



# Interim Report

**For the Three Months Ended March 31, 2009**

**April 30, 2009**

Pacific Northern Gas Ltd.  
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**Pacific Northern Gas Ltd.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
For the Three Months Ended March 31, 2009  
Dated April 30, 2009

**FORWARD-LOOKING STATEMENTS**

This Management's Discussion and Analysis ("MD&A") includes forward-looking statements. Forward-looking statements relate to, among other things, anticipated financial performance, business prospects, strategies, regulatory developments, new services, market forces, commitments and technological developments. Many of these statements can be identified by words such as "believe", "expects", "expected", "will", "intends", "projects", "anticipates", "estimates", "continues" or similar words. Pacific Northern Gas ("the Company") believes the expectations reflected in such statements are reasonable but no assurance is given that such expectations will be correct. All forward-looking statements are based on management's beliefs and assumptions based on information available at the time the assumption was made and on its experience and perception of historical trends, current conditions and expected further developments as well as other factors deemed appropriate in the circumstances. In addition to other assumptions made in this MD&A, assumptions have been made in respect of:

- gas commodity prices;
- forecasted gas deliveries;
- regulatory conditions, including decisions by the British Columbia Utilities Commission (the "Commission");
- the Company's ability to access capital;
- capital expenditure estimates, plans, schedules and activities and the development, construction, operations and cost of facilities and infrastructure;
- income tax considerations;
- operating risks and related insurance coverage and inspection and integrity systems;
- and competitive conditions.

By its nature, such forward-looking information is subject to various risks and uncertainties that are known and unknown, including those material risks discussed in this MD&A and in the Company's 2009 Annual Information Form under "Risk Factors" which could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed. Such risks and uncertainties include but are not limited to: general economic conditions and markets; gas supply and availability; gas commodity price volatility; competition; decisions by regulators; seasonal weather patterns; federal and provincial climate change initiatives; financing of investments as well as the value of such investments; the cost and availability of capital; the impact on the Company's liquidity if it were to go offside of the covenants in its debt facilities; successful execution of strategic initiatives; the ability of the Company to attract and retain quality employees; and the impact of accounting changes, including the transition to International Financial Reporting Standards. Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date it is expressed in this MD&A or otherwise, and the Company undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required by applicable securities laws.

**Non-GAAP Measures**

References to "operating margin" are to operating revenues less cost of sales. Operating margin is not a recognized measure under Generally Accepted Accounting Principles ("GAAP") and does not have a standardized meaning prescribed by GAAP. Therefore, operating margin may not be comparable to similar measures presented by other issuers. Readers are cautioned that operating

margin should not replace revenues as a measure of performance. Management believes operating margin is a meaningful measure of performance because its financial results are best measured by excluding the cost of gas which is flowed through to customer rates without a mark-up

## **Business of the Company**

### **Competitiveness of Rates**

As a distributor of natural gas, the Company continuously monitors the competitiveness of its natural gas retail rates relative to alternative heating sources in its service area. The Company's current residential rates in all divisions are lower than the comparable residential electricity rate that became effective April 1, 2009. Recent declines in gas commodity prices payable by the Company are helping to make gas rates more competitive relative to electricity. The Province of British Columbia's (the "Province") Energy Plan, released in early 2007, calls for the Province to become self-sufficient in electricity by 2016 with all new generation capacity being carbon neutral and to use demand side management to curtail growing electricity consumption. These policy objectives are expected to result in higher electricity rates. The Province implemented a carbon tax on fossil fuel consumption effective July 1, 2008. The carbon tax on natural gas is just under \$0.50 per Gigajoule ("GJ") effective July 1, 2008, rising annually to just under \$1.50 per GJ effective July 1, 2012. The Company's gas rates are expected to maintain their relative competitiveness with electricity rates as electricity rate increases are expected to be higher than the impact of the carbon tax on natural gas prices.

Amendments made to the Utilities Commission Act (British Columbia) in 2008 focus on the energy conservation and demand side management goals and objectives set forth in the Energy Plan. PNG is participating with government stakeholder groups to keep apprised of potential cost effective demand side management initiatives that make sense for its customers.

### **Customer Usage and Current Economic Conditions**

Weak economic conditions faced by the Company's customer base in the Western system service area have reduced the quantity of gas sold and delivered to the Company's customers in that area over the last several years. In particular, lower demand and lower prices for forest products in North America have resulted in deliveries to the forestry sector continuing to decline. The Company's 2009 revenue requirements application reflects the lower expected deliveries to customers resulting from the economic downturn. The Northeast system service area has not been impacted by the poor worldwide economic conditions to the same extent as in the Western system due to activity in the oil and gas exploration sector.

### **KSL Project**

The Company continues to pursue a project to loop its mainline transmission system from Kitimat to Summit Lake (the "KSL Project") through its 50 percent ownership of Pacific Trail Pipelines Limited Partnership ("PTP"). The KSL Project would provide gas transportation services for up to 1.0 billion cubic feet per day, primarily for Kitimat LNG Inc.'s proposed liquefied natural gas ("LNG") export terminal to be located approximately 15 kilometers southwest of Kitimat. The KSL Project entails the construction of approximately 470 kilometers of a 36 inch diameter pipeline and associated compression facilities, at a cost of \$1.2 billion based on estimates made in 2006.

PTP received its Environmental Assessment Certificate from the B.C. Environmental Assessment Office ("BCEAO") for the KSL Project in June 2008 and received approvals from the Canadian Environmental Assessment Agency ("CEAA") in March 2009. On April 8, 2009 the Province announced an agreement with 15 of the 16 First Nations' bands whose traditional territories would be traversed by the KSL Project. Under the agreement, the Province will provide the First Nations with \$3 million as an incentive for ratification of the KSL Project and a further \$32 million to acquire an equity position in PTP.

Subject to a number of conditions, construction of the KSL Project by PTP is planned to commence in 2010 for completion in 2013 when the LNG export terminal is planned to begin operation. Conditions to construction include the securing of contracts for use of PTP's transportation capacity, financing for construction of the KSL Project, and additional regulatory approvals for the KSL Project, including a Certificate of Public Convenience and Necessity from the Commission and other permits from the B.C. Oil and Gas Commission. The Company can give no assurances that these conditions will be satisfied or that construction of the KSL Project by PTP will proceed.

### **Capacity on the Western System**

PNG filed an application with the Commission on March 12, 2009 for approval of a Letter Agreement with Merrill Lynch Commodities, Inc. ("Merrill Lynch"). The Letter Agreement provides Merrill Lynch with an option to contract for 75 MMcf per day of firm gas transportation service using existing capacity on PNG's Western pipeline system. A similar Commission approved arrangement with another party was terminated by the Company on March 6, 2009 due to non-payment of an option fee due in mid December 2008. If Merrill Lynch exercises its option it would utilize the transportation service to deliver natural gas to a floating liquefied natural gas ("LNG") vessel to be located on the Douglas Channel near Kitimat, B.C. Merrill Lynch and Teekay Corporation have agreed to jointly develop a project to convert an existing LNG vessel into a floating LNG plant. The LNG would be transferred from the floating LNG plant to other LNG carriers for export.

The Commission approved the Letter Agreement on April 23, 2009 and a \$1.5 million option fee has been released from escrow to PNG. Merrill Lynch will have an exclusive option until December 31, 2009 to contract for firm gas transportation capacity for a 2 to 5 year primary term, with a right to renew for an additional 2 to 5 year term. Alternatively, Merrill Lynch may extend the initial option period by up to four six month periods, with payment of \$1 million for each extension. The Letter Agreement provides for the parties to negotiate and execute a transportation service agreement on or before September 5, 2009 and to promptly thereafter file the agreement with the Commission for acceptance as a filed tariff. This transportation service agreement would become effective following exercise of the option. However, in the unexpected event that the Commission does not accept the transportation service agreement, PNG would be required to refund the option fee to Merrill Lynch. If the transportation service agreement comes into effect, the PNG pipeline system would be at full capacity utilization, generating approximately \$15 million per year of incremental revenue for the benefit of PNG and its customers. The cost to reactivate the facilities left idle when Methanex Corporation ceased operations will be recovered from these incremental revenues. The reactivation costs are in the range of \$1.3 million with the largest single expense being the cost of completing a compressor overhaul at an estimated \$0.5 million. The Company anticipates expensing all reactivation costs in the first year of operation. The commencement date for the transportation service is targeted for between January 1, 2012 and January 1, 2013.

