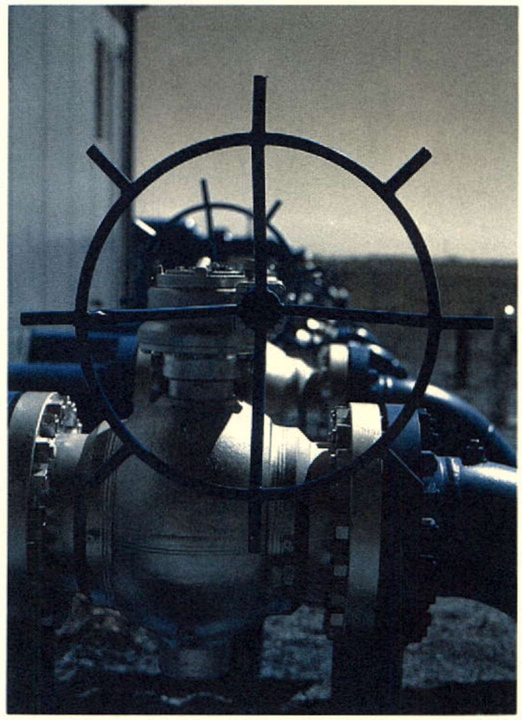
1985 ANNUAL REPORT



NORTHWESTERN UTILITIES LIMITED

NORTHWESTERN UTILITIES LIMITED

Report to Shareholders

The economic environment in the service territory of Northwestern Utilities Limited improved during 1985. Interest rates continued to decline and the rate of inflation was at the lowest level in many years. Northwestern achieved a customer growth rate of 1.6% in 1985 with 5,032 customers added. At year-end, Northwestern was serving 321,444 customers in 178 communities.

Earnings attributable to common shares were $33.9 million ($11.70 per common share) compared to $19.6 million ($6.76 per common share) in 1984. Weather favourably affected 1985 earnings by $5.2 million. Other major factors were $2.6 million resulting from the collection of $5.0 million of revenue allowed for the year 1984 but billed in the first six months of 1985; $2.6 million from the purchase of lower priced gas on the spot market; and $2.4 million resulting from an income tax reassessment for the years 1981 through 1984. In addition, short-term demand for petrochemical, refinery and fertilizer products from Northwestern's transportation customers contributed $1.0 million more than expected to 1985 earnings.

Total system throughput increased by 12.1 petajoules (PJ) to 315.5 PJ in 1985. Although sales were lower by 3.9 PJ, transportation volumes were higher by 16.0 PJ. Northwestern transports gas within Alberta for exporting companies and for industrial and other customers who have contracted for their gas supplies directly with brokers or producers.

Consolidated revenues for 1985 were $463.9 million, $8.5 million higher than in 1984. Revenues increased due to the impact on sales of colder weather and customer growth as well as changes in rates. The revenue increases were partially offset by reductions in Federal taxes and substitution of transportation service for industrial sales.

Total operating expenses, which include the cost of natural gas supply, operations, maintenance, depreciation, taxes other than income taxes, and income taxes, amounted to $406.7 million, down $8.6 million from 1984.

During 1985, the Federal Government began dismantling the National Energy Program. The Canadian Ownership Special Taxation was removed on June 1, 1985 and a program was introduced to phase out the Petroleum and Gas Revenue Tax. On October 31, 1985, the Natural Gas Agreement between the Federal Government and producing provinces was announced providing for the deregulation of natural gas pricing. By November 1, 1986, the price of gas will be set by the market, rather than by government administered pricing.

Market-oriented pricing is expected to have little impact on rates charged to residential, commercial and small industrial customers because the Alberta Natural Gas Rebates Act already shields these customers from the cost of gas above 65% of the Alberta Border Price and market-oriented prices are not expected to fall below that price. The Act has been extended to March 31, 1988.

In May 1984, Northwestern filed a general rate application with the Alberta Public Utilities Board to recover projected shortfalls in revenue for 1984 and 1985. The Board approved an interim refundable rate increase, effective November 1, 1984 which allowed Northwestern to collect $10.0 million of its 1984 revenue shortfall during the period November 1, 1984 to June 30, 1985 and $25.0 million of the 1985 revenue shortfall during 1985. A final decision on the general rate application is expected during 1986.

