Terra Energy Corp.

Management's Discussion & Analysis

For the three months ended March 31, 2008

Management's Discussion & Analysis

This Management's Discussion and Analysis ("MD&A") of financial condition and results of operations of Terra Energy Corp. ("Terra Energy" or the "Corporation") is dated May 20, 2008. It should be read in conjunction with the unaudited interim consolidated financial statements and the corresponding notes for the three months periods ended March 31, 2008 and March 31, 2007 and with the audited year end consolidated financial statements of the Corporation for the years ended December 31, 2007 and December 31, 2006.

Terra Energy's Board of Directors and Audit Committee have reviewed and approved the March 31, 2008 unaudited consolidated financial statements and related MD&A.

All references to dollar values refer to Canadian dollars unless otherwise stated.

This MD&A provides certain financial measures that do not have a standardized meaning prescribed by Canadian generally accepted accounting principles ("GAAP"). These non-GAAP financial measures may not be comparable to similar measures presented by other issuers.

This MD&A contains the terms "cash flow from operations" and "cash flow from operations per share", which should not be considered an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian generally accepted accounting principles as an indicator of the Corporation's performance. Cash flow from operations per share is calculated using the same weighted average basic and diluted number of shares outstanding used in the calculation of net income (loss) per share. All references to cash flow throughout this MD&A are based on cash flow before changes in non-cash working capital.

Petroleum and natural gas volumes are converted to an equivalent measurement basis referred to as a "barrel of oil equivalent" ("boe") using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil ("6:1"). The 6:1 conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Readers are cautioned that boe figures may be misleading, particularly if used in isolation.

The continuous disclosure materials of the Corporation, including its annual MD&A and audited financial statements, Information Circular and Proxy Statement, Annual Information Form, material change reports and press releases issued by the Corporation are available through the SEDAR system at www.sedar.com.

FORWARD LOOKING ADVISORY

Statements in this document may contain forward-looking information. Such information is subject to known and unknown risks, uncertainties and other factors that could influence actual results or events, and cause actual results or events to differ materially from those stated, anticipated or implied in the forward looking information. As such, readers are cautioned not to place undue reliance on the forward-looking information, as no assurances can be provided as to future results, levels of activity or achievements. In addition, the reader is cautioned that historical results are not necessarily indicative of future performance.

DESIGN OF INTERNAL CONTROLS OVER FINANCIAL REPORTING

Effective for the year end 2007, securities regulations state that the Corporation is to design and implement internal controls over financial reporting and disclose in its MD&A any material changes in the Corporation's internal control over financial reporting that occurred during the Corporation's most recent interim period. Internal controls are processes designed and implemented by management to provide reasonable assurance regarding the reliability the Corporation's financial reporting and the preparation of financial statements and other financial information for external purposes in accordance with Canadian GAAP. For the year ended December 31, 2007, the Chief Executive Officer and the Chief Financial Officer have designed internal controls over financial reporting, or caused them to be designed under their supervision. Management has concluded that internal controls are adequately designed in this regard, considering the employees involved and the control procedures in place, including management and Audit Committee oversight and quarterly external auditor reviews. Occasionally, the Corporation requires outside assistance and advice on taxation, new accounting pronouncements and complex accounting and reporting issues, which is common with companies of a similar size. It should be noted, that the Corporation's control system, no matter how well designed, can provide only reasonable, but not absolute, assurance of detecting, preventing and deterring errors or fraud.

CORPORATE HISTORY

Terra Energy is a publicly traded corporation, amalgamated under the Business Corporations Act of Alberta, and formed as a result of the amalgamation of Terra Energy Corp., Terrapet Energy Corp., and Rhodes Resources Corp. on January 30, 2004. This Management Discussion and Analysis along with the associated financial statements referenced above include the accounts of the Corporation and its wholly-owned subsidiary Constar Resources Ltd. and Terra Energy, a general partnership between Terra Energy Corp. and Constar Resources Ltd.

The Corporation's principal business is the exploration, development and production of petroleum and natural gas in Western Canada.

SELECTED QUARTERLY INFORMATION

Financial

THREE MONTHS ENDED MARCH 31	**2008**	2007	**%Growth**
Gross Revenue	**20,255,411**	10,384,124	95.1
Cash Flow From Operations	**8,525,863**	3,449,145	147.2
Net Loss	**(1,100,903)**	(2,168,418)	(49.2)
Weighted Average Shares – Basic	**74,080,013**	75,822,011	(2.3)
Weighted Average Shares – Diluted	**74,080,013**	75,822,011	(2.3)
Shares at Period End – Basic	**74,240,984**	75,203,284	(1.3)

AS AT	**March 31, 2008**	December 31, 2007	**%Growth**
Total Assets	**166,368,013**	166,061,884	0.2
Long-term Financing	**58,173,279**	54,631,003	6.5

Operational

THREE MONTHS ENDED	**March 31, 2008**	March 31, 2007	**%Growth**
Production			
Average Daily Production (boe/d)	**4,675**	2,476	88.8
Wells Drilled			
Gross	**2.0**	1.0	100.0
Net	**1.5**	1.0	50.0

2008 First Quarter Highlights

> Average production per day increased 88.8% to 4,675 barrels per day compared to the same quarter last year

> Gross revenue increased 95.1% to $20,255,411 from $10,384,124 compared to the same quarter last year

> Cash flow from operations increased 147.2% to $8,525,863 from $3,449,145 compared to the same quarter last year

> Production expense per unit of production decreased 20.9% to $11.08 from $14.01 compared to the same quarter last year

> In February 2008 completed pipeline project for Eight Mile South where the field was tied into third party processing facility at Doe Creek

RESULTS OF OPERATIONS

Production

THREE MONTHS ENDED MARCH 31	**2008 Average**	2007 Average	%Growth
Oil (bbl/d)	**251**	311	(19.3)
Natural Gas (Mcf/d)	**19,778**	10,278	92.4
Liquids (bbl/d)	**1,128**	452	149.6
Combined (boe/d)	**4,675**	2,476	88.8

