplied at 23,836 GWh, three per cent less than the prior year, primarily in the domestic sectors, offset by slightly increased trade volumes.

For the nine months ended December 31, 2006, total energy costs of \$1,535 million were \$277 million lower than the same period last year. This is the result of a decrease in average prices, offset by an increase in the total volume of energy supplied at 75,086 GWh, six per cent higher than the prior year, primarily in the trade sector.

Domestic Energy Costs

Domestic energy costs of \$232 million were \$27 million lower than the third quarter of fiscal 2006, a decrease of 10 per cent. The primary reason for the decrease was reduced hydro generation, as a result of lower water inflows than last year, and lower transmission charges during the period. Lower purchases from independent power producers were due to the extended outage at Island Cogen Generating Station, which was offset by increased market purchases.

Domestic energy costs of \$741 million were \$52 million lower than the nine months ended December 31, 2006, a decrease of six per cent. The primary reason for the decrease was reduced hydro generation, as a result of lower water inflows than last year, lower purchases from independent power producers and lower transmission charges during the period. Domestic consumption was met by increased thermal and other energy purchases compared to last year.

Trade Energy Costs

Trade energy costs during the third quarter of fiscal 2007 decreased by \$192 million, or 39 per cent, compared to the same period last year. This was a result of significantly lower average commodity prices partially offset by a greater volume of electricity purchases. Electricity purchases, at 6,722 GWh, were three per cent higher than prior year level at 32 per cent lower average prices. The volume of gas purchased for sale to third parties decreased from 1,673 GWh to 1,496 GWh for the current year and average gas prices were 22 per cent lower than last year.

Trade energy costs during the nine months ended December 31, 2006 decreased by \$225 million, or 22 per cent, compared to the same period last year. This was the result of significantly lower average commodity prices offset by increased volumes of electricity and gas purchases and higher transmission charges. Electricity purchases, at 26,385 GWh, were 24 per cent higher than prior year level at 25 per cent lower average prices. The volume of gas purchased for sale to third parties increased significantly from 4,208 GWh to 5,758 GWh for the current year and average gas prices were 25 per cent lower than last year.

Water Inflows

Water inflows into BC Hydro's reservoirs were 36 per cent lower during the third quarter in fiscal 2007 compared to the prior year. This resulted in a decrease in the volume of hydro generation, one factor influencing the level of electricity imports and cost of energy. The decision to import 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

Financial

and regulatory obligations such as minimum reservoir levels and stream flow requirements also affect the decision to import energy. With lower inflows, reservoirs have been managed such that the combined storage in BC Hydro reservoirs at December 31, 2006, was 106 per cent of average compared with 108 per cent of average at December 31, 2005 (average storage levels relate to the average from 1986 to 2006), with the Williston Reservoir on the Peace River system at 101 per cent of average (Fiscal 2006 – 115 per cent) and the Kinbasket Reservoir on the Columbia River system at 115 per cent of average (Fiscal 2006 – 85 per cent).

Operating Costs

Operations costs of \$62 million in the third quarter are \$3 million higher than in the same period last year. Operations costs for the nine months ended December 31, 2006 are \$175 million, or \$37 million lower than in the same period last year due to reduced demand-side management incentives for large industrial customers as a result of new stepped rates.

Maintenance costs of \$97 million in the third quarter are \$34 million higher than in the same period last year. Maintenance costs for the nine months ended December 31, 2006 of \$230 million are \$38 million higher than in the same period in the prior year. These results have been significantly impacted by the high level of restoration costs resulting from the severe weather conditions experienced during the quarter.

Administration costs of \$25 million for the third quarter are \$13 million lower than the prior year and the \$82 million for the nine months ended December 31, 2006 are \$14 million lower than the prior year primarily due to lower environmental remediation costs and employee related expenses.

Amortization Expense

Amortization expense of \$83 million for the third quarter was \$12 million lower than for the same period in the previous year. A Depreciation Study was completed during fiscal 2006 which resulted in changes to asset lives that reduced depreciation charges. This impact was partially offset by a higher level of assets in service, and higher dismantling costs incurred. Amortization expense of \$280 million for the nine months ended December 31, 2006 was \$4 million lower than for the same period in the previous year for similar reasons as the quarter's results offset by a one-time adjustment to reduce net book values by \$24 million, for which a regulatory asset has been established.

