# RISKS AND UNCERTAINTIES

## Introduction

Risk is an inevitable aspect of operating a business. Decisions that balance risk exposure with intended financial rewards within risk tolerances are the responsibility of the Corporation's management under the supervision of the Board of Directors. When a risk exposure exceeds the Corporation's risk tolerance, the Corporation will take steps to eliminate, avoid, reduce or transfer such risk.

The Corporation recognizes the importance and benefits of timely identification, assessment and management of risks that may impact the Corporation's ability to achieve its strategic objectives. In this respect, the Corporation is committed to prudent risk management practices within the context of an enterprise risk management ("ERM") framework. The Corporation undertakes an annual comprehensive review of its ERM framework and, in 2012, engaged external advisors to further refine and strengthen its risk management practices and implement an outsourced internal audit function.

What follows is a description of the Corporation's key risk governance and risk processes to support achievement of strategic performance objectives.

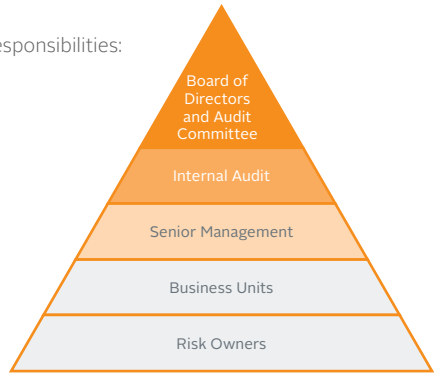
## Risk Management Principles and Governance

The Corporation's ERM framework is based on five core principles which establish the culture and tone that guide risk management decisions:

- Risk management is everyone's responsibility
- Risk management is about decision making
- Risk management is embedded within existing management routines
- Risk management is about people and culture
- Risk management is specific to each business unit

The Corporation's implementation of the ERM framework includes the following hierarchy of responsibilities:

- **Board of Directors and Audit Committee** have overall governance responsibility for overseeing management's implementation of the risk management policy.
- **Internal Audit** is responsible for reviewing management's practices to manage risk and reporting to the Audit Committee.
- **Senior Management** is responsible for ensuring the implementation of the ERM framework to all applicable activities and reporting to the Audit Committee.
- **Business Units** are responsible for ensuring the application of a risk management framework to identify, monitor and report risk.
- **Risk Owners** are responsible for the identification and day-to-day management and oversight of risks in their assigned area.

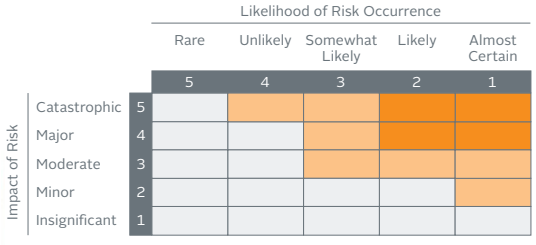



## Risk Management Processes

The Corporation's framework relies on the following six key ERM processes to integrate risk management activities with strategic and operational planning, decision-making and day-to-day oversight of business activities.

- **Risk identification** is the process of identifying and categorizing risks that could impact the Corporation's objectives.
- **Risk assessment** is the process of determining the likelihood and impact of the risk. The Corporation uses a five point rating scale for likelihood and impact.
- **Risk prioritization** is the process of ranking risks as high, medium or low based on the net risk rating as described in the diagram below.
- **Risk management** responses are measures taken to optimize the Corporation's net risk exposure within overall tolerance to achieve the desired risk reward balance.
- **Monitoring and reporting** are the processes of assessing the effectiveness of risk management responses.
- **Training and support** ensure that personnel tasked with risk management responsibilities have sufficient knowledge and experience to complete their risk management obligations.

The Corporation's risk management approach is comprehensive and proactive. It combines the experience and specialized knowledge of individual business segments and the corporate oversight functions as well as various analytic tools and methodologies, including a risk matrix (see chart to the right), to assist the Corporation in regularly assessing and updating the net exposure (including mitigants) of each known material risk facing the Corporation in the following four risk categories: operational, strategic, financial and legal and regulatory. The Corporation's assessment process results in prioritization of risks.