Operations

THREE MONTHS ENDED MARCH 31	**2008**	2007	**2008**	2007	%Growth
	$	$	**($/boe)**	($/boe)	%
Gross Revenues	**20,255,411**	10,384,124	**47.61**	46.60	2.2
Realized Gain (Loss) on Financial Instrument	**(254,137)**	309,093	**(0.60)**	1.38	(143.5)
Unrealized (Loss) on Financial Instrument	**(3,035,244)**	(2,846,646)	**(7.13)**	(12.77)	(44.2)
Revenue Before Royalties	**16,966,030**	7,846,571	**39.88**	35.21	13.3
Royalties	**(4,739,441)**	(2,222,705)	**(11.14)**	(9.97)	11.7
Revenue After Royalties	**12,226,589**	5,623,866	**28.74**	25.24	13.9
Production Expenses	**(4,711,730)**	(3,120,330)	**(11.08)**	(14.01)	(20.9)
Operating Netback	**7,514,859**	2,503,536	**17.66**	11.23	57.3
General & Administrative Expenses	**(1,020,245)**	(1,249,055)	**(2.40)**	(5.61)	(57.2)
Interest Expense	**(882,532)**	(635,376)	**(2.07)**	(2.84)	(27.1)
Realized Foreign Exchange Loss	**(6,740)**	–	**(0.02)**	–	(100.0)
Non-cash Expenses	**(7,115,217)**	(3,803,882)	**(16.72)**	(17.07)	(2.1)
Loss Before Income Taxes	**(1,509,875)**	(3,184,777)	**(3.55)**	(14.29)	(75.2)
Income Tax Recovery	**408,972**	1,016,359	**0.96**	4.56	(78.9)
Net Loss	**(1,100,903)**	(2,168,418)	**(2.59)**	(9.73)	(73.4)
Per Share – Basic	**(0.01)**	(0.03)			
Per Share - Diluted	**(0.01)**	(0.03)			

Revenue

THREE MONTHS ENDED MARCH 31	**2008**	2007	**2008**	2007	%Change
	$	$	**($/boe)**	($/boe)	%
Gross Revenue	**20,255,411**	10,384,124	**47.61**	46.60	2.2
Realized Gain (Loss) on Financial Instrument	**(254,137)**	309,093	**(0.60)**	1.38	(143.5)
Unrealized (Loss) on Financial Instrument	**(3,035,244)**	(2,846,646)	**(7.13)**	(12.77)	(44.2)
Revenue Before Royalties	**16,966,030**	7,846,571	**39.88**	35.21	13.3

Gross revenue increased 95.1% to $20,255,411 for the three month period ended March 31, 2008 compared to $10,384,124 for the same period ended March 31, 2007 primarily as a result of an 88.8% increase in production volumes. Eight Mile South pipeline was completed in February 2008. The field was tied into third party processing facility at Doe Creek. Revenue before royalties on a per unit of production increased by 13.3% to $39.88 from $35.21 per boe for the three month period ended March 31 largely due to a reduction in the unrealized loss on financial instruments in the current period compared to the prior period.

Below is a breakdown of gross revenue prices realized by the Corporation:

THREE MONTHS ENDED MARCH 31	**2008**	2007	**%Growth**
Crude Oil ($ / bbl)	**93.03**	66.38	40.1
Natural Gas Liquids ($ / bbl)	**42.42**	36.00	17.8
Natural Gas ($ / Mcf)	**7.64**	7.62	0.3

At period ends, in accordance with generally accepted accounting principles, the Corporation is required to calculate and reflect a "mark-to-market" value of its financial instruments. At December 31, 2007 this calculation resulted in a $567,483 unrealized loss on financial instruments. Further, during each period, the prior periods "unrealized loss" or gains are reversed and a new mark to market adjustment is calculated as at the period end.

For the three month period ended March 31, 2008, the Corporation's financial statements reflect a unrealized loss of $3,035,244 on financial instruments. This is the result of the reversal of the December 31, 2007 unrealized loss on financial instruments of $567,486 and an unrealized "mark-to-market" loss on financial instruments of $3,602,727 that the Corporation has on outstanding contracts at March 31, 2008.

The unrealized losses on financial instruments are non-cash items and, as a result, do not affect Terra Energy's cash flow from operations.

Royalties

THREE MONTHS ENDED MARCH 31	**2008** **$**	2007 $	**2008** **($/boe)**	2007 ($/boe)	**%Change** %
Royalties	**4,739,441**	2,222,705	**11.14**	9.97	11.7

Royalties increased 113.2% to $4,739,441 for the three month period ended March 31, 2008 compared to $2,222,705 for the same period ended March 31, 2007 as a result the Corporation's higher production and revenue. Royalties on a per unit of production increased by 11.7% to $11.14 for the three month period ended March 31, 2008 compared to $9.97 for the same period ended March 31, 2007. Royalties as a percentage of gross revenues increased to 23.4% compared to 21.4% in the prior period. Increase in royalty on a per unit of production is attributable to increase in production attracting a higher royalty rate.

Production Expenses

THREE MONTHS ENDED MARCH 31	**2008**	2007	**2008**	2007	**%Change**
	$	$	**($/boe)**	($/boe)	%
Production Expenses	**4,711,730**	3,120,330	**11.08**	14.01	(20.9)

Production expenses increased 51.0% to $4,711,730 for the three month period ended March 31, 2008 compared to $3,120,330 for the same period ended March 31, 2007 reflecting higher production volumes. Production expenses on a per unit of production basis declined 20.9% to $11.08 for the three month period ended March 31, 2008 compared to $14.01 for the same period ended March 31, 2007 primarily due to impact of fixed costs on increased production volumes.

General and Administrative Expenses

THREE MONTHS ENDED MARCH 31	**2008**	2007	**2008**	2007	**%Change**
	$	$	**($/boe)**	($/boe)	%
General and Administrative Expenses	**1,020,245**	1,249,055	**2.40**	5.61	(57.2)

General and administrative expenses decreased 18.3% to $1,020,245 for the three month period ended March 31, 2008 compared to $1,249,055 for the same period ended March 31, 2007primarilly due to lower legal expenditures being incurred.

General and administrative expenses on a per unit of production basis fell 57.2% to $2.40 for the three month period ended March 31, 2008 compared to $5.61 for the same period ended March 31, 2007 as a result of higher production levels. General and administrative expenses on a per unit of production basis fell as a result of an increasing production base and are expected to continue to fall as incremental production additions are not expected to add significant overhead expenses.

Interest Expense

THREE MONTHS ENDED MARCH 31	**2008**	2007	**2008**	2007	**%Change**
	$	$	**($/boe)**	($/boe)	%
Interest Expense	**882,532**	635,376	**2.07**	2.84	(27.1)

Interest expense increased 38.9% to $882,532 for the three month period ended March 31, 2008 compared to $635,376 for the same period ended March 31, 2007. Interest expense increased as a result of higher indebtedness required to finance the Corporation's capital expenditures program. On a per unit of production basis interest expenses decreased 27.1% to $2.07 for the three month period ended March 31, 2008 compared to $2.84 for the same period ended March 31, 2007.