Finance Charges

Finance charges of \$129 million for the three months ended December 31, 2006, were \$27 million higher than for the same period in the previous year. Higher short-term interest rates and a higher average volume of debt in the current year contributed to the higher charges. The increase also includes interest related to customer refund adjustments recorded in the quarter. No change in the Canadian dollar vis a vis the U.S. dollar in fiscal 2006 as compared with the weakening of the Canadian dollar vis a vis the U.S. dollar in fiscal 2007 also contributed to the unfavourable variance. These unfavourable variances were partially offset by higher interest during construction capitalized.

Finance charges of \$344 million for the nine months ended December 31, 2006, were \$16 million higher than for the same period in the previous year. The increase in finance charges is primarily due to higher short-term interest rates, lower capital gains in Canadian sinking fund income, and a higher average volume of debt. This increase also includes interest related to customer refund adjustments. The overall increase is partially offset by the favourable variance in foreign exchange due to the U.S. dollar principal debt hedging activities and losses from mark-to-market adjustments on certain risk management activities both in the prior year, and higher interest during construction capitalized in the current year.

Financial

Accounting Policies

There were no accounting policy changes during the third quarter of fiscal 2007.

Regulation

REGULATORY ACCOUNTS

BC Hydro has established various regulatory accounts with 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 have the effect of adjusting net income. The deferral amounts are then included in rates of future periods, subject to approval by the BCUC.

On November 10, 2006, the NSA with respect to the F07/F08 RRA was approved by the BCUC. The BCUC approved final rate increases are 1.54 per cent (for July 1, 2006 to January 31, 2007) and a further 2.1 per cent, effective February 1, 2007 onward, for a total increase of 3.64 per cent. The approved interim rate was 4.65 per cent. Customers will receive a one per cent decrease in their rates on February 1, 2007 and a refund in Spring 2007 to adjust for higher interim rates that were in place for most of fiscal 2007. At December 31, 2006, \$42 million had been accrued relating to the refund.

Included in the February 1, 2007 rate increase is a rate rider of two per cent for the purpose of recovering a portion of the current balances in the Heritage Deferral Account, Non Heritage Deferral Account, Trade Income Deferral Account and BCTC Deferral Account. Recovery is estimated to be \$50 million in fiscal 2007 and \$55 million in fiscal 2008. The rate rider has an indefinite term. Details relating to the NSA are included in note 4 of the consolidated financial statements.

Storm restoration costs are expected to be significantly higher than expected for fiscal 2007 due to the unexpected number and severity of the storms that have occurred since October 2006. BC Hydro will be filing an application to the BCUC for deferral account treatment for costs related to significant or major storms. BC Hydro has included a portion of the incremental storm restoration costs in the Non Heritage Deferral Account with the remainder being included in operating costs and resulting in a decrease in net income. Deferral of these costs is subject to BCUC approval.

Powerex Legal Proceedings

Since 2000, Powerex has been named, in some cases along with other energy providers, as a defendant in a number of lawsuits and U.S. federal regulatory proceedings which seek damages and/or contract rescission based on allegations that, during part of 2000 and 2001, the California wholesale electricity markets were unlawfully manipulated and that the energy prices were not just and reasonable. These proceedings are in various stages. A number of issues and findings are presently on appeal and none have been the subject of final judicial action. In the U.S. Court of Appeals for the Ninth Circuit's Lockyer decision of July 31, 2006, it told the U.S. Federal Energy Regulatory Commission (FERC) that it should reconsider its remedial powers thereby opening up the possibility that refunds will have to be paid for the periods from May to October 2000. On August 2, 2006, the Ninth Circuit ruled on certain issues in the FERC refund proceedings. One of those related to whether refunds should be paid for bilateral sales (those that did not go through the California Independent System Operator (CISO)). In its decision, the Ninth Circuit upheld FERC's decision that refunds should not be paid for bilateral sales. The precise effect of these decisions on Powerex cannot be determined at this time.