On August 1, 1985, the British Columbia Utilities Commission approved an increase in Northland Utilities (B.C.) Limited rates following an increase in the wholesale price of natural gas. Northland serves Dawson Creek and Tumbler Ridge in northeastern British Columbia.

Northwestern's 1985 capital additions to provide for customer growth and to meet the needs of its existing customers were $38.2 million. Net property, plant and equipment required to serve customers increased to $476.8 million at year-end.

Taking advantage of lower financing rates during 1985, Northwestern issued $15.0 million of 7.80% Second Preferred Shares to redeem $10.9 million of 9.24% Second Preferred Shares. The balance was applied to the financing of the capital expenditure program.

Northwestern continued to exercise cost control measures introduced in previous years. Since year-end 1983, Northwestern has added more than 15,000 customers, an increase of approximately 5%, while the number of employees in 1985 remained lower than the number on staff in 1983.

Two-year agreements were signed with the Natural Gas Employees' Benefit Association early in 1985 providing the equivalent of a 3% pay raise for permanent employees in 1985 and including the provision to negotiate salaries for 1986. Agreement has not yet been reached on 1986 salaries.

On August 1, 1985, R. M. Massé was appointed Controller replacing H. R. Lewis who was appointed Vice-President and Controller of Alberta Power Limited. Northwestern wishes to express its appreciation to Mr. Lewis for his valued contribution.

Northwestern also wishes to extend its appreciation to E. W. King and A. H. Mitchell for their service as members of the Board of Directors. Mr. King has been a member of the Board since 1969 and was President of the Company from 1969 until his retirement in 1984. Mr. Mitchell became a director in 1975. Messrs. King and Mitchell will not be seeking re-election to the Board.

The effective performance of the past year was made possible through the efforts and cooperation of Northwestern's employees. Northwestern gratefully acknowledges its employees' contribution to cost control programs and their dedication to the tradition of providing safe and dependable service to customers.

On Behalf of the Board of Directors,

R. D. SOUTHERN
Chairman of the Board
and Chief Executive Officer

W. R. HORTON
President
and Chief Operating Officer

February 28, 1986

NORTHWESTERN UTILITIES LIMITED

Highlights in Review

	*1985	**1984	1983	1982	1981	1975
STATISTICAL						
Customers at year-end	**321,444**	316,412	306,193	297,557	290,658	197,297
Natural gas sales — TJ†	**143,333**	147,257	163,949	193,815	224,316	175,358
Transportation of natural gas — TJ	**172,183**	156,147	113,831	67,722	41,394	3,336
Total system throughput — TJ	**315,516**	303,404	277,780	261,537	265,710	178,694
Pipelines — kilometres	**17,388**	16,952	16,326	15,818	15,163	10,230
Maximum daily demand — TJ	**1,409**	1,309	1,253	1,253	1,258	856
Communities served	**178**	179	175	171	161	153
Population served — thousands	**1,040**	1,035	998	988	948	757
Degree days — % normal	**97**	96	96	108	82	99
Owned gas reserves — PJ	**654**	637	718	746	731	665
FINANCIAL (dollars in thousands except per share data)						
Revenue	**463,898**	455,388	487,037	517,715	458,619	86,320
Earnings attributable to common shares	**33,928**	19,601	15,581	21,295	13,062	5,060
Earnings per common share — dollars	**11.70**	6.76	5.37	8.77	5.54	2.79
Capital additions	**38,221**	52,081	80,169	81,646	48,402	17,604
Gross plant	**614,258**	580,160	532,000	453,417	373,254	170,839

* On January 1, 1985 The Lloydminster Gas Company Limited was amalgamated with Northwestern Utilities Limited.

** Includes operating results of The Lloydminster Gas Company Limited for the period June 1, 1984 to December 31, 1984.

† The metric unit for measurement of energy is the joule (J) and its multiples. Large amounts of energy are reported in gigajoules (GJ), billions of joules; in terajoules (TJ), trillions of joules; and in petajoules (PJ) quadrillions of joules. One joule is equivalent to .00095 British Thermal Units.