Non Cash Expenses

THREE MONTHS ENDED MARCH 31	**2008 $**	2007 $	**2008 ($/boe)**	2007 ($/boe)	**%Change %**
Depletion and Amortization	**6,196,653**	3,375,514	**14.57**	15.15	(3.8)
Accretion Expense	**118,971**	111,517	**0.27**	0.50	(46.0)
Stock Based Compensation	**463,173**	316,851	**1.09**	1.42	(23.2)
Unrealized Foreign Exchange Loss	**336,420**	–	**0.79**	–	100.0
Non Cash Items	**7,115,217**	3,803,882	**16.72**	17.07	(2.1)

Non cash expenses rose 87.1% to $7,115,217 for the three month period ended March 31, 2008 compared to $3,803,882 for the same period ended March 31, 2007. On a per unit of production basis, non cash expenses decreased 2.1% to $16.72 for the three month period ended March 31, 2008 compared to $17.07 for the same period ended March 31, 2007. The majority of this change is attributable to depletion and amortization expense which increased 83.6% to $6,196,653 which is consistent with the 88.8% increase in production.

Stock based compensation increased by 46.2% $463,173 in the current period compared to $316,851 in the prior period largely as the result of the replacement stock options granted to employees. Replacement options issued to employees have the same characteristics as the original options except that they are issued at current market price giving rise to an increased compensation recognition.

Income Taxes

THREE MONTHS ENDED MARCH 31	**2008 $**	2007 $	**2008 ($/boe)**	2007 ($/boe)	**%Change %**
Current Tax	**3,605**	–	**0.01**	–	–
Future Tax (Recovery)	**(412,577)**	(1,016,359)	**(0.97)**	(4.56)	(78.7)
Income Taxes	**(408,972)**	(1,016,359)	**(0.96)**	(4.56)	(78.9)

A future income tax recovery of $412,577 for the three month period ended March 31, 2008 was recorded compared to a recovery of $1,016,359 for the same period ended March 31, 2007. The decrease in the future income tax recovery is consistent with the decrease in the loss before income taxes. On a per unit of production basis, the future income tax recovery was $0.97 for the three month period ended March 31, 2008 compared to an expense of $4.56 for the same period ended March 31, 2007

LIQUIDITY AND FINANCIAL CONDITION

	March 31, 2008 $	December 31, 2007 $	%Growth %
Working Capital before Financial Instruments	**(6,303,051)**	(14,676,780)	(57.1)
Financial Instruments	**(3,602,727)**	(567,483)	534.9
Working Capital	**(9,905,778)**	(15,244,263)	(35.0)
Oil and Gas Properties	**153,627,749**	157,024,959	(2.2)

The working capital deficit before financial instruments at March 31, 2008 was $6,303,051 compared to a deficit of $14,676,780 at December 31, 2007. The improvement in working capital before financial instruments was driven largely by a reduction in the capital accrual and an increase in the revenue accrual.

Terra Energy's bank credit facility is structured as a $70.0 million 364 day revolving credit facility with a one year term-out provision. If the credit facility is not renewed at maturity, the Corporation has the ability to repay any amounts outstanding on the credit facility one year from maturity. As a result of this one year repayment feature, Terra Energy has classified its bank credit facility as a long-term financial obligation.

As at March 31, 2008, Terra Energy was in compliance with all of its bank covenants.

Capitalized resource properties as at March 31, 2008 were $153,627,749 net of accumulated depletion, compared to $157,024,959 as at December 31, 2007. Oil and gas properties decreased primarily as a result of the disposition of undeveloped land. For the three month period ended March 31, 2008, Terra Energy incurred $3,256,538 in net capital expenditures broken down as:

THREE MONTHS ENDED MARCH 31	2008 $	2007 $
Exploration	**2,660,757**	2,126,157
Development	**3,432,524**	1,050,264
Undeveloped Land	**160,650**	185,149
Geological / Geotechnical	**396,476**	803,121
Facilities	**2,408,566**	4,140,671
Other Assets	**210,651**	131,652
Total Capital Expenditures	**9,269,624**	8,437,014
Net Property Dispositions	**(6,013,086)**	–
Net Capital Expenditures	**3,256,538**	8,437,014

Terra Energy financed its capital expenditures for the period through cash flow from operations.

Cash Flow from Operations (non-GAAP measure)

Cash flow from operations ("Cash Flow"), representing cash generated from operating activities before changes in non-cash working capital items, is a non-GAAP measure. Management utilizes Cash Flow as a key measure to assess the ability of the Corporation to finance operating activities and capital expenditures. Additionally, Cash Flow has been described and presented in order to provide shareholders and potential investors with information regarding the Corporation's liquidity and its ability to generate funds to finance its operations. This performance indicator may not be comparable to similar measures used by other companies.

The following table presents the non-GAAP financial measure "cash flow from operations".

THREE MONTHS ENDED MARCH 31	**2008** $	2007 $
Net income (loss) for the period	**(1,100,903)**	(2,168,418)
Future income tax	**(412,577)**	(1,016,359)
Accretion expense	**118,971**	111,517
Stock based compensation	**463,173**	316,851
Unrealized loss on financial instruments	**3,035,244**	2,846,646
Unrealized foreign exchange loss	**336,420**	–
Asset retirement obligations settled	**(94,513)**	–
Amortization of deferred credit	**(16,605)**	(16,606)
Depletion and amortization	**6,196,653**	3,375,514
Cash flow from operations	**8,525,863**	3,449,145

For the three month period ended March 31, 2008, the Corporation generated cash flows from operations of $8,525,863 ($0.12 per basic share and $0.11 per diluted share), an increase of 147.2% compared to $3,449,145 ($0.05 per basic / diluted share) for the three month period ended March 31, 2007. The primary driver for the increase in cash flow from operations was the 88.8% increase in production.

Capital Resources

The Corporation's share capital is as follows:

	MARCH 31, 2008		DECEMBER 31, 2007	
	No. of Shares	**Amounts**	No. of Shares	Amounts
Common Shares	**74,240,984**	**65,769,045**	74,297,484	65,195,721

During the three month period ended March 31, 2008, 757,100 common shares were repurchased under normal course issuer bid by the Corporation for $1,013,035 at an average price of $1.34 per common share. The Corporation recorded 664,352 as a reduction of share capital and the excess of $348,683 charged to deficit. As at March 31, 2008, 389,849 repurchased shares were held for cancellation. Shares repurchased under the normal course issuer bid held for cancellation are excluded from the outstanding number of shares.