### **Negotiated Settlement of the 2009 Revenue Requirements**

On March 24, 2009, the Company and its customers negotiated settlements of the 2009 revenue requirements applications for each of the Company's divisions. The settlements were approved by the Commission on April 23, 2009. The agreed to Western system delivery charge increase for a typical residential customer is approximately 5 percent compared to rates effective prior to January 1, 2009. This increase has been more than offset by successive gas commodity charge decreases as of January 1 and April 1, 2009. The Fort St. John/Dawson Creek division residential delivery rates declined an average of 3.4 percent primarily due to lower debt interest costs. The Tumbler Ridge division average residential delivery rate also declined by 6.5 percent. In all divisions, the agreed to delivery rates are less than the interim rates and therefore customers will be receiving refunds on gas deliveries from January 1 to April 30, 2009.

## Overall Performance

Net income for the three months ended March 31, 2009 was \$5.2 million, compared with net income of \$4.5 million for the corresponding period in 2008. After providing for preferred share dividends, the earnings per common share in the three months ended March 31, 2009 were \$1.39 compared with earnings per common share of \$1.21 for the same period in 2008.

Net income for the quarter was higher in 2009 compared to 2008 by approximately \$0.7 million with approximately \$0.2 million being due to the Company's higher net residential customer additions in the Northeast system as well as higher commercial and small industrial volumes, compared to the 2009 forecast additions and volumes used for ratemaking purposes. Another \$0.2 million of the higher net income in 2009 was due to lower expenditures on the KSL Project relative to the same period in 2008. The remaining \$0.3 million increase in 2009 first quarter net income over 2008 is related to the recovery of margin following the termination of the Methanex amortization in October 2009. This recovery is collected in rates throughout the year and will impact the first three quarters' net income positively, but will be offset by lower net income in the fourth quarter of 2009.

Included in net income for the three months ended March 31, 2009 are after-tax charges of \$0.04 million or \$0.01 per share relating to the Company's share of KSL Project development expenditures compared to \$0.2 million or \$0.07 per share for the corresponding period in 2008.

The Company's share of planned development expenditures for the KSL Project in the last nine months of 2009 is expected to be approximately \$0.1 million before income taxes (\$0.02 per share, net of income taxes). The Company's share of further KSL Project development expenditures will continue to be expensed until suitable commercial arrangements for firm gas transportation services by PTP are in place.

The rate stabilization adjustment mechanism approved by the Commission continues to contribute to the stability of the Company's earnings. This mechanism allows the Company to record the after-tax revenue variances arising from differences between actual and forecast sales volumes for residential and small commercial customers in a deferral account for collection or refund in future rates. As a result of this account, the Company's net income decreased by \$0.5 million for the three month period ended March 31, 2009.

Residential deliveries were approximately 1 percent higher in the three months ended March 31, 2009 and total commercial deliveries were 9 percent higher, relative to deliveries over the same period in 2008. Management believes that weather was a key factor in the increase in both the residential and the commercial deliveries, as it was approximately 2 percent colder for the three month period ended March 31, 2009 compared to the same period in 2008. The weather was also 7 percent colder than normal for the three month period ended March 31, 2009, with "normal" based on the average of actual temperatures in the Company's service areas for the preceding 10 years.

Industrial deliveries were lower by approximately 8 percent for the three month period ended March 31, 2009 compared to the same period in 2008. The decrease in industrial deliveries is comprised of a 19 percent decrease in large industrial customer deliveries, mainly to West Fraser Mills Ltd., offset in part by a 6 percent increase in small industrial deliveries. The increase in small industrial customer deliveries relate primarily to the Northeast system. Deferral accounts are in place that recover or refund margin differences resulting from deliveries to large industrial customers and to some small industrial customers varying from the forecast approved for ratemaking purposes.

## Results of Operations

Operating revenues in the three months ended March 31, 2009 decreased to \$48.3 million compared with \$57.5 million in the corresponding period in 2008. The decrease was primarily due to a reduction of \$12.3 million from the sale of gas surplus from the Company's customer needs ("off system gas sales"). Any profit or loss realized on off system gas sales is deferred for future recovery

from, or refund to, the Company's sales customers. The decrease in off system gas sales in the first quarter of 2009 reflects the impact of a reduction in the quantity of gas supply purchased on a committed basis in 2009 compared to 2008. Natural gas commodity prices, which are passed through to the Company's sales customers without mark-up, are volatile and can result in significant variability of the Company's reported operating revenues, but do not affect net income.

Operating margin in the three months ended March 31, 2009 increased to \$17.0 million, as compared with \$16.4 million in the same period in 2008. An estimated \$0.4 million of the higher operating margin in the first quarter is the result of changes in the timing of the Company's revenues in 2009 which will be offset in the fourth quarter of 2009, with the remainder being due to: (i) higher delivery rates in the Western system more than offsetting lower rates in the Northeast system for 2009; (ii) higher than anticipated net residential customer additions; and, (iii) higher than anticipated commercial and small industrial deliveries.

Included in project development expenditures and other income deductions for the three months ended March 31, 2009 are the Company's share of KSL Project development expenditures amounting to \$0.1 million before income taxes.

The Company filed a report with the Commission in March 2009 on past and projected gas supply costs compared to gas cost recoveries from customers. On the basis of the report, the Commission issued an order confirming the Company's request to decrease gas supply cost rates in all divisions effective April 1, 2009. The decreases ranged from \$1.38 to \$2.02 per GJ.

#### Summary of Quarterly Results for Eight Quarters Ended March 31, 2009

<i>Thousands of dollars except per share amounts</i>	Mar. 31 2009	Dec. 31 2008	Sept 30, 2008	June 30, 2008	Mar. 31 2008	Dec. 31 2007	Sept 30, 2007	June 30, 2007
Operating Revenues	\$48,318	\$41,144	\$13,834	\$20,332	\$57,529	\$40,568	\$12,002	\$17,934
KSL expenditures, net of income taxes	(44)	(177)	(84)	(79)	(246)	(266)	(428)	(367)
Net income (loss) <sup>1</sup>	5,156	3,159	(1,528)	(205)	4,511	2,636	(1,391)	(799)
Earnings per share <sup>2</sup>	1.39	0.84	(\$0.44)	(\$0.08)	1.21	0.70	(\$0.40)	(\$0.24)
- per share diluted <sup>2</sup>	1.38	0.84	(\$0.44)	(\$0.08)	1.20	0.70	(\$0.40)	(\$0.24)

<sup>1</sup> The Company did not have any extraordinary items which impacted net income over the most recently completed eight quarters.

<sup>2</sup> Per share amounts are after provision for preferred share dividends of approximately \$84,000 per quarter.

The Company's natural gas distribution business is very seasonal, with higher sales in the colder winter months and lower sales in warmer months. Deliveries to residential and commercial customers tend to be more temperature sensitive than deliveries to industrial customers, with deliveries in the first and fourth quarters accounting for more than 75 percent of annual deliveries. Given that a substantial portion of its gas sales are used for space heating purposes, the Company earns in excess of its annual net income in the first and fourth quarters of its fiscal year and generally realizes losses in the other two quarters.

#### Liquidity

The Company has credit facilities which include a \$20 million operating line, a \$20 million 5-year revolving term facility and a \$15 million risk management facility.

The operating line is subject to borrowing base requirements and a financial covenant requiring the Company's debt leverage not to exceed 65 percent, or approximately the same level currently approved by the Commission. As of March 31, 2009, the calculated borrowing base of the operating line was approximately \$29.5 million giving the Company the ability to access \$20 million while actual utilization, which was related solely to the issuance of letters of credit, was \$8.9 million. The Company was in compliance with the financial covenant under its operating line through March 31, 2009. The facility has a term of 12 months, expiring July 8, 2009 and is collateralized by a charge on the Company's accounts receivable and inventories. The Company has recently commenced the renewal process for its operating line.