Auditors' Report

To the Shareholders of
Northwestern Utilities Limited:

We have examined the consolidated balance sheet of Northwestern Utilities Limited as at December 31, 1985 and the consolidated statements of earnings and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse

Chartered Accountants

Edmonton, Canada
January 31, 1986

Consolidated Statement of Earnings and Retained Earnings

	Note	1985	1984
		Year ended December 31	
		(Thousands)	
Revenues		$463,898	$455,388
Operating Expenses			
Natural gas supply	1	242,719	262,351
Operation and maintenance		67,949	65,761
Taxes — other than income	2	43,724	51,962
Taxes — income	3	35,159	20,458
Depreciation and depletion		17,169	14,792
		406,720	415,324
		57,178	40,064
Allowance for Funds Used During Construction		4,753	6,072
Dividend Income from Affiliate		16	229
Other Income	4	3,435	2,989
		65,382	49,354
Interest on Loans from Parent Company		18,501	16,509
Interest Expense		1,724	2,162
Dividends on Preferred Shares	10	11,229	11,082
		31,454	29,753
Earnings Attributable to Common Shares		33,928	19,601
Retained Earnings at Beginning of Year		76,288	67,042
		110,216	86,643
Dividends on Common Shares		16,272	10,355
Retained Earnings at End of Year		$ 93,944	$ 76,288
Earnings per Common Share		$ 11.70	$ 6.76

NORTHWESTERN UTILITIES LIMITED

Consolidated Balance Sheet

	Note	December 31 1985	1984
		(Thousands)	
ASSETS			
Current Assets			
Accounts receivable	5	**$ 41,773**	$ 69,415
Owing by parent and affiliated companies		**6,669**	14,280
Materials and supplies		**4,041**	3,951
Natural gas stored		**5,355**	2,124
Prepaid expenses		**631**	1,703
		58,469	91,473
Property, Plant and Equipment	6	**476,815**	458,454
Deferred Expenses	7	**24,941**	18,855
		$560,225	$568,782
LIABILITIES AND CAPITALIZATION			
Current Liabilities			
Due to bank		**$ 1,862**	$ 9,836
Accounts payable and accrued liabilities		**45,143**	61,473
Income and other taxes		**9,261**	17,885
Dividends payable		**2,066**	2,165
Owing to parent and affiliated companies		**11,300**	6,782
Long-term debt — current maturities		**4,560**	5,730
		74,192	103,871
Deferred Credits			
Contributions for extensions to plant		**60,669**	56,328
Deferred income taxes		**517**	279
Other	8	**33,804**	33,249
		94,990	89,856
Capitalization			
Long-term debt	9	**147,131**	152,748
Preferred shares	10	**108,292**	104,343
Common shareholders' equity	11	**135,620**	117,964
		391,043	375,055
		$560,225	$568,782

APPROVED BY THE BOARD:

B. M. Dafoe, Director

R. G. Lock, Director

NORTHWESTERN UTILITIES LIMITED

Consolidated Statement of Changes in Financial Position

	Year ended December 31	
	1985	1984
	(Thousands)	
Cash Provided from Operations		
Earnings attributable to common shares	**$ 33,928**	$ 19,601
Depreciation and depletion	**17,169**	14,792
Other	**951**	(423)
Allowance for funds used during construction — shareholders' equity	**(1,866)**	(2,383)
Decrease (increase) in working capital	**6,869**	(8,498)
	57,051	23,089
Dividends on Common Shares	**16,272**	10,355
Cash Remaining for Investment	**40,779**	12,734
Investment		
Additions to property, plant and equipment	**38,221**	52,081
Increase (decrease) in deferred expenses for natural gas exploration — net	**6,359**	(1,378)
Allowance for funds used during construction — shareholders' equity	**(1,866)**	(2,383)
	42,714	48,320
Investment in subsidiary		1,548
Investment in affiliated company — held for redemption		(2,158)
Disposition of property, plant and equipment	**(1,547)**	(6,499)
Increase in other deferred expenses	**24**	929
	41,191	42,140
Cash Deficiency before Financing	**412**	29,406
Financing		
Issue of short-term notes		(4,500)
Issue of long-term debt		44,000
Reduction in long-term debt	**(6,786)**	(3,853)
Contributions for extensions to plant	**5,604**	3,475
Issue of preferred shares	**15,000**	2,700
Preferred shares redeemed	**(10,872)**	(2,643)
Preferred shares purchased for cancellation	**(180)**	(640)
Other	**20**	(215)
	2,786	38,324
Increase in Cash	**$ 2,374**	$ 8,918

"Long-term debt — current maturities" and cash are excluded from working capital. Cash is defined as short-term advances to parent company less "Due to bank".

