



**Terra Energy Corp.
Management's Discussion & Analysis
For the three months ended March 31, 2010**

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 12, 2010. It should be read in conjunction with the unaudited interim consolidated financial statements and the corresponding notes for the three months ended March 31, 2010 and March 31, 2009 and with the audited year end consolidated financial statements of the Corporation for the years ended December 31, 2009 and December 31, 2008.

Terra Energy's Board of Directors and Audit Committee have reviewed and approved the March 31, 2010 unaudited consolidated financial statements and related MD&A.

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

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.

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 MD&A along with the associated financial statements referenced above include the accounts of the Corporation and its wholly-owned subsidiaries, including Constar Resources Ltd., Tecton Energy Canada Ltd, Petra Energy Corp., and Terra Energy Partnership, 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.

2010 FIRST QUARTER HIGHLIGHTS

- Average production per day increased 22.1% to 7,187 barrels per day compared to the same quarter last year.
- Gross revenue increased 49.3% to \$24,244,658 from \$16,236,381 compared to the same quarter last year.
- Cash flow from operations increased 74.4% to \$10,946,691 from \$6,274,320 compared to the same quarter last year.
- Production expense per unit of production increased 2.5% to \$9.81 from \$9.57 compared to the same quarter last year.
- Completion of Asset Exchange Agreement and execution of Farm-in Agreement on 13 additional sections of prospective lands, making Terra Energy one of the largest undeveloped land owners in the prospective Montney Fairway, with over 100 net sections of land.
- In addition to deals which have been announced, the Company increased its overall land base by adding approximately 95,000 net acres of Crown lands during the first quarter.

TERRA ENERGY CORP.

(\$ in thousands, except per share amounts)	2010 Q1	2009 Q4	2009 Q3	2009 Q2	2009 Q1	2008 Q4	2008 Q3	2008 Q2
Gross Revenue	24,245	20,998	13,584	12,050	16,236	19,442	21,200	20,808
Cash Flow from Operations	10,947	8,327	6,418	4,794	6,274	10,670	12,466	10,453
Net income (loss)	(5)	4,404	(2,347)	(1,117)	(924)	4,516	13,773	5,778
Per Share (Basic)	-	0.05	(0.03)	(0.02)	(0.01)	0.06	0.18	0.08
Per Share (Diluted)	-	0.05	(0.03)	(0.02)	(0.01)	0.06	0.18	0.08
Total Assets	239,213	222,481	240,140	166,604	157,941	153,068	150,046	128,852
Bank Debt	37,703	54,390	81,451	31,489	18,320	6,316	-	-
Working Capital Surplus (Deficiency)	(15,151)	(2,601)	731	5,834	(4,706)	(7,487)	(5,590)	(2,729)

NON-GAAP MEASURES

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. The terms “cash flow from operations”, “operating netback”, “working capital” and “net debt” are not recognized under GAAP. The Corporation uses these measures to help evaluate its performance, leverage, and liquidity as well as to assess potential acquisitions.

Cash flow from operations is an important financial measure as it demonstrates the Corporation’s ability to generate funds necessary to repay debt and to fund future growth through capital investment. Cash flow from operations should not be considered an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with GAAP as an indicator of the Corporation’s performance. All references to cash flow from operations throughout this MD&A are based on cash flow from operating activities before changes in non-cash working capital. The Corporation also presents cash flow from operations per share whereby the per share amounts are calculated using weighted average shares outstanding consistent with the calculation of net income per share, which per share amount is calculated under GAAP and is more fully described in the notes to the financial statements.

Operating netback is an important financial measure as it demonstrates profitability relative to current commodity prices. Operating netback is calculated as revenues less royalties and operating expenses. There is no GAAP measure that is reasonably comparable to operating netback.