## Managing Risk

The Corporation requires that risk assessments (which encompass operational, strategic, financial and legal and regulatory risks) be performed at each business unit and at the corporate level (which takes into consideration the business unit risks that are significant to the consolidated organization). The Corporation has identified and defined the following four broad risk categories:

- Risks related to the Corporation on a consolidated basis include: risks related to the variability of dividends on the Corporation's common shares; risks related to the availability of debt and equity financing; risks arising from default under credit agreements and debt instruments;; risks related to geographic concentration; foreign currency exchange risk; risks related to acquisitions; risks related to derivatives; risks related to environmental, health and safety matters; risk of adverse changes in legislation and administrative policy; risks related to insurance; and risks arising from the reliance on key personnel;
- Risks related to the power infrastructure facilities include: operational performance risk; risks related to expiry of Power Purchase Agreements; risk related to fuel costs and supply; contract counterparty performance risk; risk related to land tenure and related rights; environmental risks; and risks related to the regulatory environment;
- Risks related to Bristol Water include: risks related to Ofwat price determinations; the risk of failure to deliver capital investment programs; the risk of failure to deliver water leakage target; risks related to Ofwat's service incentive mechanism and the serviceability assessment; risks related to economic conditions; risks related to pension plan obligations; risks related to the regulatory environment; operational performance risk; risk of competition; risks related to seasonality and climate change; and risks related to labour relations; and
- Risks related to Värmevärden include: general risks inherent in the district heating sector; risks related to fuel costs and availability; risks related to industrial and residential contracts; environmental risks; risks related to the regulatory environment; and risks related to labour relations.

In addition to the risks described in this "Managing Risk" section, there are numerous other risk factors, many of which are beyond the Corporation's control and the effects of which can be difficult to predict, that could be material to investors or cause our results to differ significantly from our plans, objectives and estimates. For a more comprehensive list and description of the risks affecting the Corporation, its power infrastructure facilities, Bristol Water and Värmevärden, please refer to the "Risk Factor" section of the Corporation's most recently filed Annual Information Form, as supplemented by risk factors contained in any of the following documents filed by the Corporation with securities commissions or similar authorities in Canada after the date of this annual MD&A, which are available on SEDAR at www.sedar.com: material change reports; business acquisition reports; interim financial statements; interim management's discussion and analysis; and information circulars.

## Risks Related to the Corporation's Securities

### Dividends on Common Shares and Preferred Shares are not Guaranteed

Although the Board of Directors of the Corporation has adopted a policy of paying a quarterly dividend on its common shares, and holders of preferred shares are entitled to receive annual fixed, cumulative, preferential dividends of $1.25 per share, payable quarterly, the declaration of common and preferred share dividends is at the discretion of the Board of Directors and may vary in the future based upon numerous factors.

### Volatile Market Price for the Corporation's Securities

A publicly-traded company will not necessarily trade at values determined by reference to the underlying value of its business or its results of operations or financial performance. The prices at which the Corporation's securities will trade cannot be predicted. The market price for the Corporation's securities may be subject to significant fluctuations in response to numerous factors, many of which are beyond the Corporation's control.

### Shareholder Dilution

The Corporation's constating documents permit the issuance of an unlimited number of common shares and a limited number of preferred shares issuable in series on such terms as the Directors determine without the approval of shareholders, who have no pre-emptive rights in connection with such issuances. In addition, the Corporation is required to issue common shares upon the conversion of its outstanding convertible debentures in accordance with their terms and the Corporation may, in certain circumstances, issue common shares to redeem or pay outstanding principal or interest amounts under the convertible debentures or issue common shares under the DRIP. Accordingly, holders of common shares may suffer dilution.

### Convertible Debentures Credit Risk, Subordination and Absence of Covenant Protection

The likelihood that holders of the Corporation's convertible debentures will receive payments of interest and principal owing to them depends on the cash flows of the Corporation. In addition, the convertible debentures are unsecured obligations of the Corporation and are subordinate in right of payment to all the Corporation's existing and future senior indebtedness. The convertible debentures do not contain any covenants restricting future leveraged transactions involving the Corporation.