Summary of Significant Accounting Policies

December 31, 1985

Consolidated Financial Statements

The consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles and conform in all material respects with the International Accounting Standards adopted by the International Accounting Standards Committee.

The consolidated financial statements include the accounts of the Company and its subsidiary company Northland Utilities (B.C.) Limited.

Regulation

The Company is regulated primarily by the Public Utilities Board of Alberta (the Board) and the Energy Resources Conservation Board of Alberta, which administer acts and regulations covering such matters as rates, financing, accounting, construction, operation and service area. The Board may award interim rates, subject to final determination. Decisions made by these authorities or management which impact on operating results or utility accounting policies are reflected in the consolidated financial statements after the date of decision.

Revenue Recognition

Customers are billed on a cycle billing basis and revenues are recognized when billed with the exception that final Board decisions relating to:

(a) prior years revenues are recorded in the current year at the date of decision

(b) current year revenues collectible or refundable in a subsequent year are recorded at the end of the current year.

Natural Gas Supply

The Province of Alberta enacted the Natural Gas Rebates Act effective January 1, 1974 to shelter the majority of Alberta natural gas customers from the full impact of significant price increases for natural gas. Under the provisions of the Act, the Company incurs a lower effective cost for natural gas in that it is reimbursed for the portion of the price paid to its suppliers which exceeds the support price.

Taxes — Income

Income taxes are provided by the Company, using the normalized—all taxes paid method approved by the Board. This method does not result in a deferral of income taxes as any timing differences between accounting earnings and taxable income are eliminated. The major portion of income taxes paid is refunded for rebate to customers under the Public Utilities Income Tax Transfer Act and the Utility Companies Income Tax Rebates Act.

Prior to adoption of this method, the Company provided for income taxes on the flow-through method which resulted in a deferral of income taxes. As the income tax component of rates is designed to recover only income taxes currently payable, no provision has been made in the consolidated financial statements for this deferral of income taxes. The customer in future years will bear an additional charge in the event of a reversal of these unbooked deferred income taxes. Significant reversals are not expected in the foreseeable future.

Inventories

Inventories are valued at the lower of cost or net realizable value. Costs for materials and supplies are determined on an average basis, whereas the cost of natural gas stored is determined on a first-in, first-out basis.

Deferred Expenses

The Company includes in gas exploration all costs, including an allowance for funds, related to the development of gas reserves. These costs are recorded net of income taxes. Costs related to a successful venture are capitalized as plant and equipment. The costs of an unsuccessful venture are charged against amounts received under The Natural Gas Pricing Agreement Act included in other deferred credits.

Expenses of issue of long-term debt are amortized over the weighted average life of the debt and expenses of issue of preferred shares are amortized over the expected life of the issue. Premiums and unamortized issue costs of redeemed long-term debt and preferred shares are amortized over the life of the issue funding the redemption.

Property, Plant and Equipment

The Company includes in the cost of additions an allowance for funds used during construction, at a rate approved by the Board for debt and equity funds.

Certain additions are made with the assistance of cash contributions where the estimated revenue is less than the cost of providing service or where special equipment is needed to supply the customers' specific requirements. These contributions are amortized on the same basis as, and offset the depreciation charge of, the assets to which they relate.

On retirement of depreciable assets, the accumulated depreciation is charged with the cost of the retired unit less net salvage. Gains and losses on extraordinary retirements are recognized in earnings as extraordinary items.

Included in the Company's Property, Plant and Equipment are gas wells that have been drilled, tested and capped and remain unconnected to the utility system. The Board has directed that the costs of such wells, including an allowance for funds, be accounted for as plant held for future use. If, after a period of 5 years, these wells have not been added to the utility system, the costs are written off against funds received under The Natural Gas Pricing Agreement Act. If at a future date a gas well is placed in service or is required to be used, the amount written off will be reinstated in Property, Plant and Equipment.

Depreciation is provided on assets on a straight-line basis over their estimated useful lives. The major assets are depreciated using rates approved by the Board varying from 1.8% to 5.7%. All resource properties are depleted on a unit of production basis. Dedicated and shared facilities are depreciated over the life of the contract.

Leases

The Board requires that application be made for the capitalization of leases in the determination of customer rates. Prior to such approval, leases that would otherwise be treated as capital leases are accounted for as operating leases.

