

*The Fort Chicago Partnership, the largest single owner of the Alliance projects, has a strong cash position of \$344 million to fund its capital commitment.*

## MANAGEMENT'S DISCUSSION & ANALYSIS

### GENERAL OVERVIEW

Fort Chicago Energy Partners L.P. ("the Partnership") is a newly created Alberta limited partnership formed to acquire the interests in the Alliance projects previously held by Chauvco Resources Ltd. ("Chauvco"), Summit Resources Limited ("Summit"), and Beau Canada Exploration Ltd. ("Beau").

During the period ending January 9, 1998, the Partnership concluded the following significant transactions:

- Purchased the combined interest in the Alliance projects, formerly held by Chauvco, Summit and Beau.
- Issued 34,950,359 Special Warrants to the principal shareholders of Chauvco and Summit, and to Summit and Beau, raising approximately \$201 million.
- Completed rights offerings to each of the shareholders of Chauvco and Summit, other than their principal shareholders, that resulted in the issuance of 31,041,009 Class A Units for approximately \$185 million.

At the conclusion of these transactions, the Partnership held and continues to hold an approximate 26 percent interest in the Alliance projects, the largest single ownership interest, and has \$344 million of cash to fund its capital commitment.

Going forward, the Partnership will pursue projects that offer the opportunity to generate significant levels of distributable cash, high rates of return and significant value creation for the Unitholders.

## SIGNIFICANT TRANSACTIONS

### *Acquisition of Alliance Interests*

During the year ended December 31, 1997, the Partnership acquired the combined interest in the Alliance projects held by Chauvco, Summit and Beau, totaling 27.901 percent. In early January 1998, Alliance issued additional equity to a third party that resulted in the Partnership's equity being reduced to 26.026 percent. The purchase price, together with additional cash calls from Alliance of \$35.2 million, was financed by the issuance of Special Warrants referred to below.

### *Issuance of Special Warrants*

During the year, the Partnership issued a total of 34,950,359 Special Warrants to the principal shareholders of Chauvco and Summit, and to Summit and Beau, for total proceeds of \$201 million. Each of the Special Warrants were issued at \$5.75 and are convertible into a Class A Unit of the Partnership. Each purchaser paid cash of \$2.00 per Special Warrant and paid the balance of \$3.75 on the closing of the rights offerings referred to below. This resulted in the Partnership receiving \$70 million in 1997 and \$131 million by January 9, 1998.

The funds received in 1997 were utilized to purchase the interests in the Alliance projects and the balance, combined with the funds received January 9, 1998, will fund the future capital obligations relative to the Alliance projects.

### *Rights Offerings*

In late 1997, the Partnership commenced a rights offering to each of the shareholders of Chauvco and Summit other than their principal shareholders. The rights offerings closed on January 9, 1998 and resulted in the issuance of 31,041,009 Class A Units for approximately \$185 million. These funds will be utilized to fund future capital commitments of the Partnership in the Alliance projects. The use of the rights offerings enabled the shareholders of Chauvco and Summit to continue to participate in the Alliance projects through Fort Chicago.

## RESULTS OF OPERATIONS

The Partnership had minimal operations during the period, earning interest income of \$187 thousand and incurring administration expenses of \$60 thousand. The Partnership accounts for its investment in the Alliance projects by the equity method, whereby it records its share of the income, which totaled \$243 thousand. Total net income of \$370 thousand is not reflective of anticipated income in future years.

## LIQUIDITY AND CAPITAL RESOURCES

With the rights offering and Special Warrants financings, the Partnership has raised \$379 million of equity (after offering costs). This level of equity should be sufficient to fund the Partnership's share of capital expenditures of the Alliance projects for the "Most Likely" capital cost of construction.

### *Equity Capital Commitments to the Alliance Projects*

The seven owners of Alliance have provided irrevocable equity commitments to fund approximately 30 percent of the currently estimated construction costs of the Alliance projects (including a cost overrun amount). Each owner committed to a base equity commitment, a cost overrun equity commitment and an extraction plant equity commitment.