The \$20 million 5-year revolving term facility, available for general corporate purposes, is repayable at maturity and is secured by the pledge of a \$20 million debenture issued by the Company. Draws under the facility are made via prime rate advances or Bankers' Acceptance equivalent loans at the Canadian Deposit Offering Rate ("CDOR") plus 1.325 percent. The 5-year revolving term facility contains a financial covenant requiring the Company's debt leverage not to exceed 65 percent and, if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the Company must maintain an interest coverage of 2.0 times or higher using earnings before interest, income taxes and expenditures on the KSL Project to a cumulative maximum of \$10 million. The Company's current interest coverage is greater than 2.0 times and its secured debt is currently rated at BBB (low).

\$9 million was outstanding under the revolving term facility at March 31, 2009 via Bankers' Acceptance equivalent loans. Additional funds available under the facility will be used for general corporate purposes including the Company's capital program and for expenditures on the KSL Project.

The Company's risk management facility allows it to hedge natural gas purchases in accordance with its annual gas contracting and gas supply price management plan and to enter into interest rate hedging transactions to a total maximum exposure of \$15 million, with exposure calculated by the facility provider using its standard methodology. The risk management facility is secured by the pledge of a \$20 million debenture issued by the Company.

Accounts receivable at March 31, 2009 are \$5.6 million lower than at December 31, 2008 due to a reduction in accounts receivable related to off system sales of \$5.4 million as well as the seasonal nature of natural gas deliveries to residential and commercial customers.

Accounts payable and accrued liabilities at March 31, 2009 are \$10.8 million lower due to lower volumes and prices of natural gas purchases made in the month of March 2009 compared to December 2008. Income and other taxes payable at March 31, 2009 are \$2.0 million higher than at December 31, 2008 primarily due to a higher current income taxes payable balance. The gas purchase variance account has changed from a \$4.2 million recoverable at December 31, 2008 to a \$2.2 million recoverable at March 31, 2009 due partly to the net liability value of the Company's derivative financial instruments recorded in the gas purchase variance account increasing by \$1.7 million to \$7.2 million in this period. Also during the same period, gas commodity charges recovered through customer rates exceeded the gas commodity costs paid by the Company by approximately \$3.2 million.

The Company purchases gas for resale to its gas sales customers and passes through the commodity cost of gas to those customers without mark-up. The rates charged to gas sales customers are based, in part, on projected gas supply prices. The Company's liquidity requirements can be affected by delays between increases or decreases in the cost of gas purchased by the Company and regulatory approval of rate adjustments to reflect the cost increases or decreases.

## **Normal Course Issuer Bid**

The Company commenced a normal course issuer bid through the facilities of the Toronto Stock Exchange on March 9, 2009. At the current trading price of the Company's common shares, management believes that purchases under the issuer bid will be beneficial to the Company's shareholders. Under the approved program, the Company is permitted to purchase up to 300,000 of its own common shares over a term of one year. Subject to certain exemptions for block purchases, the Company was permitted to purchase up to 1,627 common shares each trading day through March 31, 2009 and is permitted to purchase 1,000 common shares each trading day thereafter. As of the end of the first quarter, the Company had purchased 26,916 common shares at an average price of \$12.10 per share. Common shares purchased under the program are cancelled.

## **Capital Resources**

The Company does not have material commitments for capital expenditures at this time. Planned capital expenditures in the last three quarters of 2009 are approximately \$6.8 million in order to maintain the transmission and distribution system and to provide for expansions of its distribution system to service new customers. In addition, the Company's share of funding of the development expenditures for the KSL Project through PTP is expected to be approximately \$0.1 million net of income taxes for the remainder of 2009. The Company expects to finance these expenditures from cash flow from operations and draws on the Company's debt facilities as required.

The Company has proposed to install a new gas distribution system to serve Tomslake, a low density rural area located in the Dawson Creek service area. The projected capital cost of the system is approximately \$2.6 million and the Company's net investment is estimated at \$1.5 million after reflecting expected contributions from other parties. The system would initially serve approximately 200 residential and commercial customers. Subject to Commission approvals and sufficient customer commitments, construction on the project could commence in the summer of 2009.

## **Off-Balance Sheet Arrangements**

As of March 31, 2009, the Company had no off-balance sheet arrangements.

## **Transactions with Related Parties**

There were no transactions with related parties during the three month period ended March 31, 2009.

## **Critical Accounting Estimates**

The preparation of the Company's consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the related disclosures. These estimates are based on historical experience and current assumptions, and actual results may differ from these estimates under different assumptions and conditions. There were no material changes in the nature of the Company's critical accounting estimates during the three months ended March 31, 2009 from those disclosed in the Company's MD&A for the year ended December 31, 2008.

Operating revenues include natural gas sales that are recorded on the basis of regular meter readings and estimates of customer usage from the last meter reading date to the end of the reporting period for such operating revenues. These estimates are made assuming normal consumption patterns, adjusted for weather variations, which may differ from actual consumption patterns. The estimates of unbilled operating revenue at March 31, 2009 comprise 22 percent of the Company's operating revenues for the three month period ended March 31, 2009. Through future

meter readings, the usage estimates are replaced with actual delivered volumes which will be reflected in the Company's financial results at that time.

### Financial and Other Instruments

The Company utilizes natural gas commodity hedging contracts in order to manage the volatility inherent in the prices of its natural gas purchases. It may also utilize interest rate hedging contracts to reduce the volatility of the interest expense associated with its floating rate debt instruments. As of March 31, 2009 the Company had no interest rate hedging contracts outstanding.

The Company expects to file its annual gas contracting and gas supply price risk management plan with the Commission during the second quarter of 2009. The plan will call for gas price hedging, covering purchases over the November 1, 2009 through October 31, 2011 period, to be completed in stages beginning in May 2009. Each hedging transaction is subject to approval by the Company's price risk management plan committee.

At March 31, 2009, the Company had outstanding natural gas swap contracts, natural gas collar contracts and natural gas call options relating to natural gas supply as follows:

Financial instrument	Notional Quantity (GJ's)	Percent of Annual Gas Purchases	Delivery period	Price Range (per GJ)	Estimated Fair Value Derivative Asset (\$000's)	Estimated Fair Value Derivative Liability (\$000's)
Natural gas swap contracts	2,950,200	29.9	Apr. 2009 – Oct. 2010	\$5.91 to \$10.87	—	\$6,602
Call Options	36,800	0.4	Apr. 2009 – Oct. 2009	Cap at \$10.08	\$0.43	—
Collar contracts	309,900	3.1	Apr. 2009 – Oct. 2010	Floors from \$6.24 to \$8.38; Caps from \$8.50 to \$11.46	—	\$626
<b>Total</b>	<b>3,296,900</b>	<b>33.4</b>			<b>\$0.43</b>	<b>\$7,228</b>

The fair value reflects the estimated amounts that the Company would receive or pay at March 31, 2009 to terminate the natural gas swap contracts, natural gas collar contracts, or call options based on the estimated net cash flows under the terms of each contract. These estimated fair market values have no impact on earnings due to the regulated nature of the Company's operations. Based on the current regulatory process, any gains or losses arising from utility related financial gas hedging instruments would be treated as part of the flow through of gas supply costs in customer rates. As a result of the recognition of the derivative asset, the gas cost variance payable account was decreased by \$7.2 million, in accordance with specific regulatory treatment. At December 31, 2008, the estimated fair value of these derivative instruments was a liability of \$5.5 million.

## **Dividends**

The Board of Directors declared a semi-annual dividend of 84.375 cents per share on the Company's 6-3/4 percent cumulative, redeemable, preferred shares, payable July 1, 2009 to the shareholders of record at the close of business on June 16, 2009.

The Board of Directors also declared a quarterly dividend of 23 cents per share on the Company's common shares, an increase of 4.5 percent from the prior year, payable June 22, 2009 to shareholders of record at the close of business on June 5, 2009.

Pacific Northern Gas Ltd., for purposes of the Income Tax Act (Canada), and any similar provincial or territorial legislation, designates all dividends paid by Pacific Northern Gas Ltd. after December 31, 2005 to be "eligible dividends" unless otherwise notified by the Company. An eligible dividend paid to a Canadian resident is entitled to the enhanced dividend tax credit.