Financial

At December 31, 2006, Powerex was owed US\$ 268 million (CDN\$ 312 million) by the markets operated by the California Power Exchange (Cal Px) and the CISO related to Powerex's electricity trade activities in California during fiscal 2001. As a result of payment defaults by a number of California utilities, the Cal Px and CISO were unable to pay these amounts to Powerex. That receivable will be offset against any refunds that Powerex is requested to pay.

On March 26, 2004, FERC approved a settlement agreement between FERC staff and Powerex that acknowledged that there was no evidence that Powerex engaged in any gaming practices or concerted partnership practices with any other market participants, and further noted that Powerex was a valuable and reliable supplier of energy and ancillary services to the California market throughout the energy crisis. This settlement is still subject to rehearing at FERC and FERC's final order may subsequently be appealed to the courts.

BC Hydro was also joined as a defendant in the California Consumer Class Action lawsuit through cross-claims by other defendants. In response to an application by BC Hydro to be dismissed from the lawsuit, a U.S. Federal District Court judge ruled that BC Hydro is immune from these claims in the United States by virtue of the *Foreign Sovereign Immunities Act*. The Ninth Circuit upheld this finding. The court also upheld the District Court's finding that Powerex does not enjoy foreign sovereign entity status and therefore remains a party to the lawsuit, which was ordered to be remanded back to California State Court. Powerex is seeking appeal of the latter decision and related Ninth Circuit rulings to the U.S. Supreme Court. On January 19, 2007, the Supreme Court indicated that it would hear Powerex's appeal. Powerex anticipates that the hearing will take place in April 2007.

Due to the ongoing nature and uncertain status of the regulatory and legal proceedings related to the California power markets, management cannot predict at this time the outcome of the claims against Powerex. BC Hydro has recorded provisions for uncollectible amounts and legal costs associated with the ongoing legal and regulatory impacts of the California energy crisis during fiscal 2001. These provisions are based on management's best estimates, and are intended to adequately provide for any exposure. However, the amounts that may ultimately be collected 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 collection process.

Liquidity and Capital Resources

Cash flow provided by operating activities for the third quarter was \$122 million, compared with \$303 million for the same period last year. The decrease was primarily due to an increase in unrealized gains on mark-to-market, regulatory account transfers and changes in working capital.

The net long-term debt balance at December 31, 2006, was \$7,041 million, compared with \$6,650 million at March 31, 2006. The increase was primarily due to an increase in Canadian debt due to a bond issue of \$300 million and an increase in revolving borrowings of \$495 million. The increase was partially offset by a decrease of \$278 million of U.S. debt due to bond maturities.

Financial

Property, Plant and Equipment Expenditures

Property, plant and equipment expenditures were as follows:

(in millions)	For the three months ended December 31 ¹		For the nine months ended December 31 ¹	
	2006	2005	2006	2005
Distribution improvements and expansion	\$ 68	\$ 64	\$ 213	\$ 187
Transmission lines and substation replacements & expansion	65	46	173	110
Generation replacements and expansion	50	33	126	89
General, including computers and vehicles	15	8	36	29
Change in working capital related to property, plant and equipment expenditures ²	(1)	(1)	(8)	2
Property, plant and equipment expenditures per Consolidated Statement of Cash Flows	\$ 197	\$ 150	\$ 540	\$ 417

1. Certain amounts in the prior period have been reclassified to conform with presentation in the current period.

2. Adjustment from accrual to cash expenditures on the Consolidated Statement of Cash Flows.

The increase in distribution improvements and expansion for the three month period ended December 31, 2006 is due to a higher volume of new customer construction and connections. However, the increase is lower than the previous quarter as a result of the impact of storm restoration work causing a backlog that will be addressed in the fourth quarter. The increase in transmission activity is primarily due to work on substation distribution assets. The increase in generation asset expenditures is due to the commencement of several new projects during the quarter including Coquitlam Dam Seismic Upgrade, the Peace Canyon Turbine Overhaul, Spillway Gate Program and the Fire Risk Program.