The Corporation has no immediate requirement for additional capital.

COMMITMENTS AND CONTINGENCIES

The Corporation had outstanding letters of credit to various parties for a total of $575,927 (2007- $625,927). The amounts expire at various dates during 2008.

The Corporation is involved in various claims arising in the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Corporation's favour, the Corporation does not currently believe that the outcome of adverse decisions in any proceedings related to these matters or any amount which it may be required to pay would have a material adverse impact on its financial position, results of operations or liquidity.

OFF-BALANCE SHEET ARRANGEMENTS

The Corporation is party to certain derivative instruments, including crude oil and natural gas contracts. The Corporation enters into these contracts to manage commodity price risk in future earnings and cash flow. These contracts reduce the Corporation's exposure to the fluctuations in petroleum and natural gas revenues by locking in fixed forward prices on a portion of the Corporation's crude oil and natural gas production.

At March 31, 2008 the Corporation had entered into derivative contracts, the terms of which are summarized as follows:

Contract Type	Floor Price	Ceiling Price	Volumes Per Day	Contract Term
Financial	Sell $92.00 per Bbl	N/A	100 Bbls	January 1, 2008 to December 31, 2008
Financial	Sell $95.00 per Bbl	N/A	100 Bbls	February 1, 2008 to December 31, 2008
Financial	Sell $90.55 US per Bbl	N/A	200 Bbls	January 1, 2009 to December 31, 2009
Financial	Sell $7.66 per GJ	N/A	2,000 GJ	April 1, 2008 to June 30, 2008
Financial	Sell $7.84 per GJ	N/A	2,000 GJ	July 1, 2008 to September 30, 2008
Financial	Sell $7.55 per GJ	N/A	5,000 GJ	July 1, 2008 to September 30, 2008
Financial	Sell $8.23 per GJ	N/A	2,000 GJ	October 1, 2008 to December 31, 2008
Financial	Sell $8.00 per GJ	N/A	5,000 GJ	October 1, 2008 to December 31, 2008
Financial	Sell$ 8.40 per GJ	N/A	4,000 GJ	January 1, 2009 to March 31, 2009
Financial	Sell $8.60 per GJ	N/A	2,000 GJ	January 1, 2009 to March 31, 2009
Financial	Sell $8.60 per GJ	N/A	1,000 GJ	January 1, 2009 to March 31, 2009

The mark to market value of the above commodity products transactions of $3,602,727 has been recorded as a liability as at March 31, 2008.

RELATED PARTY TRANSACTIONS

The Corporation entered into transactions with the following related parties:

Rhodes Petroleum Corp., controlled by an officer of the Corporation

Pioneer Land Services Ltd. – a Director is an employee of Pioneer

Borden Ladner Gervais LLP – a Director is partner with the law firm

Fasken Martineau DuMoulin LLP – in 2006 the Corporate Secretary was a partner with the law firm

	March 31, 2008 **$**	March 31, 2007 $
Expenses		
Consulting - Pioneer Land Services Ltd.	**–**	209
Legal Consulting – Borden Ladner Gervais LLP	**42,749**	154,648
	42,749	154,857
Other		
Recorded as part of oil and gas properties – Pioneer Land Services Ltd	**8,463**	5,685
Recorded as part of oil and gas properties – Rhodes Petroleum Corp.	**23**	–
Recorded as part of oil and gas properties – Borden Ladner Gervais LLP	**4,490**	–
Recorded as part of share issuance cost – Borden Ladner Gervais LLP	**–**	3,084
	12,976	8,763

The above transactions are in the normal course of operations and have been valued at the exchange amounts agreed by the related parties.

SUBSEQUENT EVENT

On May 13th the Corporation sold approximately 110 sections of Montney petroleum and natural gas rights in North East British Columbia for gross proceeds received of $65.2 million. The closing on one section of mineral rights remains outstanding and is expected to be finalized once certain conditions are met.

OUTLOOK

Earlier this year, the Board of Directors of Terra Energy approved the Capital Expenditure Plan and Budget for 2008 (the "2008 Budget"). The rationale behind the 2008 Budget was to ensure that the Corporation lived within its Cash Flow from Operations. In the cash flow projections generated early this year, an average 2008 price estimate for natural gas of $7.25 per Mcf was utilized. On the basis of this price estimate and the $30 Million capital budget, the Corporation allocated approximately $8 Million to infrastructure and the balance of $22 Million to drilling, completions, land and seismic. Using the 2008 Budget as a basis for activity levels, the Corporation would anticipate exiting 2008 with approximately 5,200 Boed of production.

Subsequent to the approval of the 2008 Budget, there have been two major developments which may affect the Corporation's outlook for 2008. The first was a change in the prevailing trends for natural gas pricing, whereby both current pricing and anticipated pricing for the balance of the year are much higher than forecasted by the Corporation early this year and used as the basis for the 2008 Budget. Being predominantly a natural gas producer, the Corporation has a high level of sensitivity to natural gas pricing. A change in gas pricing from $7.25 per Mcf to $8.25 per Mcf will result in approximately $8 Million more in revenue and approximately $6 Million more in cash flow. This additional cash flow may be used by the Corporation in accelerating our development plans, with a view towards attaining an even higher exit production rate for the year.

The second major development to occur since the approval of the 2008 Budget has been the decision by the Corporation to market and to sell its Montney mineral rights in North East British Columbia. The Corporation announced on May 13th 2008 that sale of the Montney asset had been substantially completed for aggregate proceeds of $65.2 million leaving the Corporation close on one remaining section. Terra Energy's current production volumes are unaffected by the sale as no production from the Montney formation was included. Furthermore, the Corporations total proved plus probable reserves will not be significantly affected by the transaction. The proceeds from the sale of this asset will entirely eliminate the debt of the Corporation and leave the Corporation with positive working capital. In turn, this will result in a reduction of interest expense for the Corporation for the balance of 2008 of approximately $2 Million. This amount will be available for the Corporation to use in its operations with a view towards accelerating development and further increasing our exit production rate.

The sale by Terra Energy of our Montney asset will provide the Corporation with increased financial strength and the flexibility to pursue alternative growth strategies in the future. The Corporation now has the ability to grow organically by developing its many prospects, the ability to grow through the acquisition of select oil and gas assets and the ability to grow through the means of corporate transaction.

Terra Energy's other objectives for the year are to become more 'oily' in our production mix, and to expand beyond the current Fort St. John Core Area.