## **Changes in Accounting Policies**

### **Accounting for Rate-Regulated Operations**

In December 2007, the Canadian Institute of Chartered Accountants ("CICA") issued the following new guidance in accounting for rate-regulated operations which applies to fiscal years beginning on or after January 1, 2009:

- the removal of the temporary exemption in Section 1100, Generally Accepted Accounting Principles, providing relief to entities subject to rate regulation from the requirement to apply the Section to the recognition and measurement of assets and liabilities arising from rate regulation
- the amendment to Section 3465, Income Taxes, to remove the exception for entities subject to rate regulation so they are required to recognize future income tax liabilities and assets as well as a regulatory asset or liability for the amount of future income taxes expected to be recovered or refunded to customers in future rates
- slight amendments to Accounting Guideline AcG-19, Disclosures by Entities Subject to Rate Regulation to reflect the above changes.

On January 1, 2009, the Company adopted these new standards retrospectively without restating prior year's figures which resulted in the following:

- The Company recognized \$15.4 million of future income tax liabilities as well as a related regulatory asset for the amount of future income taxes expected to be recovered from customers in future rates. The Company had previously followed the deferral method of accounting for income taxes for rate setting purposes and had collected \$13.6 million of deferred tax liabilities from customers. This amount has been offset against the regulated asset established for amounts expected to be recovered from customers in future rates.
- The Company also recognized \$2.2 million of post retirement benefit liabilities composed of non-contributory health care and life insurance plans and a corresponding and offsetting regulatory asset for the amount of \$ 2.2 million for non-pension post retirement benefits expected to be included in future rates and recovered from customers. Previously, the Company followed a partial accrual basis method of accounting for its non-pension post retirement benefits as directed by the Commission.

### **Goodwill and Intangible Assets**

On January 1, 2009, the Company adopted the CICA Handbook Section 3064, Goodwill and Intangible Assets, which replaced Sections 3062, Goodwill and Other Intangible Assets, and 3450, Research and Development Costs. The new standard is aligned with International Financial Reporting Standards ("IFRS") and provides more comprehensive guidance on the recognition,

measurement, presentation and disclosure of goodwill and intangible assets in accordance with the definition of an asset and the criteria for asset recognition, in particular for internally generated intangible assets. The adoption of this standard had no impact on the Company's consolidated financial statements.

#### Fair Value of Financial Assets and Liabilities

On January 20, 2009, the CICA published the Emerging Issues Committee ("EIC") Abstract 173, Credit Risk and the Fair Value of Financial Assets and Liabilities. The EIC states that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and liabilities, including derivative instruments. This recommendation is to be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements ending on or after the date of issuance of the Abstract. The Company has adopted this standard and determined that it had no material impact on the Company's consolidated financial statements.

#### Transition to International Financial Reporting Standards (IFRS)

In February, 2008, the Accounting Standards Board confirmed that publicly accountable enterprises are required to prepare financial statements in accordance with IFRS for years beginning on or after January 1, 2011, with comparative figures for the previous year. The Company expects the transition to IFRS to impact accounting, financial reporting, business processes and information systems.

PNG started its IFRS conversion project during the third quarter of 2008 and has established a formal project team. Regular reporting to the Audit Committee will take place throughout the project. The IFRS conversion project is composed of three phases: project planning, scoping and preliminary impact analysis; detailed diagnostics and evaluation of financial impacts, selection of accounting policies, and design of operational and business processes; and implementation and review.

The Company has completed the first phase of its transition plan which entailed a review of the major differences between Canadian GAAP and IFRS and has identified the following as the areas that are expected to have the most significant impact on its financial reporting: regulatory assets and liabilities, plant, property and equipment, employee future benefit plans, income taxes, the development of the opening balances in the consolidated balance sheets and significantly more disclosure in its financial statements.

The Company is currently in the process of assessing the impact of policy alternatives on its consolidated financial statements, determining its significant accounting policies under IFRS, and executing necessary modifications to financial systems and business processes, and is also determining their impact on internal controls.

#### Disclosure Controls and Procedures and Internal Controls over Financial Reporting

Disclosure controls and procedures are controls and other procedures that are designed to: (a) provide reasonable assurance that material information required to be disclosed by the Company is accumulated and communicated to management to allow timely decisions regarding required disclosure; and (b) ensure that information required to be disclosed by the Company is recorded, processed, summarized, and reported within the time periods specified in applicable securities legislation.

Management is responsible for designing, establishing and maintaining the Company's system of internal control over financial reporting. The Company's internal control system was designed based on the framework outlined in Internal Control – Integrated Framework released by the Committee of Sponsoring Organizations of the Treadway Commission to provide reasonable assurance regarding

the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with Canadian GAAP.

The Company's Chief Executive Officer and Vice President, Finance (as chief financial officer) certified the appropriateness of the financial disclosures in the interim MD&A and unaudited interim consolidated financial statements for the period ended March 31, 2009. These executives also certified that they are responsible for the design of disclosure controls and procedures and internal control over financial reporting. There have been no changes in internal control over financial reporting during the quarter ended March 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. As in prior quarters, the Company's Audit Committee reviewed this MD&A and the attached unaudited interim consolidated financial statements and the Board of Directors approved the documents prior to their release.

#### **Other**

The Company files an Annual Information Form on SEDAR which can be accessed at [www.sedar.com](http://www.sedar.com).

Pacific Northern Gas Ltd. had 3,622,664 common shares and 200,000 preferred shares outstanding as of April 30, 2009. These are the only issued securities of the Company and it has no securities outstanding which may be converted into voting or equity securities. As at April 30, 2009, under the normal course issuer bid, the Company repurchased on the open market and cancelled 41,916 common shares.

As at April 30, 2009 there were 346,040 stock options granted and outstanding (representing 8 percent of issued and outstanding common shares). Each option is exercisable for one common share.

"Roy G. Dyce"

President and Chief Executive Officer  
April 30, 2009

# **PACIFIC NORTHERN GAS LTD.**

## Interim Consolidated Financial Statements

*(Unaudited)*

For the Three Months Ended March 31<sup>st</sup>, 2009

**PACIFIC NORTHERN GAS LTD**  
**CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**  
(in thousands, except shares and per share data)

**(UNAUDITED)**

**For the three months  
ended March 31**

	<u>2009</u>	<u>2008</u>
<b>Operating revenues:</b>		
Gas sales and transportation services	\$37,104	\$33,999
Off system sales	9,475	21,781
Other <i>[note 7]</i>	1,739	1,749
	<b>48,318</b>	<b>57,529</b>
<b>Cost of sales:</b>		
Gas sales	21,813	19,392
Off system sales	9,475	21,781
	<b>31,288</b>	<b>41,173</b>
<b>Operating margin</b>	<b>17,030</b>	<b>16,356</b>
<b>Operating and maintenance</b>	<b>3,159</b>	2,968
<b>Administrative and general</b>	<b>1,881</b>	1,727
<b>Amortization of deferred charges and other</b>	<b>(54)</b>	142
<b>Municipal and other taxes</b>	<b>1,146</b>	1,177
<b>Depreciation</b>	<b>2,069</b>	2,007
	<b>8,201</b>	<b>8,021</b>
<b>Operating income</b>	<b>8,829</b>	8,335
<b>Investment and other income</b>	<b>15</b>	48
	<b>8,844</b>	<b>8,383</b>
<b>Income deductions:</b>		
Interest on long term debt	1,374	1,586
Interest on short term debt	6	202
Project development expenditures and other income deductions	63	370
	<b>1,443</b>	<b>2,158</b>
<b>Income before income taxes</b>	<b>7,401</b>	<b>6,225</b>
<b>Income taxes:</b> <i>[note 11]</i>		
Currently payable	2,951	936
Deferred income taxes	—	831
Future income taxes	(706)	(53)
	<b>2,245</b>	<b>1,714</b>
<b>Net income and Comprehensive income for the period</b>	<b>\$5,156</b>	<b>\$4,511</b>
<b>For common shares:</b>		
Net income for the period	<b>\$5,156</b>	\$4,511
Dividends on preferred shares	<b>84</b>	84
<b>Net income applicable to common shares</b>	<b>\$5,072</b>	<b>\$4,427</b>
<b>Per common share:</b>		
Basic	<b>\$1.39</b>	\$1.21
Diluted	<b>\$1.38</b>	\$1.20
<b>Weighted average number of common shares outstanding:</b>		
Basic	<b>3,661,106</b>	3,664,580
Diluted	<b>3,673,437</b>	3,699,122