Risk Management

BC Hydro faces risks specific 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. While risks cannot be eliminated, BC Hydro's strategies aim to minimize or mitigate them with a specific 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 overseeing the identification and assessment of significant risks and ensuring strong oversight of significant risks by the Risk Management Committee. BC Hydro's Board of Directors also plays a key role in the risk management process, as the board must understand the risks being taken by BC Hydro and ensure these are appropriately managed.

During the first quarter of fiscal 2007, commodity risk continued to be elevated, driven by continued high levels of volatility and pricing in North American natural gas and western North American electricity markets as a result of the spring hydro inflows. The commodity prices were at a peak in July due to extreme high temperatures in the Southwest, followed by the onset of the cooler temperatures resulted in receding prices in August and September. During the third quarter, cooler Northwest temperatures increased seasonal heating demand resulting in increased commodity prices. While BC Hydro's reservoir storage provides some degree of flexibility to manage this risk in the

Financial

short term, the current market environment continues to increase uncertainty around the cost of energy BC Hydro imports to meet domestic demand. This situation has been accentuated by the increasing gap between the domestic demand for energy resulting from the strong economic environment in British Columbia and BC Hydro's capacity to generate energy.

BC Hydro is also exposed to financial risk, such as changes in interest rates or foreign exchange risks. During the third quarter those financial risks were relatively stable. Management's assessment of risk is ongoing. Other risks to BC Hydro have not changed materially from the Management Discussion and Analysis in the 2006 Annual Report.

During the third quarter fiscal 2007 BC Hydro had several filings under review with the BCUC including the F07/F08 RRA, the 2006 Integrated Electricity Plan (IEP), the Long-Term Acquisition Plan (LTAP), and the Alcan Amended Long Term Electricity Purchase Agreement (ALTEPA). The F07/F08 RRA was approved on November 10, 2006 through approval of the NSA and the current results have been adjusted to reflect the BCUC decision. The IEP/LTAP hearings commenced on November 22, 2006 and a decision is not expected until after the close of fiscal 2007. On December 29, 2006, the BCUC denied acceptance of the ALTEPA. BC Hydro filed notice of its intent to seek leave to appeal the BCUC order on January 22, 2007.

Future Outlook

The *Budget Transparency and Accountability Act* requires that BC Hydro publish a Service Plan each February. BC Hydro's Service Plan published in February 2006 indicated that income before regulatory accounts for this year was forecast at \$7 million (restated for changes in regulatory disclosure pursuant to Accounting Guideline 19) and net income forecast at \$50 million. BC Hydro prepared an updated third quarter forecast in January 2007 that forecasts income before regulatory accounts of \$312 million and net income of \$400 million for fiscal 2007.

BC Hydro's earnings 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 January 2007 forecast update assumes water inflows of 87 percent of average, customer sales load of 53,073 GWh, average market energy prices of US\$45/MWh, short-term interest rates of 4.41 per cent and a U.S. dollar exchange rate of US\$0.8821.

The increase in forecast income from the Service Plan is from a combination of the increase in the trade margin, the customer rate increase approved in November 2006, lower domestic energy costs due largely to lower market prices for purchased power, offset by increased operating costs, lower amortization expenses and lower finance costs.

Financial

CONSOLIDATED STATEMENT OF OPERATIONS

<i>(Unaudited)</i> <i>(in millions)</i>	For the three months ended December 31		For the nine months ended December 31	
	2006	2005	2006	2005
Revenues				
Domestic	\$ 724	\$ 708	\$ 1,965	\$ 2,035
Trade	388	592	1,097	1,285
	1,112	1,300	3,062	3,320
Expenses				
Energy costs:				
Domestic	232	259	741	793
Trade	305	497	794	1,019
Operations	62	59	175	212
Maintenance	97	63	230	192
Administration	25	38	82	96
Taxes	36	38	111	110
Amortization	83	95	280	284
	840	1,049	2,413	2,706
Operating Income	272	251	649	614
Finance charges	129	102	344	328
Income Before Regulatory Account Transfers	143	149	305	286
Net change in regulatory accounts (note 4)	33	(31)	75	(36)
Net Income	\$ 176	\$ 118	\$ 380	\$ 250

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

<i>(Unaudited)</i> <i>(in millions)</i>	For the nine months ended December 31	
	2006	2005
Retained earnings, beginning of period	\$ 1,707	\$ 1,688
Removal of British Columbia Transmission Corporation from consolidated accounts (note 7)	-	(24)
Net income	380	250
Accrued Payment to the Province	(312)	(211)
Retained earnings, end of period	\$ 1,775	\$ 1,703

See accompanying notes to the interim consolidated financial statements.