Deferred Credits — Other

As an Alberta gas producer, the Company receives a pro rata share of monies available under The Natural Gas Pricing Agreement Act. The amounts received, net of royalties and income taxes, are deferred and, subject to Board approval, are reduced by the costs of unsuccessful natural gas exploration.

Preferred Shares

The preferred dividends are recorded in the same manner as interest expense in the consolidated statement of earnings and retained earnings.

The capitalization segment of the consolidated balance sheet and the consolidated statement of earnings and retained earnings reflect the financing and cost of capital policies of the Company as a regulated utility in Alberta.

Notes to Consolidated Financial Statements

December 31, 1985

1. Natural gas supply

The natural gas supply expense is net of a rebate from the Province of Alberta of $50,083,000 (1984 — $51,106,000).

2. Taxes — other than income

	Year ended December 31	
	1985	1984
	(Thousands)	
Federal Canadian ownership taxes	**$10,170**	$15,105
Federal natural gas and gas liquids taxes		5,249
Federal petroleum and natural gas revenue taxes	**3,729**	3,922
	13,899	24,276
Franchise taxes — City of Edmonton	**19,201**	17,785
Franchise taxes — other	**6,668**	5,577
Property taxes	**3,313**	3,242
Provincial mineral taxes	**643**	1,082
	$43,724	$51,962

No natural gas and gas liquids taxes and Canadian ownership taxes have been levied since February 1, 1984 and June 1, 1985 respectively.

3. Taxes — income

Under the normalized—all taxes paid method of accounting for income taxes the expected rate of income tax on accounting earnings would equal the statutory rate in the absence of permanent differences. The following table describes the permanent differences and their effect on the statutory rate:

	Year ended December 31	
	1985	1984
Statutory income tax rate	**47.9%**	47.0%
Allowance for funds used during construction	**(1.8)**	(3.5)
Crown royalties and other non-deductible Crown payments	**6.8**	9.5
Earned depletion and resource allowance	**(5.2)**	(9.8)
Reassessments	**(3.0)**	
Other	**(.9)**	(3.2)
Actual income tax rate	**43.8%**	40.0%

Taxes — income includes deferred income taxes of $239,000 (1984 — $2,278,000) provided for timing differences in the Company and its subsidiary.

As a result of income tax reassessments, Taxes — income has been reduced by $2,396,000. Had the changes been applied retroactively, the income tax expense of each of the years would have been increased (decreased) as follows:

1981	$(3,782,000)
1982	103,000
1983	750,000
1984	533,000
	$(2,396,000)

A provision for certain deferred income taxes is not included in the consolidated financial statements. Unbooked deferred income taxes increased during the year by $2,073,000 (1984 — $343,000) to an accumulated amount of $37,938,000.

4. **Other income**

	Year ended December 31	
	1985	1984
	(Thousands)	
Interest	**$3,175**	$2,538
Other	**260**	451
	$3,435	$2,989

5. **Accounts receivable**

	December 31	
	1985	1984
	(Thousands)	
Customer accounts	**$37,010**	$52,812
Receivable from the Province of Alberta	**4,208**	14,942
Other receivables and deposits	**555**	1,661
	$41,773	$69,415

6. **Property, plant and equipment**

	December 31			
	1985		1984	
	Cost	**Accumulated Depreciation**	Cost	Accumulated Depreciation
	(Thousands)		(Thousands)	
Plant and equipment	**$606,291**	**$137,443**	$569,264	$121,706
Construction work in progress	**2,685**		5,718	
Land	**5,282**		5,178	
	$614,258	**$137,443**	$580,160	$121,706
Net property, plant and equipment	**$476,815**		$458,454	

Plant held for future use in the amount of $22,191,000 (1984 — $27,099,000) is included in plant and equipment.

7. **Deferred expenses**

	December 31	
	1985	1984
	(Thousands)	
Gas exploration — net	**$22,099**	$15,740
Unamortized debt and preferred share issue expenses	**2,650**	2,729
Other	**192**	386
	$24,941	$18,855

8. **Deferred credits — other**

	December 31	
	1985	1984
	(Thousands)	
Funds received under The Natural Gas Pricing Agreement Act — net	**$31,423**	$30,429
Other	**2,381**	2,820
	$33,804	$33,249

During 1985 and 1984 there were no unsuccessful gas exploration costs charged against monies received under The Natural Gas Pricing Agreement Act.