See accompanying notes

**PACIFIC NORTHERN GAS LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands)

<b>(UNAUDITED)</b>	<b>March 31,</b>	<b>December 31,</b>
<b>ASSETS</b>	<b><u>2009</u></b>	<b><u>2008</u></b>
<b>Current assets:</b>		
Cash	\$ 5,144	\$ 577
Accounts receivable <i>[note 13]</i>	22,401	28,047
Gas purchase variance recoverable	2,162	4,171
Inventories of supplies and natural gas	1,056	2,227
Prepaid expenses	723	958
Derivative financial instruments <i>[note 13]</i>	—	1,843
Future income taxes <i>[note 11]</i>	2,574	—
	<u>34,060</u>	<u>37,823</u>
<b>Plant, property and equipment</b>	<u>177,017</u>	<u>177,773</u>
<b>Other Items:</b>		
Deferred charges	5,075	5,588
Other	6,512	581
Future income taxes <i>[note 11]</i>	—	284
	<u>11,587</u>	<u>6,453</u>
	<u>\$222,664</u>	<u>\$222,049</u>
<b>LIABILITIES</b>		
<b>Current liabilities:</b>		
Bank indebtedness	\$ —	\$ 2,998
Accounts payable and accrued liabilities	13,057	23,897
Income taxes payable	2,511	486
Other taxes payable	4,065	4,064
Other current liabilities	675	—
Methanex Termination Payment deferral, current portion	3,798	3,781
Long term debt due within one year	2,400	2,400
Derivative financial instruments <i>[note 13]</i>	7,228	7,319
	<u>33,734</u>	<u>44,945</u>
<b>Non-current liabilities</b>	2,412	217
<b>Long term debt, non-current portion</b>	77,560	74,533
<b>Deferred income taxes</b> <i>[note 11]</i>	—	13,630
<b>Future income taxes</b> <i>[note 11]</i>	16,217	—
	<u>96,189</u>	<u>88,380</u>
	<u>129,923</u>	<u>133,325</u>
<b>SHAREHOLDERS' EQUITY</b>		
Preferred shares <i>[note 5]</i>	5,000	5,000
Common shares <i>[notes 3 and 6]</i>	9,094	9,161
Share capital	14,094	14,161
Contributed surplus <i>[note 3]</i>	3,629	3,610
Retained earnings	75,018	70,953
	<u>92,741</u>	<u>88,724</u>
	<u>\$222,664</u>	<u>\$222,049</u>

ON BEHALF OF THE BOARD

“Robert F. Chase”  
Director

“Roy G. Dyce”  
Director

See accompanying notes

**PACIFIC NORTHERN GAS LTD.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
(in thousands)

<b>(UNAUDITED)</b>	<b>For the three months ended March 31</b>	
	<b><u>2009</u></b>	<b><u>2008</u></b>
<b>Preferred shares</b>	<b>\$5,000</b>	\$5,000
<b>Common shares</b>		
Balance at beginning of period	\$9,161	\$9,161
Share repurchase under normal course issuer bid <i>[note 6]</i>	(67)	—
Balance at end of period	<b>\$9,094</b>	\$9,161
<b>Contributed surplus</b>		
Balance at beginning of period	\$3,610	\$3,490
Stock option expense <i>[note 3]</i>	41	61
Share repurchase under normal course issuer bid <i>[note 6]</i>	(22)	—
Balance at end of period	<b>\$3,629</b>	\$3,551
<b>Retained earnings</b>		
Balance at beginning of period	\$70,953	\$68,578
Share repurchase under normal course issuer bid <i>[note 6]</i>	(249)	—
Net income	5,156	4,511
Dividends — Common shares	(842)	(806)
Balance at end of period	<b>\$75,018</b>	\$72,283
 <b>Total Shareholders' equity</b>	 <b>\$92,741</b>	 \$89,995

See accompanying notes

**PACIFIC NORTHERN GAS LTD**  
**CONSOLIDATED STATEMENTS OF CASH FLOW**  
(in thousands)

<b>(UNAUDITED)</b>	<b>For the three months ended March 31</b>	
	<b><u>2009</u></b>	<b><u>2008</u></b>
<b>Operating activities:</b>		
<b>Net income for the period</b>	<b>\$5,156</b>	\$4,511
<b>Add (deduct) items not involving cash:</b>		
Deferred income taxes	—	831
Future income taxes	<b>(706)</b>	(53)
Depreciation and amortization <i>[note 12]</i>	<b>2,042</b>	2,177
Amortization of Methanex Termination Payment deferral (2008 amount is net of income taxes) <i>[note 7]</i>	<b>(1,634)</b>	(1,166)
Stock option expense <i>[note 3]</i>	<b>41</b>	61
Deferred income taxes on deferred charges	—	(1,056)
Imputed interest on deferred charges	—	57
Other	<b>(19)</b>	(135)
	<b>4,880</b>	5,227
<b>Non-cash working capital changes</b> <i>[note 12]</i>	<b>1,344</b>	(1,238)
	<b>6,224</b>	3,989
<b>Investing activities:</b>		
Additions to plant, property and equipment	<b>(1,248)</b>	(1,803)
Decrease in deferred charges and credits (2008 amount is net of income taxes)	<b>769</b>	566
Net cash provided by (used in) investing activities	<b>(479)</b>	(1,237)
<b>Financing activities:</b>		
Decrease in bank indebtedness	<b>(2,998)</b>	(1,800)
Issue of long term debt	<b>3,000</b>	—
Share repurchase under normal course issuer bid <i>[note 6]</i>	<b>(338)</b>	—
Dividends paid	<b>(842)</b>	(806)
Net cash used in financing activities	<b>(1,178)</b>	(2,606)
<b>Increase in cash during the period</b>	<b>4,567</b>	146
<b>Cash, beginning of period</b>	<b>577</b>	802
<b>Cash, end of period</b>	<b>5,144</b>	948

*Supplemental cash flow information [note 12]*

*See accompanying notes*

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

These unaudited interim consolidated financial statements are prepared, from the records of the Company, in accordance with Canadian generally accepted accounting principles (“GAAP”), except that disclosures do not conform, in all respects, to the requirements for annual consolidated financial statements. While management believes that the disclosures presented are adequate to make the information not misleading, these consolidated financial statements and notes should be read in conjunction with the Company’s most recent annual consolidated financial statements.

These interim consolidated financial statements follow the same accounting policies and methods of their application as the Company’s most recent annual consolidated financial statements, except as described in note 1 below.

Earnings for the interim periods may not be indicative of results for the fiscal year due to weather variations and other factors.

### **1. CHANGES IN ACCOUNTING POLICIES**

#### Accounting for Rate-Regulated Operations

In December 2007, the Canadian Institute of Chartered Accountants (“CICA”) issued the following new guidance in accounting for rate-regulated operations which applies to fiscal years beginning on or after January 1, 2009:

- the removal of the temporary exemption in Section 1100, Generally Accepted Accounting Principles, providing relief to entities subject to rate regulation from the requirement to apply the Section to the recognition and measurement of assets and liabilities arising from rate regulation
- the amendment to Section 3465, Income Taxes, to remove the exception for entities subject to rate regulation so they are required to recognize future income tax liabilities and assets as well as a regulatory asset or liability for the amount of future income taxes expected to be recovered or refunded to customers in future rates
- slight amendments to Accounting Guideline AcG-19, Disclosures by Entities Subject to Rate Regulation to reflect the above changes.