CHANGES IN ACCOUNTING POLICIES

Financial Instruments

On January 1, 2008, the Company adopted the following new Handbook Sections, which were effective for interim periods beginning on or after October 1, 2007:

Section 3862 – "Financial Instruments – Disclosures", describes the required disclosure for the assessment of the significance of financial instruments for an entity's financial position and performance and of the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. This section and Section 3863, Financial Instruments – Presentation" replaced Section 3861, "Financial Instruments – Disclosure and Presentation".

Section 3863 – "Financial Instruments – Presentation", establishes standards for presentation of financial instruments and non-financial derivatives.

Section 1535 – "Capital Disclosures", establishes standards for disclosing information about an entity's capital and how it is managed. It describes the disclosure requirements of the entity's objectives, policies and processes for managing capital, the quantitative data relating to what the entity regards as capital, whether the entity has complied with capital requirements, and, if it has not complied, the consequences of such non-compliance.

Section 3031 – "Inventories", will be adopted on January 1, 2008. This new standard did not have an impact on the Company's financial statements.

The CICA has amended Section 1400, "General Standards of Financial Statement Presentation", which is effective for interim periods beginning on or after January 1, 2008, to include requirements to assess and disclose the Company's ability to continue as a going concern. The adoption of this new section will not have an impact on the financial statements

International Financial Reporting Standards

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge ith International Financial Reporting Standards ("IFRS") by the end of 2011. The Corporation continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

CRITICAL ACCOUNTING ESTIMATES

In preparing financial statements in accordance with generally accepted accounting principles, management undertakes certain judgments and estimates. Changes in these judgments and estimates could have a material impact on the financial results and condition. The following discussion outlines accounting policies and practices that are critical to determining the Corporation's financial results.

Proved Oil and Gas Reserves

Under Canadian Securities Regulations National Instrument 51-101 "Standards of Disclosure for Oil and Gas Activities" (NI 51-101), "proved" reserves are those reserves that can be estimated with a high degree of certainty to be recoverable (it is likely that the actual remaining quantities recovered will exceed the estimated proved reserves). In accordance with this definition, the level of certainty targeted by the reporting Corporation should result in at least a 90% probability that the quantities actually recovered will equal or exceed the estimated reserves. There was no such consideration of probability under National Policy 2B (NP 2B). In the case of "probable" reserves, which are obviously less certain to be recovered than proved reserves, NI 51-101 states that it must be equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves. With respect to the consideration of certainty, in order to report reserves as proved plus probable, the reporting Corporation must believe that there is at least a 50% probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable reserves. The implementation of NI 51-101 has resulted in a more rigorous and uniform standardization of reserve evaluation.

The oil and gas reserve estimates are made using all available geological, reservoir and historical production data. Estimates are reviewed and revised as appropriate. Revisions may occur as a result of changes in prices, costs, fiscal regimes, reservoir performance or a change in the Corporation's plans.

Ceiling Test

Under the Canadian Institute of Chartered Accountants (CICA) full cost accounting guidelines, the Corporation calculates a ceiling test annually whereby the carrying value of petroleum and natural gas properties is compared to estimated future cash flow from the production of proved reserves. The Corporation has early adopted the requirement of CICA Accounting Guideline 16 “Oil and Gas Accounting - Full Cost” (“AcG 16”). The requirements of the guideline were to be followed for all fiscal years beginning on or after January 1, 2004. At March 31, 2008, the Corporation calculated the ceiling test using AcG 16 without any material adverse impact on the Corporation’s financial position or results of operations.

Asset Retirement Obligation

CICA Handbook Section 3110 “Asset Retirement Obligations” requires accrued reclamation and abandonment obligations be recognized on the balance sheet by increasing oil and gas properties offset by a liability of an equal amount. Estimates are required to determine the future obligation. The asset and liability are initially measured at fair value, being the discounted future value of the liability, and then capitalized as part of the cost of the asset and subsequently amortized over the life of the asset. The liability then accretes until the retirement obligation is settled.

Litigation

The Corporation is involved in various claims and litigation arising from the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Corporation’s favor, the Corporation does not currently believe that the outcome of adverse decisions in any pending or threatened proceeding related to these and other matters or any amount which it may be required to pay by reason thereof, would have a material adverse effect on its financial position or results of operations.

Depletion and Depreciation Expense

Terra Energy uses the full cost method of accounting for exploration and development activities whereby all costs associated with these activities are capitalized, whether successful or not. The aggregate of capitalized costs, net of certain costs related to unproved properties, and estimated future development costs is amortized using the unit-of-production method based on estimated proved reserves. Changes in estimated proved reserves or future development costs have a direct impact on depletion and depreciation expense. Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been assigned, at which point they would be included in the depletion calculation, or for impairment, for which any write-down would be charged to depletion and depreciation expense.

Stock Based Compensation and Share Purchase Warrants

The Corporation calculates the fair value of the options granted and share purchase warrants issued. This calculation is based on estimates which could differ significantly from actual results. This could have a significant impact on the financial statements.

Income Taxes

The determination of Terra Energy’s income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

Financial Instruments

The Corporation's results are impacted by external market risks associated with fluctuations in commodity prices, operational and safety and environmental risks. The Corporation partially mitigates its exposure to market risks through the use of various financial instruments and physical contracts. The Corporation does not utilize derivative instruments for speculative purposes.

RISK FACTORS RELATING TO OIL AND GAS EXPLORATION, DEVELOPMENT AND PRODUCTION

Uncertain Discovery of Viable Commercial Prospects

The Corporation's future success may be dependent upon its ability to economically locate commercially viable oil or gas deposits. Terra Energy can make no representations, warranties or guaranties that it will be able to consistently identify viable prospects, or that such prospects will be commercially exploitable. An inability of the Corporation to consistently identify and exploit commercially viable hydrocarbon deposits would have a material and adverse effect on the Corporation's business and financial position. Exploratory drilling is subject to numerous risks, including the risk that no commercially productive oil and gas reservoirs will be encountered. The cost of drilling, completing and operating wells is often uncertain, and drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including unexpected formation and drilling conditions, pressure or other irregularities in formations, blowouts, equipment failures or accidents, as well as weather conditions, compliance with governmental requirements and/or shortages or delays in the delivery of equipment. The inability to successfully locate and drill wells that will economically produce commercial quantities of oil and gas could have a material adverse effect on the Corporation's business and financial position. Terra Energy's properties are in various stages of exploration and development. Whether the Corporation ultimately drills a property may depend on a number of factors including funding, the receipt of additional seismic data or reprocessing of existing data, material changes in oil or gas prices, the costs and availability of drilling equipment, success or failure of wells drilled in similar formations or which would use the same production facilities, changes in estimates of costs to drill or complete wells, the Corporation's ability to attract industry partners to acquire a portion of its working interest to reduce exposure to drilling and completion costs, decisions of the Corporation's joint working interest owners, and/or restrictions under provincial regulators.