Financial

CONSOLIDATED BALANCE SHEET

<i>(Unaudited)</i>	as at December 31	as at March 31
<i>(in millions)</i>	2006	2006
ASSETS		
Property, Plant and Equipment, net	\$ 9,866	\$ 9,608
Intangible assets	410	413
Current Assets		
Cash and cash equivalents	38	23
Accounts receivable and accrued revenue	502	446
Materials and supplies	144	135
Prepaid expenses	41	93
Mark-to-market gains	409	277
	1,134	974
Other Assets and Deferred Charges		
Sinking funds	724	846
Regulatory assets (note 4)	929	863
	1,653	1,709
	\$ 13,063	\$ 12,704
LIABILITIES AND EQUITY		
Long-term debt net of sinking funds	\$ 5,524	\$ 5,696
Sinking funds presented as assets	724	846
Long-Term Debt	6,248	6,542
Current Liabilities		
Current portion of long-term debt	1,517	954
Accounts payable and accrued liabilities	1,078	1,089
Mark-to-market losses	347	301
	2,942	2,344
Other Liabilities		
Regulatory liabilities (note 4)	431	440
Deferred contributions	902	856
Debt issue and related costs	145	125
Other long-term liabilities	470	538
Foreign currency contracts	150	152
	2,098	2,111
Retained Earnings	1,775	1,707
	\$ 13,063	\$ 12,704

Commitments and Contingencies (note 6)

See accompanying notes to the interim consolidated financial statements.

Approved on behalf of the Board:

L.I. (Larry) Bell
Chair

W.C. (Wanda) Costuros
Chair, Audit and Risk Management Committee

Financial

CONSOLIDATED STATEMENT OF CASHFLOWS

<i>(Unaudited)</i>	For the three months		For the nine months	
<i>(in millions)</i>	ended December 31		ended December 31	
	2006	2005	2006	2005
Operating Activities				
Net income	\$ 176	\$ 118	\$ 380	\$ 250
Adjustments for non-cash items:				
Regulatory account transfers	(82)	20	(179)	5
Amortization of regulatory accounts	48	12	104	30
Amortization expense	83	95	280	284
Foreign exchange translation (gains) losses	7	1	(1)	18
Deferred revenue	24	23	24	20
Amortization of debt issue and related costs	(2)	(2)	(7)	(6)
Unrealized (gains) losses on mark-to-market	(54)	(10)	(86)	13
Sinking fund income	(8)	(11)	(28)	(44)
Employee benefit plan expenses	7	7	22	20
Other non-cash items	3	1	12	9
	202	254	521	599
Working capital changes	(80)	49	(235)	(45)
Cash provided by operating activities	122	303	286	554
Investing Activities				
Property, plant and equipment expenditures	(197)	(150)	(540)	(417)
Intangible asset expenditures	(2)	(5)	(9)	(13)
Deferred contributions	16	21	67	57
Proceeds from property sales	2	2	1	2
Dismantling costs	(3)	(3)	(11)	(9)
Cash used in investing activities	(184)	(135)	(492)	(380)
Financing Activities				
Bonds:				
Issued	-	-	300	400
Retired	(526)	(100)	(526)	(616)
Revolving borrowings	467	(38)	495	126
Sinking fund withdrawals	147	-	148	194
Deferred debt costs	-	-	27	90
Payment to the Province	-	-	(223)	(338)
Cash provided by (used in) financing activities	88	(138)	221	(144)
Increase in cash and cash equivalents	26	30	15	30
Cash and cash equivalents, beginning of period	12	17	23	17
Cash and cash equivalents, end of period	\$ 38	\$ 47	\$ 38	\$ 47
Supplemental disclosure of cash flow information				
Interest paid	\$ 132	\$ 122	\$ 386	\$ 375