On January 1, 2009, the Company adopted these new standards retrospectively without restating prior year’s figures which resulted in the following:

- The Company recognized \$15.4 million of future income tax liabilities as well as a related regulatory asset for the amount of future income taxes expected to be recovered from customers in future rates (see note 11). The regulatory deferral accounts recorded on the balance sheet are now presented on a gross basis. Previously they were presented net of deferred income taxes.
- The Company also recognized \$2.2 million of post retirement benefit liabilities composed of non-contributory health care and life insurance plans and a corresponding and offsetting regulatory asset for the amount of \$ 2.2 million for non-pension post retirement benefits expected to be included in future rates and recovered from customers. Previously, the Company followed a partial accrual basis method of accounting for its non-pension post retirement benefits as directed by the British Columbia Utilities Commission.

## 1. CHANGES IN ACCOUNTING POLICIES (cont'd)

### Goodwill and Intangible Assets

On January 1, 2009, the Company adopted the CICA Handbook Section 3064, Goodwill and Intangible Assets, which replaced Sections 3062, Goodwill and Other Intangible Assets, and 3450, Research and Development Costs. The new standard is aligned with International Financial Reporting Standards ("IFRS") and provides more comprehensive guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets in accordance with the definition of an asset and the criteria for asset recognition, in particular for internally generated intangible assets. The adoption of this standard had no impact on the Company's consolidated financial statements.

### Fair Value of Financial Assets and Liabilities

On January 20, 2009, the CICA published the Emerging Issues Committee ("EIC") Abstract 173, Credit Risk and the Fair Value of Financial Assets and Liabilities. The EIC states that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and liabilities, including derivative instruments. This recommendation is to be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements ending on or after the date of issuance of the Abstract. The Company has adopted this standard and determined that it had no material impact on the Company's consolidated financial statements.

## 2. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Pacific Northern Gas Ltd., its wholly owned subsidiary Pacific Northern Gas (N.E.) Ltd., as well as the Company's proportionate interest in the assets, liabilities, revenue and expenses of all incorporated and unincorporated joint ventures, that are subject to joint control. The Company has determined that it has no investments in any variable interest entities. All intercompany transactions and balances are eliminated for subsidiaries and on a pro rata basis for joint ventures.

Significant subsidiaries and joint ventures are as follows, as at March 31:

	Direct and Indirect Interest Held by the Company (percent)	
	2009	2008
<b>Subsidiaries:</b>		
Pacific Northern Gas (N.E.) Ltd.	100	100
<b>Joint Ventures and Non-Controlled Partnerships [note 9]:</b>		
Pacific Trail Pipelines Limited Partnership	50	50
Pacific Trail Pipelines Management Inc.	50	50

### 3. STOCK-BASED COMPENSATION

The Company does not have any plans which result in the direct award of stock, stock appreciation rights and awards that call for settlement in cash or other assets, except as described below.

#### Stock Option Plan

The Company has one stock option plan. During the three months ended March 31, 2009, 62,800 (2008: 40,400) stock options, at an exercise price of \$12.24, were issued. The compensation cost that has been charged against income (and credited to contributed surplus) in the quarter ended March 31, 2009 is \$41,000 (2008 - \$61,000) and represents expense for options issued in the current and previous periods which are being amortized over their vesting period. The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

	Three months ended March 31 2009	Three months ended March 31 2008
Risk free interest rate	2.2%	3.3%
Expected volatility (annualized)	22.3%	24.9%
Expected years of option life (average)	7.5	7.5
Expected annual rate of dividends	7.5%	4.9%

The fair value of the options granted at the time of the grants was \$50,000 in 2009 and \$114,000 in 2008.

#### Deferred Share Unit Plan

The Company has a deferred share unit plan for outside directors of the Company. Under this plan, an outside director may elect to defer all or a portion of total compensation as stock units of the Company's common shares. Director compensation expense is recorded in the period in which the compensation is earned. Changes in the amount of the compensation as a result of dividends and share price movement are recorded as director compensation expense in the period of the change.

During the three months ended March 31, 2009, 2,943 (2008: 1,927) deferred share units were granted and all units granted remained outstanding at that date. Liabilities related to this plan are recorded in accounts payable and accrued liabilities on the balance sheet and amounted to \$254,000 (2008: \$184,000) at March 31, 2009. Directors' compensation related to this plan for the three months ended March 31, 2009 was \$35,000 (2008 - \$34,000).

### 4. SEASONALITY

Due to the seasonal nature of natural gas sales, the Company generally reports net income in the first and fourth quarters of the year, and losses in the second and third quarters, reflecting the typical timing of the heating season.

### 5. PREFERRED SHARES

The 6.75 percent preferred shares are redeemable at the option of the Company at \$26 per share plus any accrued and unpaid dividends at the date of the redemption.

### 6. COMMON SHARES

On March 9, 2009, the Company commenced a normal course issuer bid to repurchase up to 300,000 of the Company's common shares at market prices from shareholders that accept the bid over a period up to 12 months. As at March 31, 2009, the Company repurchased on the open market and cancelled 26,916 common shares.

## 6. COMMON SHARES (cont'd)

The Company has outstanding stock options of 346,040 common shares, of which 242,620 are exercisable at March 31, 2009. There were 261,840 stock options outstanding at March 31, 2009 (142,900 stock options at March 31, 2008) that could potentially dilute basic earnings per share in the future but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

## 7. METHANEX TERMINATION PAYMENT DEFERRAL

On August 30, 2005, Methanex Corporation gave notice of termination of its Firm and Interruptible Gas Transportation Service Agreement with the Company. Under the terms of the agreement, Methanex made a termination payment to the Company of approximately \$23.3 million on February 28, 2006, the effective date of the termination. As approved by the British Columbia Utilities Commission (the "Commission"), the termination payment was recorded in 2006, net of income taxes of \$7.96 million, as an interest bearing credit deferral, and is being amortized into income over the period from March 1, 2006 to October 31, 2009. For the three month periods ended March 31, 2009 and March 31, 2008, \$1.6 million of the termination payment was included in other operating revenues.

## 8. COMMITMENTS

The Company's purchase commitments at March 31, 2009 under various gas supply and transportation service contracts expiring through 2012 were as follows:

<b>(in thousands)</b>	
2009	<b>\$8,443</b>
2010	<b>9,619</b>
2011	<b>11,698</b>
2012	<b>7,612</b>
2013	<b>—</b>
Thereafter	<b>—</b>
<b>Total</b>	<b>\$37,372</b>

## 9. JOINT VENTURES

In 2005 the Company commenced a preliminary study and investigation of a project to loop its main line transmission system from Kitimat to Summit Lake (the "KSL Project"). On July 17, 2006, the Company announced the formation of Pacific Trail Pipelines Limited Partnership, an equal partnership between the Company and Galveston LNG Inc., the parent company of Kitimat LNG Inc., for the purpose of developing the KSL Project.

The following amounts represent the Company's proportionate interest in Pacific Trail Pipelines Limited Partnership and its general partner, Pacific Trail Pipelines Management Inc. at March 31, 2009 and December 31, 2008:

<b>(in thousands)</b>	<b>At March 31, 2009</b>	<b>At December 31, 2008</b>
<b>Balance Sheet</b>		
Current assets	<b>\$75</b>	<b>\$110</b>
Non-current assets	<b>—</b>	<b>—</b>
Current liabilities	<b>(\$33)</b>	<b>(\$6)</b>
Non-current liabilities	<b>—</b>	<b>—</b>

## 9. JOINT VENTURES (cont'd)

Income Statement	For the three months ended March 31	
	2009	2008
Revenues	\$ —	\$ —
Expenses	63	370
Net loss	<b>(\$63)</b>	<b>(\$370)</b>
<b>Cash Flow</b>		
Cash Provided by (Used In):		
Operations	<b>(\$29)</b>	(\$381)
Financing	—	250
Investments	—	—
Proportionate share of decrease in cash of joint ventures	<b>(\$29)</b>	<b>(\$131)</b>

## 10. RELATED PARTY TRANSACTIONS

There were no transactions with related parties during the three month period ended March 31, 2009 nor the three month period ended March 31, 2008.