Should an owner, including the Partnership, fail to meet all or some part of its equity commitment obligations to Alliance and Aux Sable, Alliance and Aux Sable will: (i) enforce any security held by them, and then, if the equity commitment continues to be unfunded; (ii) call on any over-subscription pool commitments, should one exist; (iii) offer the right to subscribe for the units and shares to the existing owners on a pro-rata basis; and (iv) obtain financing from third parties. If the unpaid equity commitment is funded by any of the means described in (ii), (iii) or (iv), the funding party shall be entitled to purchase a corresponding portion of the defaulting party's shares and units in the Alliance projects, if prior to the receipt of all regulatory approvals, at 25 percent of the original cost, or, if after the receipt of all regulatory approvals, at 50 percent of the original cost. In addition, a defaulting party will be required to pay the greater of one percent of its remaining equity commitment and \$250 thousand if the default is cured by any such means and will be liable for all consequential damages if the equity default is not cured by another party.

The following table sets forth the funds which will be required to meet the Partnership’s anticipated equity commitment to the Alliance projects (based on a 26.026 percent equity commitment and on a range of construction costs). The table does not include the amount paid to purchase the interests in the Alliance projects previously held by Chauvco, Summit and Beau, and the equity contributions paid to the Alliance projects by the Partnership prior to January 22, 1998 in the aggregate amount of \$39.4 million.

#### FUTURE EQUITY COMMITMENTS

(\$ millions)

	Low	Most Likely	High
ALLIANCE CANADA PIPELINE	\$ 139.9 <sup>3</sup>	\$ 155.4 <sup>1</sup>	\$ 176.1 <sup>4</sup>
ALLIANCE U.S. PIPELINE	114.3 <sup>3</sup>	127.1 <sup>1, 2</sup>	147.7 <sup>4</sup>
AUX SABLE PLANT (5)	49.2 <sup>3</sup>	54.6 <sup>1, 2</sup>	60.0 <sup>6</sup>
	\$ 303.4	\$ 337.1	\$ 383.8

Notes:

1 Based on the capital estimate included with the equity commitment notice as the base equity commitment.

2 Based on a U.S./Canadian dollar conversion of 1.40.

3 Based on 90% of the Most Likely cost.

4 Based on base equity commitment and cost overrun equity commitment.

5 Assuming no debt financing.

6 Based on 110% of the Most Likely case.

The Partnership had cash available of approximately \$340 million to fund its equity commitment to the Alliance projects. On January 22, 1998, the Partnership was required to pledge cash to secure 50 percent of its equity commitment obligations to the Alliance projects including cost overrun amounts, an amount of approximately \$192 million. Before any drawdowns by Alliance of bank or bond financing, the Partnership will be required to increase the pledged cash up to 100 percent of the equity commitment obligations for the “High Cost” case. The Partnership will require a letter of credit, or additional cash, for a minimum of \$37.7 million to meet these obligations. The Partnership is negotiating with a number of banks to provide the letter of credit.

In the event that the Partnership is unable to obtain a letter of credit or additional cash, the Partnership may raise additional equity capital or sell a portion of its interests in the Alliance projects.

#### *Alliance Debt Financing Plans*

Alliance has executed a term sheet with four banks to provide debt financing for the two major aspects of the Alliance Pipeline project – the Alliance Canada Pipeline and Alliance U.S. Pipeline. The banks have provided a fully underwritten commitment to fund 70 percent of the currently estimated base capital costs and a cost overrun amount. The four banks are presently syndicating the loans to a large number of North American and international banks.

The banks' commitment is subject to a number of conditions being met, including but not limited to completion of definitive documentation, receipt of required regulatory approvals and execution of transportation service agreements with shippers pursuant to the existing precedent agreements, and is subject to termination in certain stated events.

Alliance has been conducting negotiations with bond underwriters regarding the issuance of bonds to reduce the amount of financing from the banking group. Alliance has sought indicative ratings for the senior indebtedness from each of Moody's Investor Service, Standard & Poor's Rating Services, Dominion Bond Rating Service and Canadian Bond Rating Service for this purpose.

Alliance is considering whether to issue bonds to cover construction costs prior to receipt of final NEB and FERC regulatory approvals. Any such bonds would be secured by an assignment of the equity commitments made by Alliance owners, including the Partnership. It is anticipated that the holders of these bonds would have the ability to "put" the bonds back to Alliance should required regulatory approvals not be received and other conditions relative to bank financing not being met within one year of issuance of the bonds. If such a put occurs, Alliance would be required to draw down the equity commitments to pay the principal and accrued interest of such bonds and, if applicable, a redemption or "make-whole" premium.