Volatility of Oil and Natural Gas Contracts

The ultimate profitability, cash flow and future growth of the Corporation will be affected by changes in prevailing oil and gas prices. Oil and gas prices have been subject to wide fluctuations in recent years in response to changes in the supply and demand for oil and natural gas, market uncertainty, competition, regulatory developments and other factors which are beyond the control of the Corporation. It is impossible to predict future oil and natural gas price movements with any certainty. An extended or substantial decline in oil and gas prices would have a material adverse effect on (i) the Corporation's access to capital, and (ii) the Corporation's financial position and results of operations.

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on exploration by Terra Energy will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While close well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

New Alberta Royalty Regime

On October 25, 2007, the Alberta government released a report entitled “The New Royalty Framework” (the “NRF”) containing the government’s proposals for Alberta’s new royalty regime which is scheduled to be effective on January 1, 2009. Given that the NRF has only recently been announced, it is not possible at this time to determine the full impact of the NRF on Terra Energy’s financial condition and operations; however, as Terra Energy’s assets are primarily in British Columbia, this impact will be minimal.

Terra Energy cannot provide any assurance that the NRF will be implemented in the form proposed. If changes are made to the NRF before it is implemented by the Alberta government, such changes could result in the implementation of a new royalty regime that impacts Terra Energy in a materially different manner, and that is more adverse to Terra Energy, than the NRF as currently proposed.

Prices, Markets and Marketing of Crude Oil and Natural Gas

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of Terra Energy. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices will result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the future volume of Terra Energy’s oil and gas production. Terra Energy might also elect not to produce from certain wells at lower prices. All these factors could result in a material decrease in Terra Energy’s future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to Terra Energy will be in part determined by the borrowing base of Terra Energy. A sustained material decline in prices from historical average prices could reduce Terra Energy’s future borrowing base, therefore reducing the bank credit available to Terra Energy, and could require that a portion of any existing bank debt of Terra Energy be repaid.

In addition to establishing markets for its oil and natural gas, Terra Energy must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by Terra Energy will be affected by numerous factors beyond its control. Terra Energy will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by Terra Energy. The ability of Terra Energy to market natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Terra Energy will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and the management of other aspects of the oil and natural gas business. Terra Energy has limited direct experience in the marketing of oil and natural gas.

Substantial Capital Requirements; Liquidity

Terra Energy anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. If Terra Energy's future revenues or reserves decline, Terra Energy may have limited ability to expend the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to Terra Energy. Moreover, future activities may require Terra Energy to alter its capitalization significantly. The inability of Terra Energy to access sufficient capital for its operations could have material adverse effect on Terra Energy's financial condition, results of operations or prospects.

Competition

The Corporation engages in the highly competitive industry of exploration for and production of oil and gas. The Corporation competes directly and indirectly with major and independent oil and gas companies in its exploration for and development of desirable oil and gas properties. Many companies and individuals are engaged in the business of acquiring interests in and developing oil and gas properties in Canada, and the industry is not dominated by any single competitor or a small number of competitors. Many of such competitors have substantially greater financial, technical, sales, marketing and other resources, as well as greater historical market acceptance than does the Corporation. The Corporation will compete with numerous industry participants for the acquisition of land and rights to prospects, and for the equipment and labor required to operate and develop such prospects. Competition could materially and adversely affect the Corporation's business, operating results and financial condition. Such competitive disadvantages could adversely affect the Corporation's ability to participate in projects with favorable rates of return.

Shortage of Supplies and Equipment

The Corporation's ability to conduct operations in a timely and cost effective manner is subject to the availability of natural gas and crude oil field supplies, rigs, equipment and service crews. Although none are expected currently, any shortage of certain types of supplies and equipment could result in delays in our operations as well as in higher operating and capital costs.

Interruption From Severe Weather

The Corporation's operations are conducted principally in the central region of Alberta, northeastern British Columbia and Saskatchewan. The weather in these areas can be extreme and can cause interruption or delays in our drilling and construction operations.

Dependence on Third-Party Pipelines

Substantially all of Terra Energy's sales of natural gas production were through deliveries to local third-party gathering systems to processing plants. In addition, the Corporation relies on access to interprovincial pipelines for the sale and distribution of substantially all of our gas. As a result, a curtailment of our sale of natural gas by pipelines or by third-party gathering systems, an impairment of our ability to transport natural gas on interprovincial pipelines or a material increase in the rates charged to us for the transportation of natural gas by reason of a change in federal or provincial regulations or for any other reason, could have a material adverse effect upon us. In such event, we would have to obtain other transportation arrangements. There can be no assurance that we would have economical transportation alternatives or that it would be feasible for us to construct pipelines. In the event such circumstances were to occur, our netbacks from the affected wells would be suspended until, and if, such circumstances could be resolved.

Operating Hazards and Uninsured Risks

The oil and gas business involves a variety of operating risks, including fire, explosion, pipe failure, casing collapse, abnormally pressured formations, adverse weather conditions, governmental and political actions, premature reservoir declines and environmental hazards such as oil spills, gas leaks and discharges of toxic gases. The occurrence of any of these events with respect to any property operated or owned (in whole or in part) by us could have a material adverse impact on us. The Corporation and the operators of our properties, maintain insurance in accordance with customary industry practices and in amounts that we believe to be reasonable. However, insurance coverage is not always economically feasible and is not obtained to cover all types of operational risks. The occurrence of a significant event that is not insured or insured fully could have a material adverse effect on our financial condition.

Restoration, Safety and Environmental Risks

Our operations are in Alberta, British Columbia and Saskatchewan. Certain laws and regulations exist that require companies engaged in petroleum activities to obtain necessary safety and environmental permits to operate. Such legislation may restrict or delay us from conducting operations in certain geographical areas. Further, such laws and regulations may impose liabilities on us for remedial and clean-up costs, personal injuries related to safety and environmental damages, such liabilities collectively referred to as "asset retirement obligations".

Expiration of Licenses and Leases

The Corporation's properties are held in the form of licenses and leases and working interests in licenses and leases. If the Corporation or the holder of the license or lease fails to meet the specific requirement of a license or lease, the license or lease may terminate or expire. There can be no assurance that any of the obligations required to maintain each license or lease will be met. The termination or expiration of the Corporation's licenses or leases or the working interests relating to a license or lease may have a material adverse effect on the Corporation's results of operations and business.