## 11. FUTURE INCOME TAXES

For rate setting purposes, the Company recovers tax expense based on the taxes payable method, as prescribed by the Commission. Under the income taxes currently payable method, no provisions are made for future income taxes as a result of temporary differences between the accounting basis and tax basis of assets and liabilities. Therefore, current rates do not include the recovery of future income taxes related to temporary differences. Consequently, the Company did not record future income taxes for its regulated activities as the Company expects that all future income taxes will be recovered in rates when they become payable. The Company does record future income taxes related to non-regulated activities.

From July 1, 1978 until November 1, 1986, the Company used the deferral income tax method for the purposes of rate setting and collected \$15.4 million of deferred tax liabilities from its customers. In its 2009 revenue requirement application for the Western system, the Company requested approval to draw down deferred income taxes by \$900,000 during 2009 with a credit applied to the cost of service. A drawdown of \$900,000 was also approved during the 2008 and 2007 revenue requirement applications. During the three month period ended March 31, 2009, the previously collected deferred tax liabilities were drawn down by \$225,000. This has been reflected in amortization of deferred charges and other.

Effective January 1, 2009, the amendment to Section 3465 Income Taxes results in the recognition of future income tax assets and liabilities and related regulated liabilities and assets for the amount of the expected future income taxes to be refunded or recovered in future rates. The previously collected deferred tax liabilities has been offset against the regulated asset established for amounts expected to be recovered from customers in future rates. Accordingly, the Company will use the asset and liability method of accounting for income taxes for both its regulated and non regulated activities.

As at January 1, 2009, the impact of this amendment is the recognition of a \$15.4 million future income tax liability on regulated operations.

## 11. FUTURE INCOME TAXES (cont'd)

Future income tax assets and liabilities are comprised of the following:

(amounts in \$'000s)	March 31, 2009	December 31, 2008
Plant, property & equipment	\$(13,986)	
Employee future benefits	(155)	
Methanex termination payment deferral	1,139	
Gas purchase variance recoverable	1,523	
Deferred charges	(1,240)	
Other	(924)	\$284
<b>Total</b>	<b>\$(13,643)</b>	<b>\$284</b>
Current Future Income Taxes	\$2,574	
Non current Future Income Taxes	(16,217)	\$284
<b>Total</b>	<b>\$(13,643)</b>	<b>\$284</b>

## 12. SUPPLEMENTAL CASH FLOW INFORMATION

(in thousands)	For the three months ended March 31	
	2009	2008
<b>Depreciation and amortization:</b>		
Depreciation, per income statement	\$2,069	\$2,007
Amortization of deferred charges and other, per income statement	(54)	142
Amortization of debt issue costs, included in long term interest expense	27	28
<b>Total depreciation and amortization</b>	<b>2,042</b>	<b>2,177</b>
<b>Non-cash working capital changes:</b>		
<b>(Increase) decrease in:</b>		
Accounts receivable	5,646	1,520
Inventories of supplies and natural gas	1,171	7
Prepaid expenses	235	832
<b>Increase (decrease) in:</b>		
Accounts payable and accrued liabilities	(10,919)	(2,708)
Gas purchase variance payable	3,185	(1,808)
Income and other taxes payable	2,026	919
<b>Attributable to operating activities</b>	<b>1,344</b>	<b>(1,238)</b>
<b>Interest and tax payments:</b>		
Income taxes paid	875	150
Interest paid	1,039	1,262
<b>Non-cash transactions:</b>		
Property, plant and equipment purchases included in accounts payable and accrued liabilities	66	290

### 13. FINANCIAL INSTRUMENTS

#### Fair Values

Due to the short term nature of cash, accounts receivable, bank indebtedness, and accounts payable and accrued liabilities, their respective carrying amounts in the consolidated balance sheet approximate their fair value.

The fair value of the Company's floating rate long term debt instruments is estimated to be equal to their carrying amounts in the consolidated balance sheet due to the regular resetting of interest rates applicable to the instruments in relation to current market rates. The fair value of the Company's fixed rate long term debt instruments are estimated by reference to quoted market prices for instruments of similar credit quality and term. As of March 31, 2009, the estimated fair value of the long term debt is \$80.0 million.

At March 31, 2009, the Company had outstanding natural gas swap contracts and natural gas collar contracts relating to natural gas supply as follows:

Financial instrument	Notional Quantity (GJ's)	Percent of Annual Gas Purchases	Delivery period	Price Range (per GJ)	Estimated Fair Value Derivative Asset (\$000's)	Estimated Fair Value Derivative Liability (\$000's)
Natural gas swap contracts	2,950,200	29.9	Apr. 2009 – Oct. 2010	\$5.91 to \$10.87	—	(\$6,602)
Call Options	36,800	0.4	Apr. 2009 – Oct. 2009	Cap at \$10.08	\$0.43	—
Collar contracts	309,900	3.1	Apr. 2009 – Oct. 2010	Floors from \$6.24 to \$8.38; Caps from \$8.50 to \$11.46	—	(\$626)
<b>Total</b>	<b>3,296,900</b>	<b>33.4</b>			<b>\$0.43</b>	<b>(\$7,228)</b>

The fair value reflects the estimated amounts that the Company would receive or pay at March 31, 2009 to terminate the natural gas swap contracts, natural gas collar contracts, or call options based on the estimated net cash flows under the terms of each contract. These estimated fair market values have no impact on earnings due to the regulated nature of the Company's operations. Based on the current regulatory process, any gains or losses arising from utility related financial gas hedging instruments would be treated as part of the flow through of gas supply costs in customer rates. As a result of the recognition of the derivative asset, the gas cost variance payable account was decreased by \$7.2 million in accordance with specific regulatory treatment.

### 13. FINANCIAL INSTRUMENTS (cont'd)

At December 31, 2008, the estimated fair value of these derivative instruments was a liability of \$5.5 million as follows:

Financial instrument	Notional Quantity (GJ's)	Percent of Annual Gas Purchases	Delivery period	Price Range (per GJ)	Estimated Fair Value Derivative Asset (\$000's)	Estimated Fair Value Derivative Liability (\$000's)
Fixed price contracts	900,000	9.1	Jan. 2009 – Mar. 2009	\$9.31	—	(2,885)
Natural gas swap contracts	3,453,800	35.1	Jan. 2009 – Oct. 2010	\$6.25 to \$10.87	—	(2,228)
Call Options	66,300	0.7	Jan. 2009 – Oct. 2009	\$10.08 to \$11.79	—	4
Collar contracts	406,600	4.1	Jan. 2009 – Oct. 2010	Floors from \$6.24 to \$8.38; Caps from \$8.40 to \$11.46	—	(367)
<b>Total</b>	<b>4,826,700</b>	<b>49.0</b>			<b>—</b>	<b>(\$5,476)</b>

#### Credit Risk

The Company is exposed to credit risk in the event that a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises mainly from its accounts receivable and derivative financial instruments. There has been no change to the Company's credit risk from the prior year. In accordance with established credit approval practices, the Company deals only with recognized high credit quality institutions as counterparties to its derivative instruments and physical off system gas sales and does not expect any counterparties to fail to meet its obligations. Should the Company incur a financial loss as a result of the failure of a counterparty to meet its obligations, the Company would require regulatory approval to recover related costs through future rate adjustments.

The Company's credit policy requires a review of each customer for creditworthiness and often will require residential and commercial customers to pay a customer deposit based on two times the highest estimated monthly gas consumption prior to the installation of service. For industrial customers, the Company has the right to require securities such as letters of credit should a customer fail to pay its bills. No letters of credit or alternate security are currently in place with any individual industrial customer.

The Company establishes an allowance for doubtful accounts that represents its estimate of accounts receivable which may not be recoverable. The main components of this allowance are a specific provision that relates to individual significant exposures and a general provision for the core market (residential and commercial) customers based on past experience. The Company actively reviews the adequacy of its allowance for doubtful accounts.