## Risks Related to the Corporation and its Businesses

### Availability of Debt and Equity Financing

There can be no assurance that debt or equity financing will be available or, together with internally-generated funds, will be sufficient to meet or satisfy the Corporation's objectives or requirements or be available on acceptable terms. In particular, Bristol Water is expected to continue to require access to the capital markets in connection with its capital investment program so the inability to raise debt or equity financing could have a material adverse effect on its business. The inability of the Corporation to access sufficient capital on acceptable terms could have a material adverse effect on the Corporation's ability to meet its other objectives or requirements.

### Default under Credit Agreements and Debt Instruments

The Corporation and various of its subsidiaries and investees, as applicable, are parties to various credit agreements and debt instruments. A failure to comply with the obligations under the applicable credit agreement or debt instrument could result in a default, which, if not cured or waived, could result in the termination of distributions generated by the applicable entity and permit acceleration of the relevant indebtedness. Further, if the indebtedness under any of the credit agreements or debt instruments were to be accelerated, there could be no assurance that the assets of the applicable borrower, or the applicable guarantors, would be sufficient to repay that indebtedness in full. A portion of the cash flow of each applicable subsidiary or investee is devoted to servicing its debt and there can be no assurance that such entity will continue to generate sufficient cash flows from operations to meet the required interest and principal payments on its credit facility or debt instruments. If such an entity were unable to meet such interest or principal payments, it could be required to seek renegotiation of such payments or obtain additional equity, debt or other financing. Although many of the credit agreements related to the power infrastructure facilities are fully amortizing, there can also be no assurance that the Corporation, its subsidiaries or its investees could refinance these credit agreements or debt instruments or obtain additional financing on commercially reasonable terms, if at all. Borrowings under certain credit agreements and debt instruments may be at variable rates of interest, which, in the absence of effective hedges, expose the Corporation to the risk of increased interest rates. This factor may increase the sensitivity of the Corporation's cash flows to interest rate variations.

### Geographic Concentration

Approximately 53.0% of the Corporation's Adjusted EBITDA is derived from those power infrastructure facilities that are located in Ontario. In addition, Bristol Water's operations are all located in the Bristol area of the UK and Värmevärden's heat production facilities and distribution networks are all located in certain municipalities in Sweden. Accordingly, the Corporation, its subsidiaries and investees, as applicable, are subject to risks associated with if any of Ontario, Bristol, UK or the applicable municipalities in Sweden were to experience adverse changes in local or regional economic conditions or adverse changes to the regulatory environment in Ontario, Bristol, UK or certain municipalities in Sweden, as applicable.

### Foreign Currency Exchange

Through its investments in Bristol Water and Värmevärden, the Corporation is exposed to foreign currency exchange risk through exchange rate movements as the revenue generated by and the assets of Bristol Water and Värmevärden are denominated in UK pound sterling and Swedish krona, respectively. The Corporation's foreign currency exchange hedging strategy focus on reducing foreign currency exchange risk primarily in relation to expected future dividends from and interest paid by Bristol Water and Värmevärden, as applicable. However, the Corporation could be exposed to losses by undertaking hedging activities.

### Acquisitions and Development

The Corporation's strategy includes growth through identifying suitable acquisition and development opportunities, pursuing such opportunities, consummating acquisitions, constructing development projects and effectively integrating and operating (or contracting for the operation of) such businesses. The Corporation competes for acquisitions and development opportunities and so there is a risk that the Corporation may not be successful in acquiring or developing such opportunities. Further, if the Corporation is unable to identify, pursue, integrate or manage acquisition or development projects, this could have an adverse impact upon its strategy. As well, in pursuing development opportunities, the Corporation may be required to make material capital expenditures with no guarantee that the development project will achieve commercial operation.

### Environmental, Health and Safety

The power infrastructure facilities, Bristol Water and Värmevärden are each subject to a complex and stringent environmental, health and safety regulatory regime. As such, the operation of these businesses carries an inherent risk of environmental, health and safety liabilities (including potential civil actions, compliance or remediation orders, fines and other penalties) and may result in the applicable business being involved from time to time in administrative and judicial proceedings related to such matters. Changes in regulations, or more aggressive enforcement of existing regulations, could lead to material increases in unanticipated liabilities or expenditures for investigation, assessment, remediation or prevention, capital expenditures, restrictions or delays in the business' activities, the extent of which cannot be predicted. To mitigate the risk of administrative sanctions and to minimize safety risks to employees and contractors, the Corporation works continuously with all employees and contractors to

ensure the development and implementation of a progressive, proactive safety culture within all operations. The Corporation has safety committees operating within each operating unit to ensure existing safety programs are continuously improved.

