

Environmental

The primary environmental risks associated with Värmevärden operations include potential air quality and emissions issues, soil contamination resulting from oil spills, issues around the storage and handling of chemicals used in normal operations and the storage of fuel on site. Värmevärden's procedures, in place to prevent and minimize any impact of the foregoing, meet generally acceptable industry practices.

Regulatory Environment

Värmevärden is subject to regulation under legislation governing the district heating industry as well as under consumer protection and other legislation and regulations of general application. Värmevärden's business is presently not subject to price regulation or third-party access ("TPA") regulations. However, there is the risk that price regulation or TPA could occur in the future. Värmevärden's operations, including its heat production and distribution activities, require numerous licences and permits from various governmental authorities and such operations are subject to laws and regulations governing production, taxes, labour standards, occupation health, waste disposal, toxic substances, land use, environmental protection, project safety and other matters. Värmevärden may experience increased costs and delays in the production and distribution of district heating as a result of complying with applicable laws, regulations, licences and permits. While Värmevärden is currently compliant with all material regulations and standards, Värmevärden could incur significant expenses to achieve or maintain compliance with any new laws or regulations that are introduced. If Värmevärden is unable to comply with applicable regulations and standards, it could become subject to claims, costs and enforcement actions.

Labour Relations

Approximately 80% of Värmevärden's employees are represented by unions. While Värmevärden has traditionally maintained positive labour relations, there can be no assurance that it will not in the future, whether in connection with a renegotiation process or otherwise, experience strikes, labour stoppages or any other type of conflict with unions or employees. Such risks may be partially mitigated by Swedish legislation that prohibits labour disruptions in the provision of essential services, such as district heating.

ENVIRONMENTAL, HEALTH AND SAFETY REGULATION

Capstone's Canadian power facilities and the water distribution and district heating businesses, respectively, operated by Bristol Water and Värmevärden (collectively the "Facilities") hold all material permits and approvals required for their operations and are managed to comply with environmental, health and safety laws.

The Facilities are subject to complex and stringent environmental, health and safety regulatory regimes, which primarily focus on:

- air emissions;
- taking of water, and discharges into water;
- the storage, handling, use, transportation and distribution of dangerous goods and hazardous materials;
- the prevention of releases of hazardous materials into the environment;
- the prevention, presence and remediation of hazardous materials in soil and ground water, both on and off site;
- workers' health and safety; and
- sound regulation.

Due to the nature of their operations, the Facilities are not subject to any material contingent environment liabilities or environmental remediation costs upon the retirement of assets.

Greenhouse Gases and other Air Pollutants

Certain of the Facilities have an impact on the environment, particularly the Cardinal and Whitecourt facilities, which both emit greenhouse gases ("GHGs"), such as carbon dioxide ("CO₂") and nitrous oxides ("NOx"). All Facilities comply in all material respects, with the applicable Canadian, UK, Swedish and European Union legislation and guidelines regarding GHGs and other emissions. There are a number of draft proposals in respect of changes to such legislation and guidelines (including proposed limits on GHG emissions) – in various stages of development. However, it is difficult to predict how these changes may apply to the Facilities.

Capstone mitigates the potential impact of future changes to environmental legislation and guidelines by remaining diligent in the operation of the Facilities, including stringent policies and procedures to prevent the improper discharge of emissions or other pollutants. Capstone's environmental footprint is also mitigated by the renewable profile of its wind, hydro, biomass and solar power facilities, which could generate GHG offset credits, where eligible.

Cardinal

There is currently no limit on the amount of CO₂ that the Cardinal facility may emit, although the facility is required to report its CO₂ emissions under various federal and provincial regulations. Environmental regulations in Ontario also provide for, among other things, the reporting, allocation and retirement of NOx emissions. Under this system, applicable facilities receive a maximum yearly emission compliance limit, which may be achieved by controlling or reducing source emissions, or by trading NOx allowances. For 2012, Cardinal received 1,094 tonnes of NOx allowances based on actual generation in 2010. Cardinal expects to retire 375 tonnes of NOx allowances for 2012, leaving a cumulative allowance balance of 7,678 tonnes. NOx emissions from Cardinal's generating equipment are lower than the levels mandated by legislation.

Whitecourt

The Whitecourt Facility uses biomass combustion technology to convert the energy content in wood waste into electricity. Biomass is generally considered to be "carbon-neutral" as the amount of CO₂ arising from combustion is equal to what would be emitted if the biomass were to decompose naturally. As a result, electricity generated from biomass is regarded as an environmentally-friendly form of power generation. The Whitecourt facility is subject to limits governing the emissions of carbon monoxide, NO_x and particulates in accordance with the facility's Environmental Approval. Average annual emission levels at the Whitecourt facility are below the levels of permitted emissions for the facility. The Whitecourt Facility is also subject to certain federal and provincial GHG reporting requirements and is in compliance with these requirements.

Hydro Facilities

Capstone's hydro facilities do not produce GHGs. However, their operations are governed by water management plans, which specify the hydrological conditions during which production may occur.

Erie Shores Wind Farm

Erie Shores does not produce GHGs, but is subject to regulations and/or approvals relating to birds, mammals, other animals, and to sound.

Amherstburg Solar Park

The operation of the Amherstburg does not generate GHGs and the primary environmental regulation relates to potential sound emissions issues.

Värmevärden

In 2007, the European Union adopted a long-term climate change target, commonly referred to as 20-20-20. The goal of the target is for member states (including Sweden) to reduce energy use by 20%, reduce CO₂ emissions by 20%, and increase their proportion of renewable energy by 20%, all by 2020. The government of Sweden has subscribed to the 20-20-20 targets and has made biomass-fired and waste-fired heating facilities an important component in its overall plan to meet its CO₂ reduction commitments.

Bristol Water

Energy use in water treatment and other activities carried out by Bristol Water results in indirect emissions of GHGs. Bristol Water is subject to the UK Climate Change Levy, although the forecast cost for 2012-2013 is an immaterial amount due to credits arising from Bristol Water's purchase of green energy. Bristol Water is also subject to the CRC Energy Efficiency Scheme, a mandatory UK carbon emissions reduction plan for significant consumers of energy; costs for 2012-2013 are projected to be an immaterial amount.

Further information regarding Environmental, Safety and Health Regulations matters is contained in the Corporation's Annual Information Form (which is available under the Corporation's profile on www.sedar.com).

RELATED PARTY TRANSACTIONS

Capstone's related party transactions in 2012 comprise compensation to key management, which commenced after the internalization of management on April 15, 2011.

In 2011, Capstone terminated its management and administration agreements with MGL, which established the related party relationship between Capstone and MGL. The 2011 transactions with MGL and MPML are described in note 26 (Related Party Transactions) in the consolidated financial statements for the year ended December 31, 2012.

Compensation of Key Management

Key management includes the Corporation's directors, Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). Compensation awarded to key management consisted of salaries, directors' fees and short-term employee benefits, which include fees paid to directors. Eligible directors and senior management of the Corporation also receive forms of stock-based compensation. Key management compensation is described in note 26 (Related Party Transactions) in the consolidated financial statements for the year ended December 31, 2012.

Prior to April 15, 2011, the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") of Capstone and other employees were employed by MGL. Accordingly, employee compensation disclosure only includes executive compensation since the internalization of management.