9. Long-term debt

Long-term debt outstanding, net of current maturities, is as follows:

	December 31 1985	December 31 1984
	(Thousands)	
First mortgage sinking fund bonds 5¾% to 9¾% due to 1994	**$ 10,822**	$ 12,009
Sinking fund debentures payable to parent company 8.57% to 17.50% due to 2002	**136,309**	140,739
	$147,131	$152,748

Annual repayment of maturing issues and sinking fund requirements for each of the following years are:

	Maturing Issues	Sinking Fund Requirements	Sinking Fund Purchased in Advance	Total
	(Thousands)			
1986	$	$ 5,083	$(523)	$ 4,560
1987	20,000	5,083	(523)	24,560
1988	4,440	4,768	(396)	8,812
1989		4,768	(8)	4,760
1990		4,768		4768

The $44,000,000 13.10% debenture 1984 series, due June 1, 1994 grants the holder of the debenture the option of requiring the Company to redeem all or part of the holder's debenture on June 1, 1989 at a price equal to the principal amount plus accrued and unpaid interest to June 1, 1989.

10. Preferred shares

Authorized:

105,000 4% Cumulative Redeemable Preferred Shares; voting, non-participating.

An unlimited number of Series Second Preferred Shares, issuable in series, which have been designated as Cumulative Redeemable Second Preferred Shares.

Issued:

	1985 Shares	1985 Amount	1984 Shares	1984 Amount
		(Thousands)		(Thousands)
Cumulative Redeemable Preferred Shares				
4%	105,000	**$ 10,500**	105,000	$ 10,500
Cumulative Redeemable Second Preferred Shares				
Non-retractable				
9.24% Series B			434,877	10,872
7.30% Series C	191,520	**4,788**	198,720	4,968
		15,288		26,340
Retractable				
10.12% Series E	463,441	**11,586**	463,441	11,586
14.00% Series F	1,199,240	**29,981**	1,199,240	29,981
14.50% Series G	480,000	**12,000**	480,000	12,000
8.74% Series I	869,462	**21,737**	869,462	21,736
8.375% Series J	108,000	**2,700**	108,000	2,700
7.80% Series K	600,000	**15,000**		
		93,004		78,003
		$108,292		$104,343

(Note 10 continued)

All of the Cumulative Redeemable Second Preferred Shares are held by the parent company, Canadian Utilities Limited.

During 1985 the Company redeemed the 9.24% Cumulative Redeemable Second Preferred Shares Series B. The redemption price was $25.25 per share, plus $0.3734 of accrued dividends. The Company issued for cash $15,000,000 of Cumulative Redeemable Second Preferred Shares Series K.

Stated values, redemption premiums and dividends:

	Stated Value	1986 Redemption Premium	Dividends Year ended December 31 1985	1984
			(Thousands)	
Cumulative Redeemable Preferred Shares				
4%	$100	4%	**$ 420**	$ 420
Cumulative Redeemable Second Preferred Shares				
Non-retractable				
10¼% Series A	$ 25			47
9.24% Series B	$ 25		**976**	1,016
7.30% Series C	$ 25	1.6%	**354**	369
			1,750	1,852
Retractable				
10.12% Series E	$ 25	4%	**1,173**	1,173
14.00% Series F	$ 25	4%	**4,197**	4,197
14.50% Series G	$ 25		**1,740**	1,740
8.74% Series I	$ 25		**1,896**	1,913
8.375% Series J	$ 25		**226**	207
7.80% Series K			**247**	
			9,479	9,230
			$11,229	$11,082

Redemption privileges

The preferred shares of the Company are redeemable subject to premiums listed above plus accrued dividends. The Cumulative Redeemable Preferred Shares and the non-retractable Cumulative Redeemable Second Preferred Shares are redeemable at the option of the Company at any time. The retractable Cumulative Redeemable Second Preferred Shares will be subject to redemption at the option of the Company commencing at the dates specified and with an initial premium as stated:

		Redemption Premium
Series E	March 1, 1986	4%
Series F	October 1, 1986	4%
Series G	May 1, 1987	4%
Series I	November 1, 1988	4%
Series J	January 31, 1992	Nil
Series K	October 15, 1993	Nil

It is the Company's intention to approve the redemption of the Series E shares in March, 1986.