### Changes in Legislation and Administrative Policy

There can be no assurance that certain laws applicable to the Corporation, its subsidiaries and its investees, including tax laws, will not be changed in a manner which could adversely affect the value of the Corporation. In addition, there can be no assurance that the administrative policies and assessing practices of the Canada Revenue Agency will not be changed in a manner which adversely affects the holders of the Corporation's securities.

### Reliance on Key Personnel

The Corporation's success depends heavily on its ability to attract, retain and motivate key employees, including its senior management, individuals with operational experience in industries related to the power infrastructure facilities and the management of Bristol Water and Värmevärden. If the Corporation loses the services of any of these key personnel and cannot replace them in a timely manner, its business and prospects may be adversely affected.

## Risks Related to the Power Infrastructure Facilities

### Power Purchase Agreements

Most of the electricity that is generated by the power infrastructure facilities is sold to large utilities or creditworthy customers under fixed-term PPAs. In particular, the first automatic one-year renewal following the initial 20-year term of the Cardinal PPA ends on December 31, 2014. As PPAs expire or are terminated, there can be no assurance that the applicable facility will be able to renegotiate or enter into a power supply contract on terms that are commercially reasonable, if at all, and it is possible that the price received for power under subsequent arrangements may be reduced significantly. It is also possible that subsequent PPAs may not be available at prices that permit the operation of a facility on a profitable basis. With respect to the Cardinal facility, which contributed approximately 22.3% of the Corporation's Adjusted EBITDA and approximately 65.8% of its AFFO in 2012, the Corporation expects that the price that the OPA will be willing to pay for electricity under any new PPA for the Cardinal facility will be less than the price paid under its current PPA. In addition, excess power currently generated by certain of the facilities may be sold in the open market and, upon expiry or termination of its PPA, a facility may choose to sell all of the power it produces on the open market. In such circumstances, the price received for power sold will depend on market conditions at the time and there can be no assurance that the market price received for the electricity so offered will exceed the facility's marginal cost of operation.

### Operational Performance

The operational performance of Erie Shores, the hydro power facilities and Amherstburg Solar Park are dependent upon wind speed and density, water flows and the availability and constancy of solar insolation, respectively. The weather-related risk at the hydro power facilities is partially offset by their geographic diversification in the three different watersheds. All of the power infrastructure facilities are subject to risks related to premature wear or failure, defects in design, material or workmanship and longer than anticipated down times for maintenance and repair, including grid outages and curtailment. These risks are partially mitigated by the proven nature of the technologies employed at each facility, regular maintenance and the design of each facility. While much of the technology utilized at the power infrastructure facilities has a history of reliable performance at similar facilities throughout Canada, some of the components of Amherstburg Solar Park have not previously been used in operations in Canada for extended periods of time. The Corporation has attempted to mitigate some of these risks by obtaining manufacturers' warranties and a weather-adjusted performance guarantee and having all operations and maintenance services required for the facility provided by SunPower Corporation, which built the facility.

### Fuel Costs and Supply

The supply of natural gas required by the Cardinal facility is contracted under a gas purchase agreement, which expires on May 1, 2015. The Whitecourt facility has a contract with a substantial forest products company to supply a majority of its wood waste fuel requirements. Upon the expiry of each of these supply agreements, the Corporation will have to renegotiate the agreement or enter into a new supply agreement or buy fuel in the open market, where available. There can be no assurance that such agreements will be able to be renegotiated, or new supply agreements be entered into, on terms that are similar to the existing agreements, if at all. Furthermore, there can be no assurance as to the supply or price of natural gas or wood waste available on the open market or at the time of the expiry of the supply agreements. Accordingly, there is the risk that, at the time of the expiry of a particular supply agreement, the price of natural gas or wood waste, as applicable, available to the relevant facility may be in excess of the price available under the current supply arrangements or such fuel may not be available in the quantities required. Furthermore, each of these facilities is also dependent on the supply of fuel to it. There is the risk that there could be an interruption in the supply of fuel (as a result of transportation or otherwise) or increases in fuel transportation costs. In particular, the natural gas used at the Cardinal facility is transported to the

facility through a number of pipelines, including the TCPL Canadian Mainline pipeline. The tolls on the TCPL Canadian Mainline pipeline are regulated by the National Energy Board and have increased significantly in the past few years.