See accompanying notes to the interim consolidated financial statements

Financial

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) DECEMBER 31, 2006

Purpose

British Columbia Hydro and Power Authority (BC Hydro), was established in 1962 as a Crown corporation of the Province of British Columbia (the Province) by enactment of the *Hydro and Power Authority Act*. As directed by the *Hydro and Power Authority Act*, BC Hydro's mandate is to generate, manufacture, distribute and supply power. BC Hydro's corporate purpose is to provide "Reliable power, at low cost, for generations." BC Hydro is subject to regulation (see note 4) by the British Columbia Utilities Commission (BCUC) which, among other things, approves the rates BC Hydro charges for its services.

BC Hydro owns and operates electric generation and distribution facilities in the Province. BC Hydro also owns transmission facilities in the Province that are operated by British Columbia Transmission Corporation (BCTC), an independent Crown corporation of the Province.

Note 1: Accounting Policies

The interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP) for preparation of interim financial statements and do not conform in all respects to the disclosure requirements for annual financial statements. BC Hydro follows certain accounting practices that reflect the effects of regulation, and differ from the accounting practices for enterprises that do not operate in a rate-regulated environment. These interim consolidated financial statements and the notes (except for note 2 below) should be read in conjunction with the Annual Consolidated Financial Statements and accompanying notes in BC Hydro's 2006 Annual Report.

These interim consolidated financial statements follow the same accounting policies as those described in BC Hydro's 2006 Annual Report.

Certain figures for the previous period have been reclassified to conform to presentation in the current period.

Note 2: Change in Accounting Estimates

As a result of a depreciation study that was conducted on property, plant and equipment, the estimated useful lives of various assets were changed. The changes in estimates were effective April 1, 2006 and have been accounted for prospectively. These changes in accounting estimates did not have a material impact on the net income during the period. The impact in subsequent periods is indeterminable and will depend on the level of future capital expenditures and asset disposals. The revised depreciation rates were approved by the BCUC as part of the F07/F08 RRA NSA.

Note 3: Seasonality of Operating Results

Due to the seasonal nature of BC Hydro's operations, the interim consolidated statement of operations is not indicative of operations on an annual basis. Seasonal impacts of weather, including its impact on water inflows, energy consumption within the region and market prices of energy, can have a significant impact on BC Hydro's operating results.

Note 4: Regulation

BC Hydro is regulated by the BCUC, and both entities are subject to general or special directives and directions issued by the Province. BC Hydro operates primarily under a cost of service regulation as prescribed by the BCUC. Orders in Council from the Province establish the basis for determining BC Hydro's equity for regulatory purposes, as well as its allowed return on equity and the annual payment to the Province. Calculation of its revenue requirements and rates charged to customers are established through applications filed with and approved by the BCUC.

BC Hydro applies various accounting policies that differ from GAAP for enterprises that do not operate in a rate-regulated environment. Generally, these policies result in deferral and amortization of costs and recoveries to allow for adjustment of future rates. In the absence of rate-regulation, these amounts would otherwise be included in the determination of net income in the year the amounts are incurred. These accounting policies support BC Hydro's

Financial

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) DECEMBER 31, 2006

regulation and have been established through ongoing application by approval of the BCUC.

F07/F08 REVENUE REQUIREMENTS APPLICATION (F07/F08 RRA)

On November 10, 2006, the BCUC approved the Negotiated Settlement Agreement (NSA) filed with respect to the F07/F08 RRA. The BCUC approved final rate increases are 1.54 per cent (for July 1, 2006 to January 31, 2007) and further 2.1 per cent, effective February 1, 2007, for a combined increase of 3.64 per cent. The approved interim rate was 4.65 per cent. Customers will receive a one per cent decrease in their rates on February 1, 2007 and a refund in Spring 2007 to adjust for higher interim rates that were in place for most of fiscal 2007. At December 31, 2006, \$42 million has been accrued relating to the refund.