Title

Title to oil and natural gas interests is often not capable of conclusive determination without incurring substantial expense. In accordance with industry practice, Terra Energy will conduct such title reviews in connection with its principal properties as it believes are commensurate with the value of such properties. However, no absolute assurances can be given that title defects do not exist. If title defects do exist, it is possible that Terra Energy may lose all or a portion of its right title and interest in and to the properties to which the title defects relate.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and federal, provincial and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require Terra Energy to incur costs to remedy such discharge. Implementation of strategies with respect to climate change and reducing greenhouse gases whether to meet the limits required by the Kyoto Protocol or as otherwise determined by federal or provincial governments could have a material impact on the nature of oil and natural gas operations, including those of Terra Energy. See "Industry Conditions – Environmental Regulation". Terra Energy is in material compliance with environmental laws. No assurance can be given that the application of environmental laws to the business and operations of Terra Energy will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect Terra Energy's financial condition, results of operations or prospects.

Reserve Estimates

There are numerous uncertainties inherent in estimating quantities in oil, natural gas and natural gas liquids reserves and cash flows to be derived therefrom, including many factors beyond the Corporation's control. The reserve and associated cash flow information set forth herein represents estimates only. In general, estimates of economically recoverable oil and natural gas reserves and the future net cash flows therefrom are based upon a number of variable factors and assumptions, such as historical production from the properties, production rates, ultimate reserve recovery, timing and amount of capital expenditures, marketability of oil and gas, royalty rates, the assumed effects of regulation by governmental agencies and future operating costs, all of which may vary from actual results. All such estimates are to some degree speculative, and classifications of reserves are only attempts to define the degree of speculation involved. For those reasons, estimates of the economically recoverable oil and natural gas reserves attributable to any particular group of properties, classification of such reserves based on risk of recovery and estimates of future net revenues expected therefrom prepared by different engineers, or by the same engineers at different times, may vary. The Corporation's actual production, revenues, taxes and development and operating expenditures with respect to its reserves will vary from estimates thereof and such variations could be material. Further, the evaluations are based in part on the assumed success of exploitation activities intended to be undertaken in future years. The reserves and estimated cash flows to be derived therefrom contained in such evaluations will be reduced to the extent that such exploitation activities do not achieve the level of success assumed in the evaluation.

Estimates of proved reserves that may be developed and produced in the future are often based upon volumetric calculations and upon analogy to similar types of reserves rather than actual production history. Estimates based on these methods are generally less reliable than those based on actual production history. Subsequent evaluation of the same reserves based upon production history and production practices will result in variations in the estimated reserves and such variations could be material.

In accordance with applicable securities laws, GLJ, the independent reserves evaluator, has used forecast price and cost estimates in calculating reserve quantities included herein. Actual future net revenue will be affected by other factors such as actual production levels, supply and demand for oil and natural gas, curtailments or increases in consumption by oil and natural gas purchasers, changes in governmental regulation or taxation and the impact of inflation on costs. Actual production and revenues derived therefrom will vary from the estimates contained in the GLJ Report, and such variations could be material. The GLJ Report is based in part on the assumed success of activities the Corporation intends to undertake in future years. The reserves and estimated cash flows to be derived therefrom contained in the GLJ Report will be reduced to the extent that such activities do not achieve the level of success assumed in the GLJ Report. The GLJ Report is effective as of a specific effective date and has not been updated and thus does not reflect changes in the Corporation's resources since that date.

Reserve Replacement

Terra Energy's future oil and natural gas reserves, production, and cash flows to be derived therefrom are highly dependent on Terra Energy successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves Terra Energy may have at any particular time and the production therefrom will decline over time as such existing reserves are exploited. A future increase in Terra Energy's reserves will depend not only on Terra Energy's ability to develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. There can be no assurance that Terra Energy's future exploration and development efforts will result in the discovery and development of additional commercial accumulations of oil and natural gas.

Reliance on Operators and Key Employees

To the extent Terra Energy is not the operator of all of its oil and gas properties, Terra Energy will be dependent on such operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, the success of Terra Energy will be largely dependent upon the performance of its management and key employees. Terra Energy does not have any key man insurance policies, and therefore there is a risk that the death or departure of any member of management or any key employee could have a material adverse effect on Terra Energy.

Corporate Matters

To date, Terra Energy has not paid any dividends on its outstanding common shares and does not anticipate the payment of any dividends on its common shares for the foreseeable future. Certain of the directors and officers of Terra Energy are also directors and officers of other oil and gas companies involved in oil and gas exploration and development, and conflicts of interest may arise between their duties as officers and directors of Terra Energy and as officers and directors of such other companies. Such conflicts must be disclosed in accordance with, and are subject to such other procedures and remedies as apply under the ABCA.

Management of Growth

The Corporation may be subject to growth-related risks including capacity constraints and pressure on its internal systems and controls. The ability of the Corporation to manage growth effectively will require it to continue to implement and improve its operational and financial systems and to expand, train and manage its employee base. The inability of the Corporation to deal with this growth could have a material adverse impact on its business, operations and prospects.

Permits and Licences

The operations of Terra Energy may require licences and permits from various governmental authorities. There can be no assurance that Terra Energy will be able to obtain all necessary licences and permits that may be required to carry out exploration and development at its properties.

Additional Funding Requirements

Terra Energy's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, Terra Energy may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause Terra Energy to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If Terra Energy's revenues from its reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect Terra Energy's ability to expend the necessary capital to replace its reserves or to maintain its production. If Terra Energy's cash flow from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on favourable terms. Any equity financing may result in a change of control of Terra Energy or holders of its common shares suffering further dilution.

Variations in Foreign Exchange Rates

World oil and gas prices are quoted in United States dollars and the price received by Canadian producers is therefore effected by the Canadian/U.S. dollar exchange rate, which will fluctuate over time. In recent years, the Canadian dollar has increased materially in value against the United States dollar. Such material increases in the value of the Canadian dollar have negatively impacted Terra Energy's operating entities production revenues. Further material increases in the value of the Canadian dollar would exacerbate this negative impact. This increase in the exchange rate for the Canadian dollar and future Canadian/United States exchange rates could accordingly impact the future value of Terra Energy's reserves as determined by independent evaluators.