### Contract Performance

To a large extent, the Corporation's cash flows are dependent upon the parties to the various material supply, purchase and operations and management agreements relating to the power infrastructure facilities fulfilling their contractual obligations, As such, there is the risk of the inability or failure by any such party to meet its contractual commitments.

### Land Tenure and Related Rights

The power infrastructure facilities have various land tenure and resource access rights upon which they depend for their operations. There can be no assurance that these rights will not be challenged, and, if challenged, whether such challenge will be successful. Furthermore, there can be no assurance that such rights will be able to be renegotiated or extended on commercially reasonable terms, if at all. At such time as any of these rights are successfully challenged or expire and cannot be renewed or renegotiated upon acceptable terms, the affected power infrastructure facility will likely be unable to continue to operate. In addition, in these circumstances, there can be no assurance that the Corporation or its subsidiaries will have the necessary financial resources or will be able to obtain the necessary financial resources to fund or cause to be funded any required restoration and remediation works.

### Environmental

The primary environmental risks associated with the operation of the Cardinal facility and the Whitecourt facility include potential air quality and emissions issues, soil and water contamination resulting from oil spills, issues around the storage and handling of chemicals used in normal operations and, in the case of the Whitecourt facility, storage of wood waste fuel on site. The Corporation has procedures in place to prevent and minimize any impact of the foregoing, which procedures meet generally acceptable industry practices. The primary environmental risks associated with the operation of the hydro power facilities include possible dam failure which results in upstream or downstream flooding, and equipment failure which results in oil or other lubricants being spilled into the waterway. In addition, the operation of a hydro power facility may cause the water in the associated waterway to flow faster, or slower, which could result in water flow issues which could impact fish population, water quality and potential increases in soil erosion around a dam facility. In order to monitor and mitigate these risks, the Corporation completes facility inspections and ensures each of its facilities are in compliance with the appropriate regulatory requirements. The primary environmental risks associated with the operation of the Erie Shores Wind Farm include potential harm to the local migratory bird population, harm to the local bat population as well as concerns over sound levels and visual "harm" to the scenic environment around the facility. In order to monitor and mitigate these risks, the Corporation completes facility inspections and ensures its facilities are in compliance with the appropriate regulatory requirements. However, in the event of sound complaints or impacts, the Corporation could be subject to claims, costs and/or enforcement actions.

### Regulatory Environment

The Corporation's power infrastructure facilities are highly regulated and must abide by the relevant market rules as administered by the system operators in each local jurisdiction. The performance of these facilities depends in part on a favourable regulatory climate and on the ability to obtain, maintain, comply with or renew all material licences, permits or government approvals. While these facilities are currently compliant with all material regulatory requirements, the Corporation could incur significant expense to achieve or maintain compliance with any new laws, rules or regulations that are introduced or with any modifications to their necessary licences, permits or government approvals. If the Corporation is unable to comply with applicable regulations and standards, or material licences, permits or government approvals, it could become subject to claims, costs or enforcement actions.

## Risks Related to Bristol Water

### Ofwat Price Determinations

The price determinations periodically made by Ofwat limit the prices Bristol Water can charge its customers. The conditions of Bristol Water's Instrument of Appointment, including any condition relating to the prices Bristol Water can charge its customers, can be modified by Ofwat either with Bristol Water's agreement or, following reference to the UK Competition Commission, on public interest grounds. Implicit within the most recent price limits set by Ofwat) are assumptions concerning Bristol Water's future operating expenditures and the achievement of operating cost savings. If these efficiencies are not achieved, this may be reflected in less favourable outcomes in future profitability and cash flows or in Ofwat's future price determinations. During 2013, Ofwat obtained the consent of all UK water companies (including Bristol Water) to certain amendments to their Instruments of Appointment which will enable Ofwat to set different price limits for different parts of each water company's business. While these changes do not impact the RPI+/-K formula for price controls on a water company's "wholesale" activities, there is no certainty that Ofwat will retain in future price reviews the RPI+/-K form of price control for "retail" activities related to the provision of goods or services directly to non-domestic customers.