(Note 10 continued)

Purchase obligations

The Company's parent company, Canadian Utilities Limited, is required in each year to make all reasonable efforts to purchase for cancellation the number of shares of the Cumulative Redeemable Second Preferred Shares listed below at a price not exceeding $25 per share plus costs of purchase. If after all reasonable efforts the parent company is unable to do so, the obligation to purchase shares in such year is extinguished. The Company's requirement to purchase will be limited to its proportionate share of the corresponding issue that the parent company has been able to acquire.

	1985 Share Purchase Obligations	Purchased in 1985 Shares	Amount
			(Thousands)
Series B	15,000		**$**
Series C	7,200	7,200	**180**
Series E	9,600		
Series F	47,993		
Series G	19,200		
Series I	26,400		
			$180

Retraction privileges

Certain series of the Cumulative Redeemable Second Preferred Shares have retraction privileges on specified dates at the option of the holder at the stated value plus accrued dividends. The series and retraction dates are shown below:

Series E	March 1, 1988
Series F	September 29, 1989
Series G	May 1, 1987
Series I	November 1, 1991
Series J	January 31, 1992
Series K	October 15, 1993

11. Common shareholders' equity

	December 31 **1985**	December 31 1984
	(Thousands)	
Common shares	**$ 41,676**	$ 41,676
Retained earnings	**93,944**	76,288
	$135,620	$117,964

Common shares

Authorized: An unlimited number of shares without nominal or par value.

Issued: 2,900,528 shares.

Retained earnings

The bond and debenture indentures place certain limitations on the Company which include restrictions on the payment of dividends on common shares. Consolidated retained earnings in the amount of $21,147,000 was free from such restrictions.

12. Amalgamation

On January 1, 1985, The Lloydminster Gas Company Limited was amalgamated with the Company. During 1984 all shares of The Lloydminster Gas Company Limited were acquired for cash in the amount of $1,548,000. The results of operations were included in the 1984 consolidated financial statements effective June 1, 1984.

13. Amount held in trust

The amount held in trust for income tax rebates, which is not included in the consolidated financial statements, is $6,889,000 (1984 — $2,972,000).

14. Related party transactions

Certain costs of administration, systems development, financial management, equipment, rent and leasehold improvements are incurred by the parent company, Canadian Utilities Limited. These costs are allocated to the Company on the basis of usage and on the basis of assets and employees. Total charges amounted to $10,688,000 (1984 — $10,002,000).

Transactions with affiliated companies include the purchase of natural gas for $20,607,000 (1984 — $2,116,000), revenue from the sale of natural gas of $9,340,000 (1984 — $16,260,000), and revenue from transportation of natural gas of $7,372,000 (1984 — $6,097,000). The Company participates in oil and natural gas joint ventures. When the Company acts as operator it has, in some instances, contracted ATCO Ltd. subsidiaries for well drilling and servicing, equipment purchases and related services, the total amount being approximately $657,000 (1984 — $487,000). A portion of these expenditures is reimbursed by the other participants in the joint ventures. A subsidiary of ATCO Ltd. acted as a general contractor for construction of an operations base and office leasehold improvements for which fees, including administration costs, amounted to $87,000 (1984 — $79,000).

These transactions are considered to be in the normal course of business, at fair market value and subject to review by the Board.

15. Rate application

The Company received an interim rate decision effective October 1984. The application was for an additional $23,000,000 of revenue in 1984. The Public Utilities Board approved interim rates which allowed the Company to recover approximately $10,000,000 in the period November 1, 1984 to June 30, 1985, of which approximately $5,000,000 was recorded in 1984. The Board also approved an interim rate increase effective January 1, 1985 allowing the Company to collect approximately $25,000,000 during 1985. A final decision on the rate application is expected during 1986.

16. Employee Pension Plan

The Company and its subsidiary has a defined benefit pension plan covering substantially all employees. Employees participate through contributions to the plan which provides for pensions based on length of service and final average earnings. During the year, the Company made no changes to the benefits offered by the plan which uses the accrued benefit cost method with projection of employee compensation levels to determine the costs of the reporting period. Pension costs for the year amounted to $3,479,000 (1984 — $3,253,000) including amortization of past service costs and experience deficiencies of $1,470,000 (1984 — $1,251,000). Based on the most recent actuarial evaluation, December 31, 1983, the estimated plan deficit now amounts to $9,724,000. Of this deficit $587,000 is a result of plan experience and is being amortized and funded over 3 years. The balance of $9,137,000 arising from changes in plan assumptions is being amortized and funded over periods ranging from 3 to 13 years.