Issuance of Debt

From time to time Terra Energy may enter into transactions to acquire assets or the shares of other corporations. These transactions may be financed partially or wholly with debt, which may increase Terra Energy's debt levels above industry standards. Neither Terra Energy's articles nor its bylaws limit the amount of indebtedness that Terra Energy may incur. The level of Terra Energy's indebtedness from time to time could impair Terra Energy's ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise. Terra Energy's ability to meet its debt service obligations will depend on Terra Energy's future operations which are subject to prevailing industry conditions and other factors, many of which are beyond the control of Terra Energy. As certain of the indebtedness of Terra Energy bears interest at rates which fluctuate with prevailing interest rates, increases in such rates would increase Terra Energy's interest payment obligations and could have a material adverse effect on Terra Energy's financial condition and results of operations. Further, Terra Energy's indebtedness is secured by substantially all of Terra Energy's assets. In the event of a violation by Terra Energy of any of its loan covenants or any other default by Terra Energy on its obligations relating to its indebtedness, the lender could declare such indebtedness to be immediately due and payable and, in certain cases, foreclose on Terra Energy's assets. In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, cratering, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Financial Instruments

From time to time the Corporation may enter into agreements to receive fixed prices on its oil and natural gas production to offset the risk of revenue losses if commodity prices decline; however, if commodity prices increase beyond the levels set in such agreements, the Corporation will not benefit from such increases. Similarly, from time to time the Corporation may enter into agreements to fix the exchange rate of Canadian to United States dollars in order to offset the risk of revenue losses if the Canadian dollar increases in value compared to the United States dollar; however, if the Canadian dollar declines in value compared to the United States dollar, the Corporation will not benefit from its fluctuating exchange rate.

Availability of Drilling Equipment and Access Restrictions

Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to Terra Energy and may delay exploration and development activities.

Aboriginal Claims

Aboriginal peoples have claimed aboriginal title and rights to portions of western Canada. The Corporation is not aware that any claims have been made in respect of its property and assets; however, if a claim arose and was successful this could have an adverse effect on the Corporation and its operations.

Seasonality

The level of activity in the Canadian oil and gas industry is influenced by seasonal weather patterns. Wet weather and spring thaw may make the ground unstable. Consequently, municipalities and provincial transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Also, certain oil and gas producing areas are located in areas that are inaccessible other than during the winter months because the ground surrounding the sites in these areas consists of swampy terrain. There can be no assurance that these seasonal factors will not adversely affect the timing and scope of the Corporation's exploration and development activities, which could in turn have a material adverse impact on the Corporation's business, operations and prospects.

Third Party Credit Risk

The Corporation is, or may be exposed to, third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its petroleum and natural gas production and other parties. In the event such entities fail to meet their contractual obligations to the Corporation, such failures could have a material adverse effect on the Corporation and its cash flow from operations. In addition, poor credit conditions in the industry and of joint venture partners may impact a joint venture partner's willingness to participate in the Corporation's ongoing capital program, potentially delaying the program and the results of such program until the Corporation finds a suitable alternative partner.

Alternatives to and Changing Demand for Petroleum Products

Fuel conservation measures, alternative fuel requirements, increasing consumer demand for alternatives to oil and natural gas, and technological advances in fuel economy and energy generation devices could reduce the demand for crude oil and other liquid hydrocarbons. The Corporation cannot predict the impact of changing demand for oil and natural gas products, and any major changes may have a material adverse effect on the Corporation's business, financial condition, results of operations and cash flows.

Kyoto Protocol

Canada is a signatory to the United Nations Framework Convention on Climate Change and has ratified the Kyoto Protocol established thereunder to set legally binding targets to reduce nationwide emissions of carbon dioxide, methane, nitrous oxide and other so-called "greenhouse gases". Terra Energy's exploration and production facilities and other operations and activities emit a small amount of greenhouse gases which will likely subject Terra Energy to legislation regulating emissions of greenhouse gases. The Government of Canada has developed a "Turning the Corner" climate change plan, which outlines future regulatory requirements that will set greenhouse gas emission reduction requirements for various industrial activities, including oil and gas exploration and production. Future federal legislation, together with provincial emission reduction requirements, such as those contained in Alberta's Climate Change and Emissions Management Act and proposed in British Columbia's Bill 18: Greenhouse Gas Reduction (Cap and Trade) Act, may require the reduction of emissions or emissions intensity with Terra Energy's operations and facilities. The direct or indirect costs of these regulations may adversely affect the business of Terra Energy.

Environmental Regulation

The oil and natural gas industry is currently subject to environmental regulations pursuant to provincial and federal legislation. Environmental legislation provides for restrictions and prohibitions on releases or emissions and regulation on the storage and transportation of various substances produced or utilized in association with certain oil and gas industry operations and can affect the location and operation of wells and facilities and the extent to which exploration and development is permitted. In addition, legislation requires that well and facility sites be abandoned and reclaimed to the satisfaction of provincial authorities. As well, applicable environmental laws may impose remediation obligations with respect to property designated as a contaminated site upon certain responsible persons, which include persons responsible for the substance causing the contamination, persons who caused the release of the substance and any past or present owner, tenant or other person in possession of the site. Compliance with such legislation can require significant expenditures and a breach of such legislation may result in the suspension or revocation of necessary licences and authorizations, civil liability for pollution damage, the imposition of fines and penalties or the issuance of clean-up orders.

Applicable environmental laws in Alberta are consolidated in the Environmental Protection and Enhancement Act (the "EPEA"). In British Columbia, environmental laws are primarily found in the Environmental Management Act (the "EMA"). Under the EPEA and the EMA, environmental standards and compliance for releases, clean-up and reporting are stricter and more onerous than in previous legislation. Also, the range of enforcement actions available and the severity of penalties have been significantly increased. These changes will have an incremental effect on the cost of conducting operations in both provinces. Both Alberta and British Columbia review energy projects through an environmental assessment process, which may be held in conjunction with a federal assessment. These review processes involve public participation.

Climate change is an issue that is increasingly subject to government regulation. Although Canada has ratified the Kyoto Protocol and despite legislation to this end introduced by opposition parties in Parliament, it remains uncertain whether the targets in the Kyoto Protocol will be enforced in Canada. Alberta, British Columbia and the federal Government have all introduced climate change action plans that include various means of achieving emissions or emissions intensity reductions, including direct reductions, emissions trading, carbon capture and storage, technology fund contributions and credit for early action. Coordination between these plans has not yet been developed and remains a source of uncertainty. Given the evolving regulatory schemes related to climate change and the control of greenhouse gases and resulting requirements, it is not currently possibly to predict the final form these requirements will take or the impact on Terra Energy and its operations and financial condition at this time.