### Failure to Deliver Capital Investment Programs

Bristol Water is expected to continue to be required to undertake significant capital expenditures in its business, particularly in relation to new and replacement plant and equipment for water distribution networks and treatment facilities. There can be no assurance that operating cash flows will not decline or that external debt financing and other sources of capital will be available or at similar cost to that assumed by Ofwat in order to meet future capital expenditure requirements. Delivery of capital investment programs could also be affected by a number of factors and may affect Bristol Water's ability to meet regulatory and other environmental performance standards, which may result in sanctions being imposed against Bristol Water. In addition, the failure by Bristol Water to successfully complete its capital investment programs could adversely impact future calculations of Bristol Water's RCV, which could adversely impact Ofwat's determination of future price limits for Bristol Water.

### Economic Conditions

Bristol Water's RCV is adjusted annually for inflation so, if RPI decreases, the RCV would be adjusted downward to reflect this decrease. Further, generally unfavourable economic conditions may also adversely influence Ofwat's determination of future price limits. Given the significant investments Bristol Water is set to undertake over the remainder of AMP5, it faces risks arising from any adverse changes in RPI.

### Operational Performance

Bristol Water controls and operates a large water network and maintains the associated assets with the objective of providing high quality drinking water on a continuous basis. However, its facilities are subject to risks related to premature wear or failure, defects in design, material or workmanship, longer than anticipated down times for maintenance and repair, energy shortages, malicious intervention, failure by a supplier, pollution or contamination, human error, unavailability of access to critical sites or key staff, labour disputes, pollution or contamination and other events. These risks are partially mitigated by the proven nature of the technologies employed at each facility, regular maintenance and the design of each facility. Management also has limited control over future energy or chemical costs, abstraction charges, levels of customer bad debt or taxes. In particular, since 2000, domestic customers cannot be disconnected from their water supply for failure to pay their bill, although. an allowance for bad debts is included when Ofwat sets price limits, which partially mitigates the risk of such bad debts.

### Failure to Deliver Water Leakage Target

Bristol Water is required to meet an annual target for water leakage. If Bristol Water fails to achieve the leakage target by a significant margin in any one year or by a small margin over a number of years, Ofwat may impose various sanctions, including a reduced revenue allowance at the next review of price limits. In addition, if performance were to decline, Bristol Water may incur additional operating or capital expenditure to restore performance.

### SIM and the Serviceability Assessment

For the 2010-2015 period, Ofwat introduced the service incentive mechanism (the "SIM",) which compares water companies' performance in terms of the quality of service that is delivered to customers. The SIM comprises both a quantitative measure of complaints and unwanted contacts, and a qualitative measure, based on survey evidence, that looks at how satisfied customers are with the quality of service that they receive. Depending upon Bristol Water's relative performance under the SIM, it could receive a reduced or increased revenue allowance when price limits are next reset in 2014. In addition, Bristol Water is required to maintain the serviceability of its water assets, ensuring they continue to deliver a level of service and performance at least as good as in the past. Where serviceability falls below required reference levels of performance, Ofwat may impose a reduced revenue allowance at the next price review. In addition, if performance were to decline, Bristol Water may incur additional operating or capital expenditure to restore performance.

### Pension Plan Obligations

Bristol Water operates both defined benefit and defined contribution pension arrangements. Since 2002, all new employees have been offered membership only in the defined contribution pension plan. Estimates of the amount and timing of future funding for Bristol Water's defined benefit plan are based on various actuarial assumptions and other factors, which may require Bristol Water to make additional contributions to its pension plan which may not be recoverable under the regulatory price determination process.

### Regulatory Environment

Bristol Water is subject to and must ensure its compliance with various laws and regulations of the UK and the EU. Failure to comply with these laws and regulations could expose Bristol Water to regulatory and other proceedings and, in the most extreme case, lead to revocation of Bristol Water's Instrument of Appointment or the appointment of an administrator to manage the affairs, business and property of the company. Furthermore, the impact of future changes in laws or regulations or the introduction of new laws or regulations that affect the business cannot always be predicted and, from time to time, interpretation of existing laws or regulations may also change or the approach to their enforcement may become more rigorous.