17. Commitments and contingencies

Minimum non-capitalized lease payments, which extend over periods not exceeding ten years, are $477,000, $257,500, $163,500, $110,000 and $108,000 for the years 1986-1990 respectively.

The Company purchases natural gas from approximately 190 producers under approximately 381 purchase contracts. Substantially all of these contracts have provisions requiring payment by the Company when it is unable to nominate specified minimum annual quantities for delivery. The available market has exceeded the minimum contract supply quantities and no "take-or-pay" payments were required.

18. Financial statements

Certain of the 1984 figures have been reclassified to conform with the consolidated financial statement presentation adopted in 1985.

Management's Responsibility for Financial Reporting

The consolidated financial statements and other financial information relating to the Company contained in this annual report have been prepared by management, which is responsible for the integrity and objectivity of this information. The financial information contained elsewhere in this annual report is consistent with that in the consolidated financial statements. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles as applied to regulated utilities and conform in all material respects with International Accounting Standards.

Where management makes a choice from acceptable alternatives it uses methods which it believes are prudent. These consolidated financial statements necessarily include some amounts that are based on informed judgements and best estimates of management.

Management depends upon a system of internal accounting controls to meet its responsibility for reliable and accurate reporting which includes periodic review by the internal audit function. Management modifies and improves its system of internal accounting controls in response to changes in business conditions. The Board of Directors oversees management's responsibilities for financial reporting.

Price Waterhouse, the Company's independent auditors, are engaged to express a professional opinion on the consolidated financial statements. The examination is conducted in accordance with generally accepted auditing standards and includes tests and other procedures which allow the auditors to report on the fairness of the consolidated financial statements prepared by management.

TRANSFER AGENT AND REGISTRAR

Montreal/Toronto/
Edmonton/Calgary

Preferred Shares
Guaranty Trust Company of Canada

TRUSTEE AND REGISTRAR

Halifax/Montreal/Toronto/
Winnipeg/Regina/Edmonton/
Vancouver

Bonds
Montreal Trust Company

STOCK EXCHANGE LISTINGS

Preferred Shares
Toronto and Alberta Stock Exchanges

AUDITORS

Price Waterhouse
2401 Toronto Dominion Tower
Edmonton Centre
Edmonton, Alberta T5J 2Z1

ANNUAL MEETING

The annual meeting of shareholders will be held in Edmonton, Alberta on April 16, 1986.

Board of Directors

J. E. Barrett, Calgary
Vice President and General Manager
ATCO Metal

B. M. Dafoe, Edmonton
Senior Vice-President
Northwestern Utilities Limited and
Canadian Western Natural Gas Company Limited

W. A. Elser, Calgary
President and Chief Executive Officer
ATCOR Resources Limited

H. Hole, Edmonton
Vice President and General Manager
Lockerbie and Hole Western Ltd.

W. R. Horton, Edmonton
Executive Vice-President, Utilities
Canadian Utilities Limited

E. W. King, Edmonton
Corporate Director

R. G. Lock, Edmonton
Vice President and General Manager
Northwestern Utilities Limited

A. R. McBain, Edmonton
President, McBain Camera Ltd.

A. H. Mitchell, Edmonton
Chairman of the Board
Mitchell & Associates Ltd.

C. S. Richardson, Calgary
Deputy Chairman of the Board and
Chief Financial Officer
Canadian Utilities Limited

J. L. Schlosser, Edmonton
President, Tri-Jay Investments Ltd.

R. D. Southern, Calgary
Chairman of the Board and
Chief Executive Officer
Canadian Utilities Limited

J. D. Wood, Edmonton
President and Chief Operating Officer
Canadian Utilities Limited

Officers

R. D. Southern
Chairman of the Board
and Chief Executive Officer

J. D. Wood
Deputy Chairman of the Board

W. R. Horton
President and Chief Operating Officer

B. M. Dafoe
Senior Vice-President

R. G. Lock
Vice-President and General Manager

W. L. Graburn
Vice-President, Gas Supply

D. B. Mitchell
Vice-President, Human Resources

A. M. Anderson
Secretary/Treasurer

R. M. Massé
Controller

J. H. Cook
Assistant Secretary

C. K. Sheard
Assistant Secretary

D. P. Wood
Assistant Secretary

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An ATCO Company

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