### 13. FINANCIAL INSTRUMENTS (cont'd)

The following table shows the breakdown of accounts receivables by major customer class:

(in thousands)

	<b>March 31, 2009</b>	December 31, 2008
Core Market – Residential and Commercial	<b>\$21,731</b>	\$21,513
Industrial customers	<b>1,038</b>	1,347
Off-system sales customers	<b>1,198</b>	6,580
Other	<b>249</b>	342
<b>Accounts Receivable</b>	<b>\$24,216</b>	29,782

The following table sets forth details of the aging of receivables:

(in thousands)

	<b>March 31, 2009</b>	December 31, 2008
Not past due (unbilled)	<b>\$9,757</b>	\$12,551
Past due 0 to 30 days (current)	<b>12,488</b>	15,431
Past due 31 to 90 days	<b>358</b>	212
Past due over 91 days	<b>1,613</b>	1,588
<b>Sub-total accounts receivables</b>	<b>24,216</b>	29,782
Less: Allowance for doubtful accounts	<b>(1,815)</b>	(1,735)
<b>Total accounts receivables</b>	<b>\$22,401</b>	\$28,047

Changes in the allowance for doubtful accounts are as follows:

(in thousands)

	<b>Three month period ended March 31, 2009</b>
Balance at January 1, 2009	<b>\$1,735</b>
Provision for doubtful accounts	<b>78</b>
Write-off of bad debts, net of recoveries, and other	<b>2</b>
<b>Balance at March 31, 2009</b>	<b>\$1,815</b>

#### Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet obligations associated with financial liabilities and commitments as they become due. The Company manages liquidity risk through the management of its capital structure and financial leverage. It also regularly monitors actual and projected cash flows. The Company believes that future cash flows generated from operations and access to additional liquidity through capital and banking markets will be adequate to meet its financial obligations in the foreseeable future.

The Company has credit facilities which include a \$20 million operating line, a \$20 million 5-year revolving term facility maturing August 3, 2012, and a \$15 million risk management facility. As of March 31, 2009, the calculated borrowing base of the operating line was approximately \$29.5 million and actual utilization, all by way of issued letters of credit, was \$8.9 million. \$9.0 million was outstanding under the \$20 million revolving term facility at March 31, 2009 via Bankers' Acceptance equivalent loans. The Company's overall liquidity risk has not changed significantly from December 1, 2008.

### **13. FINANCIAL INSTRUMENTS (cont'd)**

#### Overall Market Risk

Market risk is the risk that changes in market prices, including foreign exchange, interest rates and commodity prices will affect the fair value of the Company's financial instruments. The Company is not exposed to any foreign exchange risks. The Company's overall market risk has not changed significantly from the prior year.

#### Market Risk - Commodity Prices

The commodity cost of natural gas can be highly volatile. The Company utilizes derivative and other financial instruments in connection with the management of gas supply. The Company enters into forward, future, swap, fixed price and option contracts to manage the impact of market fluctuations on assets, liabilities or other contractual commitments. Based on the current regulatory process, any gains or losses arising from utility related derivative financial instruments are treated as part of the flow through of gas supply costs in customer rates.

#### Market Risk - Interest Rates

As directed by the Commission, the Company has an interest deferral mechanism that mitigates exposure to fluctuations in floating rates on both short term and long term debt instruments.

### **14. CAPITAL MANAGEMENT**

The Company's objective in managing capital remains unchanged from December 31, 2008. The capital structure consisted of the following components at March 31, 2009 and December 31, 2008: bank indebtedness, long term debt, preferred shares and common shareholder's equity.

The Company's objectives with its capital structure are:

- to maintain the proportion of common equity in its capital structure at the level approved by the Commission for the purpose of determining rates which is necessary to ensure that the Company has the opportunity to earn the rate of return on common equity allowed by the Commission; and,
- to maintain a credit rating at which the Company has sufficient liquidity and access to natural gas and other supplies on reasonable terms to be able to provide safe, secure and reliable service to its customers, which in turn is critical to the Company's ongoing prosperity.

However, the Company is not currently able to meet both objectives as it believes that the proportion of common equity approved by the Commission is not sufficient to allow the Company to maintain a satisfactory credit rating. The Company currently carries approximately \$20 million more common equity on its balance sheet than is allowed by the Commission for the purpose of determining rates. The normal course issuer bid announced by the Company on March 4, 2009, for the purchase of up to 300,000 of its common shares on the facilities of the Toronto Stock Exchange, is expected to stabilize its common equity capitalization ratio this year following increases from 40.9 percent at December 31, 2002 to 49.6 percent at the end of 2008. Based on discussions with its rating agency, the Company does not believe that the normal course issuer bid will impact its credit rating. To further address this situation the Company has sought and will continue to seek relief from the Commission.

The financial terms and conditions of the Company's debentures and credit facilities remain unchanged since December 31, 2008. The \$20 million operating line and \$20 million 5-year revolving term facility are subject to a financial covenant requiring the Company's debt leverage not to exceed 65 percent. The 5-year revolving term facility contains an additional covenant which states that if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the Company must maintain an interest coverage of 2.0 times or higher using earnings

before interest, income taxes and expenditures on the KSL Project to a cumulative maximum of \$10 million. The Company is in compliance with its debt covenants.

## **15. COMPARATIVE FIGURES**

Certain items in the consolidated financial statements have been reclassified to conform to the 2009 presentation.

**PACIFIC NORTHERN GAS LTD.  
FORM 52-109F2  
CERTIFICATION OF INTERIM FILINGS**

I, Roy Dyce, the Chief Executive Officer of Pacific Northern Gas Ltd., certify that:

1. I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of Pacific Northern Gas Ltd., (the issuer) for the interim period ended March 31, 2009;
2. Based on my knowledge, having exercised reasonable diligence, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings; and
3. Based on my knowledge, having exercised reasonable diligence, the interim financial statements together with the other financial information included in the interim filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings; and
4. The issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR), as those terms are defined in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*, for the issuer.
- 5 Subject to the limitations, if any, described in paragraphs 5.2 and 5.3, the issuer's other certifying officer and I have, as at the end of the period covered by the interim filings
  - (a) designed DC&P, or caused it to be designed under our supervision, to provide reasonable assurance that
    - i. material information relating to the issuer is made known to us by others, particularly during the period in which the interim filings are being prepared; and
    - ii. information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation; and
  - (b) designed ICFR, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP.
- 5.1 The control framework the issuer's other certifying officer and I used to design the issuer's ICFR is the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework.

5.2 N/A

5.3 N/A

6. The issuer has disclosed in its interim MD&A any change in the issuer's ICFR that occurred during the period beginning on January 1, 2009 and ended on March 31, 2009 that has materially affected, or is reasonably likely to materially affect, the issuer's ICFR.

*"Roy G. Dyce"*

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Roy G. Dyce  
Chief Executive Officer

Date: April 30, 2009

**PACIFIC NORTHERN GAS LTD.  
FORM 52-109F2  
CERTIFICATION OF INTERIM FILINGS**

I, Janet P. Kennedy, the Vice President, Finance of Pacific Northern Gas Ltd. (certifying as the chief financial officer of the Company), certify that:

1. I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of Pacific Northern Gas Ltd., (the issuer) for the interim period ended March 31, 2009;
  2. Based on my knowledge, having exercised reasonable diligence, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings; and
  3. Based on my knowledge, having exercised reasonable diligence, the interim financial statements together with the other financial information included in the interim filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings; and
  4. The issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR), as those terms are defined in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*, for the issuer.
- 5 Subject to the limitations, if any, described in paragraphs 5.2 and 5.3, the issuer's other certifying officer and I have, as at the end of the period covered by the interim filings
- (c) designed DC&P, or caused it to be designed under our supervision, to provide reasonable assurance that
    - i. material information relating to the issuer is made known to us by others, particularly during the period in which the interim filings are being prepared; and
    - ii. information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation; and
  - (d) designed ICFR, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP.
- 5.1 The control framework the issuer's other certifying officer and I used to design the issuer's ICFR is the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework.

5.2 N/A

5.3 N/A

6. The issuer has disclosed in its interim MD&A any change in the issuer's ICFR that occurred during the period beginning on January 1, 2009 and ended on March 31, 2009 that has materially affected, or is reasonably likely to materially affect, the issuer's ICFR.

*"Janet Kennedy"*

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Janet Kennedy  
Vice President, Finance  
(certifying as chief financial officer)

Date: April 30, 2009