### Competition

Recently, legislation has been proposed in the UK that could eventually expand the competitive market allowing retail competition for all non-household customers as an initial step in opening markets to competition. Ofwat and the UK Environment Agency are also considering the introduction of reforms to the regulation of water abstraction licences that would allow the trading of licences. Ofwat is also examining the scope for upstream competition in treated water supply and has recently commenced consultations on future price limits. Ofwat has taken steps to introduce competition into the water supply market through inset appointments and the water supply licensing regime. One inset appointment is pending and further inset appointments may be made in the future, resulting in increased competition. In addition, Ofwat or the UK government may take steps that lead to other changes in the structure of the water industry with potentially adverse consequences to Bristol Water.

### Seasonality and Climate Change

Although there is little seasonal variation in demand, the proportion of water used from each type of Bristol Water's sources of water varies on a daily and seasonal basis according to the availability of water, the relative costs and other operational constraints, and the quantity of treated water supplies fluctuates owing to a variety of seasonal factors, such as dry weather and burst pipes due to freeze/thaw cycles affecting the ground during winter months. In addition, climate or weather pattern changes may adversely affect the availability of water resources or the demand by customers. As with other UK water companies, Bristol Water is dependent upon suitable weather conditions supplying raw water as inflow for its abstraction points and it has a drought contingency plan in place should there be a lack of such rainfall.

### Labour Relations

Approximately 33% of Bristol Water's employees are represented by unions. While Bristol Water has traditionally maintained positive labour relations, there can be no assurance that it will not, either in connection with a renegotiation process or otherwise, experience strikes, labour stoppages or any other type of conflict with unions or employees in the future.

## Risks Related to Värmevärden

### Operational Performance

Värmevärden controls and operates several district heating networks and maintains the associated assets with the objective of providing heat to its customers on a continuous basis. However, its facilities are subject to risks related to premature wear or failure, defects in design, material or workmanship, longer than anticipated down times for maintenance and repair, energy shortages, malicious intervention, failure by a supplier, pollution or contamination, human error, unavailability of access to critical sites or key staff, labour disputes, pollution or contamination and other events. These risks are partially mitigated by the proven nature of the technologies employed at each facility, regular maintenance and the design of each facility. In addition, Värmevärden's revenue and costs are also affected by the demand for heat, which varies with weather conditions. Unusually cold weather may result in Värmevärden's marginal cost of production exceeding its marginal revenue. Warmer weather may also lead to a decrease in demand for heat which could result in lower revenue.

### Fuel Costs and Availability

Värmevärden purchases most of its fuel on a rolling basis and is therefore exposed to market price fluctuations. Although Värmevärden has the ability to pass on fuel price increases on an annual basis to its customers, this ability is limited in the short term. Additionally, price increases may make alternative heating technologies, such as pellet boilers and geothermal pumps, more competitive with the district heating service provided by Värmevärden. Further, Värmevärden could be materially and negatively affected if the supply of fuel, particularly biomass which comprises a majority of its fuel mixture, is interrupted or if there is an increase in the costs to transport the fuel to the district heating facilities. There can be no assurance as to the supply or price of fuel (or alternative fuel sources) available on the open market. As a result, Värmevärden is subject to the risk of significant increases in fuel costs or unavailability of fuel.

### Industrial and Residential Contracts

Värmevärden has entered into a number of contracts with large industrial consumers for the supply of heat and/or steam which account for a material amount of Värmevärden's total revenue. Värmevärden is subject to counterparty credit risk and risk of reduction in demand from such industrial customers. Certain of the contracts also include termination and/or buyback options. Värmevärden enjoys a relatively stable base of residential customers as a result of the large majority of the Swedish population residing in multi-unit residential buildings, the majority of which derive their heat from district heating operations. However, residential customers are able to cancel their contracts with Värmevärden at any time upon short notice. As its industrial and residential contracts expire, there is a risk that Värmevärden may not be able to renegotiate or enter into new contracts or do so on commercially reasonable terms which, in some cases, could adversely impact upon the business, operating results and financial condition of Värmevärden and could, in turn, adversely affect the Corporation's cash flows and the likelihood that holders of securities of the Corporation will receive payments, whether of interest or dividends or upon redemption or maturity, as applicable.

### 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 ("$CO_2$") 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 $CO_2$ that the Cardinal facility may emit, although the facility is required to report its $CO_2$ 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.