Included in the February 1, 2007 rate increase is a rate rider of two per cent for the purpose of recovering a portion of the current balances in the Heritage Deferral Account, Non Heritage Deferral Account, Trade Income Deferral Account and BCTC Deferral Account. The rate rider has an indefinite term. Recovery is estimated to be \$50 million in fiscal 2007 and \$55 million in fiscal 2008.

As part of the NSA, the following changes were made to the regulatory accounts:

- The Fiscal 2007 Revenue Deficiency deferral account was reduced to zero.
- The Large Hydro Investigation Costs regulatory account was approved.
- Amounts related to variance in load from forecast will not be deferred.

- The amortization expense for contributions in aid incurred prior to 1996 will continue to be amortized over 25 years, not 45 years as recommended in the depreciation study and applied for in the F07/F08 RRA, through a new regulatory account referred to as the CIA Amortization Variance.
- The adjustment to net book value of \$24 million resulting from the depreciation study will be amortized into income over five years as opposed to the requested period of two years.

The impact of the NSA changes in the first half of the fiscal year was reflected in the current quarter. This resulted in a decrease in net income of \$49 million on the results for the quarter ending December 31, 2006.

STORM RESTORATION COSTS

BC Hydro is preparing an application to the BCUC to seek recovery of restoration costs incurred as a result of severe weather storms experienced during the quarter. An estimate of these costs has been included in the Non Heritage Deferral Account. The recovery of these amounts will be subject to BCUC approval.

Financial

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) DECEMBER 31, 2006

Regulatory Accounts

The following regulatory assets and liabilities have been established through rate regulation. For the nine months ended December 31, 2006, the impact of regulatory accounting has resulted in an increase to net income of \$75 million (2006 – a decrease to net income of \$35 million).

<i>(in millions)</i>	April 1, 2006	Additions	Amortn./ Other	Net change	December 31, 2006	December 31, 2005
Regulatory Assets						
Heritage Deferral Account	\$241	\$ 27	\$ (43)	\$ (16)	\$ 225	\$113
Non-Heritage Deferral Account	205	96	(36)	60	265	143
BCTC Deferral Account	25	(6)	1	(5)	20	22
Demand-Side Management Programs	269	27	(26)	1	270	246
Foreign Exchange Gains and Losses	2	(1)	(12)	(13)	(11)	6
Large Hydro Investigation Costs	-	3	-	3	3	-
Fiscal 2007 Revenue Deficiency	-	29	(29)	-	-	-
Depreciation Study Adjustments	-	24	(4)	20	20	-
CIA Amortization Variance	-	11	-	11	11	-
Dam Safety and Site Survey Investigation Costs	-	-	-	-	-	49
First Nation Negotiations, Litigation and Settlement Costs	121	9	(4)	5	126	54
Total Regulatory Assets	\$863	\$ 219	\$ (153)	\$ 66	\$ 929	\$633
Regulatory Liabilities						
Regulatory Provision for Future Removal and Site Restoration Costs	\$226	\$ -	\$ (11)	\$ (11)	\$ 215	\$228
Trade Income Deferral Account	214	40	(38)	2	216	198
Unitized Bond Fund Account	-	-	-	-	-	58
Total Regulatory Liabilities	\$440	\$ 40	\$ (49)	\$ (9)	\$ 431	\$484
Net	\$423	\$ 179	\$ (104)	\$ 75	\$ 498	\$149

Financial

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) DECEMBER 31, 2006

Note 5: Employee Future Benefits

BC Hydro's cost for employee future benefits for the third quarter ended December 31, 2006 was \$17 million (2005 – \$22 million). The cost for employee future benefits for the nine months ended December 31, 2006 was \$52 million (2005 - \$56 million).