## D I S T R I B U T I O N S

The Partnership will distribute distributable cash to Unitholders on a quarterly basis. The General Partner anticipates distributing distributable cash in respect of the quarters ending March, June, September and December in each year to Unitholders of record on the last day of the applicable quarter. Payments will be made on or before the 30th day after each record date. It is unlikely that there will be any distribution to Unitholders until after the Alliance Pipeline is in service, which is not expected prior to July 1, 2000. There is no assurance that the Alliance Pipeline will be placed into service by this date or at all.

The annual distributable cash in the initial years following the in-service date will vary based on a number of factors including the following: (i) the rate of return allowed on the Alliance Canada Pipeline and the Alliance U.S. Pipeline; (ii) the return of capital allowed on the Alliance Canada Pipeline and the Alliance U.S. Pipeline; (iii) the size and scope of the Aux Sable Plant; (iv) the amount of cash held in reserve; and (v) the operating expenses of the Partnership.

## OWNERSHIP RESTRICTIONS

The Partnership was organized in accordance with the terms and conditions of a limited partnership agreement dated as of October 9, 1997 as amended and restated on November 21, 1997 (the "Partnership Agreement"). The Partnership Agreement provides that no Class A Units may be transferred to (i) a person who is a "non-resident" of Canada, a person in which an interest would be a "tax shelter investment" or a partnership which is not a "Canadian partnership" for purposes of the *Income Tax Act* (Canada) or (ii) a person who is a "Competitor" (as defined in the Partnership Agreement). The Partnership Agreement further provides that no person, other than an "Exempt Person" (as defined in the Partnership Agreement), may beneficially own 10 percent or more of the outstanding Class A Units until 180 days after the in-service date of the Alliance Pipeline project.

## RISK FACTORS

Investment in the Partnership is subject to a number of risks. There is a risk that a purchaser may lose some or all of his investment. Initially, the Partnership's sole asset will be its interest in the Alliance projects. The Alliance Pipeline project has not yet received the regulatory approvals required to commence construction. Should required approvals not be received on a timely basis, the in-service date for the Alliance Pipeline project would be delayed and therefore income distributions would be delayed.

While Alliance has signed a committed term sheet with lenders for debt financing, there is no assurance that definitive loan documents will be finalized or that conditions precedent to the availability of advances will be met. The Partnership has not secured all the financing required to meet its cost overrun equity commitment obligations to the Alliance projects. The Partnership believes that it will be able to provide a letter of credit to meet its cost overrun obligations. Should it not be able to obtain a letter of credit, the Partnership would have to issue additional equity capital or sell a portion of

its interest in the Alliance projects in order to satisfy its equity commitment obligations. Failure to meet the equity commitment obligations may result in the sale of the Partnership's interest in the Alliance projects at a significant loss. Should the Alliance projects not proceed, the Partnership will be dissolved and remaining cash will be distributed to holders of Class A Units.

Should the Alliance projects proceed to completion, the business of the Partnership will be subject to the normal risks associated with the pipeline and natural gas liquids industries, including government and environmental regulations where applicable, price fluctuations of natural gas and natural gas liquids, availability of inlet natural gas, risk of default by shippers, competitive pressures, fluctuation of the Partnership's operating costs and fluctuations in the U.S.–Canada exchange rate. Further, risks of substantial costs and liabilities relating to environmental claims are inherent in pipeline operations and there can be no assurance that such costs or liabilities will not be incurred.

Distributions by the Partnership to the Unitholders will fluctuate and there can be no assurance regarding the amounts to be distributed. The revenue of the Partnership will be based upon tolls charged pursuant to transportation service agreements, which agreements end 15 years after the in-service date, unless renewed. Therefore, beyond the initial term of such agreements, the revenues derived by the Partnership will depend upon demand for natural gas in markets served by the Alliance Pipeline and the availability of competitive alternatives for transportation of natural gas to such markets.

The Partnership may issue an unlimited number of additional Class A Units without the approval of the Unitholders, such that the Unitholders may be subject to a dilution of their interests. A Unitholder, to maintain limited liability, must not take part in the management or control of the Partnership's business.

## Y E A R 2 0 0 0

The Partnership has recently acquired computer hardware and software to manage its affairs. All such hardware and software are "Year 2000" compliant.