Note 6: Commitments and Contingencies

POWEREX LEGAL PROCEEDINGS

Since 2000, Powerex has been named, in some cases along with other energy providers, as a defendant in a number of lawsuits and U.S. federal regulatory proceedings which seek damages and/or contract rescission based on allegations that, during part of 2000 and 2001, the California wholesale electricity markets were unlawfully manipulated and that the energy prices were not just and reasonable. These proceedings are in various stages. A number of issues and findings are presently on appeal and none have been the subject of final judicial action. In the U.S. Court of Appeals for the Ninth Circuit's Lockyer decision of July 31, 2006, it told the U.S. Federal Energy Regulatory Commission (FERC) that it should reconsider its remedial powers thereby opening up the possibility that refunds will have to be paid for the periods from May to October 2000. On August 2, 2006, the Ninth Circuit ruled on certain issues in the FERC refund proceedings. One of those related to whether refunds should be paid for bilateral sales (those that did not go through the California Independent System Operator (CISO)). In its decision, the Ninth Circuit upheld FERC's decision that refunds should not be paid for bilateral sales. The precise effect of these decisions on Powerex cannot be determined at this time.

At December 31, 2006, Powerex was owed US\$ 268 million (CDN\$ 312 million) by the markets operated by the California Power Exchange (Cal Px) and the CISO related to Powerex's electricity trade activities in California during fiscal 2001. As a result of payment defaults by a number of California utilities, the Cal Px and CISO were unable to pay these amounts to Powerex. That receivable will be offset against any refunds that Powerex is requested to pay.

On March 26, 2004, FERC approved a settlement agreement between FERC staff and Powerex that acknowledged that there was no evidence that Powerex engaged in any gaming practices or concerted partnership practices with any other market participants, and further noted that Powerex was a valuable and reliable supplier of energy and ancillary services to the California market throughout the energy crisis. This settlement is still subject to rehearing at FERC and FERC's final order may subsequently be appealed to the courts.

BC Hydro was also joined as a defendant in the California Consumer Class Action lawsuit through cross-claims by other defendants. In response to an application by BC Hydro to be dismissed from the lawsuit, a U.S. Federal District Court judge ruled that BC Hydro is immune from these claims in the United States by virtue of the *Foreign Sovereign Immunities Act*. The Ninth Circuit upheld this finding. The court also upheld the District Court's finding that Powerex does not enjoy foreign sovereign entity status and therefore remains a party to the lawsuit, which was ordered to be remanded back to California State Court. Powerex is seeking appeal of the latter decision and related Ninth Circuit rulings to the U.S. Supreme Court. On January 19, 2007, the Supreme Court indicated that it would hear Powerex's appeal. Powerex anticipates that the hearing will take place in April 2007.

Due to the ongoing nature and uncertain status of the regulatory and legal proceedings related to the California power markets, management cannot predict at this time the outcome of the claims against Powerex. BC Hydro has recorded provisions for uncollectible amounts and legal costs associated with the ongoing legal and regulatory impacts of the California energy crisis during fiscal 2001. These provisions are based on management's best estimates, and are intended to adequately provide for any exposure. However, the amounts that may ultimately be collected 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 collection process.

Financial

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) DECEMBER 31, 2006

ENERGY COMMITMENTS – 2006 CALL FOR POWER

Under the fiscal 2006 Open Call for Power, BC Hydro awarded 38 Electricity Purchase Agreements (EPAs) to producers throughout the province. As a result of a parallel tender process, BC Hydro also awarded a contract to the Brilliant Expansion Power Corporation, an affiliate of the Columbia Power Corporation. Once developed, these projects will add approximately 1,500 MW of capacity and over 7,000 GWh of energy per year (4,200 GWh of firm energy net of attrition and outages) to BC Hydro's integrated system. Allowing for an estimated attrition and outage factor of 31 per cent, BC Hydro's obligations in the years 2009 to 2051 have a total nominal value of approximately \$16 billion.

There are no other material changes to the commitments and contingencies disclosed in the notes to BC Hydro's 2006 Annual Consolidated Financial Statements.

Note 7: British Columbia Transmission Corporation

The consolidated financial statements of BC Hydro include the accounts of BCTC for the year ended March 31, 2005. BC Hydro removed BCTC from its consolidated accounts effective April 1, 2005 when BCTC was considered operationally and financially independent of BC Hydro.