Net debt and working capital are both important financial measures as they are used to assess liquidity and general financial strength. Working capital is calculated as current assets less current liabilities. Net debt is calculated as the sum of working capital and long-term financing excluding the mark to market adjustment of financial instruments. There is no GAAP measure that is reasonably comparable to working capital or net debt.

FORWARD-LOOKING ADVISORY

This MD&A contains certain statements or disclosures relating to Terra Energy that are based on the expectations of its Management, as well as assumptions made by and information currently available to Terra Energy which may constitute forward-looking statements or information (“forward-looking statements”) under applicable securities laws. Forward-looking statements are often, but not always, identified by the use of words such as “seek”, “anticipate”, “plan”, “continue”, “estimate”, “expect”, “may”, “will”, “project”, “predict”, “potential”, “targeting”, “intend”, “could”, “might”, “should”, “believe” and similar expressions. All such statements and disclosures, other than those of historical fact, which address activities, events, outcomes, results or developments that the Corporation anticipates or expects may, or will occur in the future (in whole or in part) should be considered forward-looking statements. Information presented in such statements or disclosures, may, among other things, relate to: the anticipated benefits and enhanced shareholder value resulting from operations; the success of the Corporation’s growth strategy; sources of income; forecasts of capital expenditures and the sources of the financing thereof; expectations regarding the ability of the Corporation to raise capital, movements in currency exchange rates, anticipated income taxes, the Corporation’s business outlook, plans and objectives of Management for future operations’ forecast business results and anticipated financial performance. Many factors could cause the performance or achievements of Terra Energy to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements.

In particular, such forward-looking statements include:

- (a) Under the heading “Liquidity and Capital Resources” the statement that:
- i. Terra Energy is in the financial position to weather the economic storm with \$29,014,513 in unutilized credit facility at March 31, 2010 and \$10,946,691 in cash flow from operations for the period ended March 31, 2010.
 - ii. The existing capital structure will provide sufficient cash resources to meet its existing and future cash requirements.
 - iii. The Corporation has no immediate requirement for additional capital but may re-evaluate its position if opportunities arise.
- (b) Under the heading “Commitments and Contingencies” the statement that:
- i. 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.
- (c) Under the heading “Outlook” the Corporation stated that:
- i. Focusing on resource plays and slowly shifting the balance of production over time in our conventional business closer towards a long term target of 50%-50% in our oil to gas ratio, are strategies that will ensure success for the Company in years to come.
 - ii. It is hoped that this horizontal well and other operations taking place in the Altares area this year will position the Company to move forward on full commercial development.
 - iii. The main objective for the Company is to advance the unconventional Montney gas play where the Company owns more than 100 net sections of land in the prospective Montney Fairway and a total of more than one half million net acres of undeveloped land. It is expected that achieving this objective will result in an increase in the overall reserves of the Company, the preparation of a resource study for part or parts of this play, the commercial development of the Groundbirch field, the advancement of the Altares field to commercial development stage, and the necessary work involved in advancing infrastructure development associated with all of the above.
 - iv. A secondary objective will be to continue our search for an oil resource play or plays for future development.
 - v. Other objectives include taking advantage of market opportunities to strengthen and enhance the Company’s asset base given the current market conditions and numerous asset packages which are becoming available.
 - vi. In the weeks and months to come, the Company hopes to report on its progress towards achieving many of these objectives. The success of the Company will be a function of how well the Company embraces science and technology, and how strong the Company’s engineering and geotechnical teams prove to be.
 - vii. The Company also remains confident that natural gas prices in North America will recover to more sustainable levels. Natural gas is the solution to many of our energy needs, and as such gas-weighted producers such as Terra Energy have much to be optimistic about.
- (d) Under the heading “Significant Accounting Policies – Property, Plant and Equipment” the statement that:
- i. The Corporation plans to use proved and probable reserves for the depletion calculation.
- (e) Under the heading “Significant Accounting Policies – Stock Based Compensation” the statement that:
- i. The Corporation intends to use the IRFS I exemption under which stock options vested prior to January 1, 2010 are not required to be restated.
- (f) Under the heading “Critical Accounting Estimates – Proved Oil and Gas Reserves” the statements that:

- i. Estimated future development costs will be funded from the Corporation's unutilized credit facility or from cash flow from operations. The cost of funding estimated future development costs will not make the development of a property uneconomic or have an impact on disclosed reserves or future cash flow from the production of proved reserves.
- (g) Under the heading "Critical Accounting Estimates – Litigation" the statement that:
 - i. 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.
- (h) Under the heading "Critical Accounting Estimates – Stock Based Compensation and Share Purchase Warrants" the statement that:
 - i. The assumptions used could differ from actual fair value of the stock options at any time.
- (i) Under the heading "Income Taxes" the statement that:
 - i. The actual income tax liability may differ significantly from that estimated and recorded.
- (j) Under the heading Risk Factors Relating to Oil and Gas Exploration, Development and Production - "Global Economic Conditions" the statement that:
 - i. An \$80.0 million revolving line of credit, which was drawn by \$37.7 million at March 31, 2010, gives Terra Energy the financial flexibility to manage through these uncertain times.
- (k) Under the heading "British Columbia Royalty Regime" the statement that:
 - i. The new Alberta royalty regime and drilling credit program and the British Columbia royalty regime may have an impact on decisions that the Corporation will make in determining where to focus its drilling activities in the future.
- (l) Under the heading "Capital Markets" the statement that:
 - i. Terra Energy believes it has sufficient funds available to fund its projected capital expenditures.

The Corporation's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this MD&A:

- (a) general economic conditions in Canada, the United States and globally;
- (b) industry conditions, including fluctuations in the price of oil and natural gas;
- (c) governmental regulation of the oil and gas industry, including environmental regulation;
- (d) fluctuation in foreign exchange or interest rates;
- (e) liabilities inherent in oil and natural gas operations;
- (f) geological, technical, drilling and processing problems;
- (g) unanticipated operating events which can reduce production or cause production to be shut in or delayed;
- (h) failure to realize the anticipated benefits of acquisitions;
- (i) failure to obtain industry partner and other third party consents and approvals, when required;
- (j) stock market volatility and market valuations;
- (k) competition for, among other things, capital, acquisitions of reserves, undeveloped land and skilled personnel;

- (l) competition for, and inability to, retain drilling rigs and other services;
- (m) rights to surface access; and
- (n) the need to obtain required approvals from regulatory authorities; and the other factors considered under “Risk Factors” in this MD&A and other risk factors identified in the Corporation’s Annual Information Form and other documents incorporated herein by reference.

Statements relating to “reserves” or “resources” are by their nature forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described can be profitably produced in the future. With respect to forward-looking statements contained or incorporated by reference in this MD&A, Terra Energy has made assumptions regarding: future exchange rates; energy markets and the price of oil and natural gas; the impact of increasing competition; condition in general economic and financial markets; availability of drilling and related equipment; availability of skilled labour; availability of prospective drilling rights; current technology; cash flow; commodity prices; production rates; effects of regulation and tax laws by governmental agencies; future operating costs and the Corporation’s ability to obtain financing on acceptable terms. In addition, forward-looking statements in documents incorporated by reference herein may be based on additional assumptions as disclosed in such documents. Readers are cautioned that the foregoing list of factors is not exhaustive.

The above summary of assumptions and risks related to forward-looking statements has been provided in this MD&A and the documents incorporated by reference herein in order to provide readers with a more complete perspective on Terra Energy’s future operations. Readers are cautioned that this information may not be appropriate for other purposes. These forward-looking statements speak only as of the date of this MD&A or as of the date specified in the documents incorporated by reference, as the case may be. The Corporation does not intend and does not undertake to update or revise these forward-looking statements except as required pursuant to applicable securities laws.

The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

REPORTING CONTROLS

The Corporation’s Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) are responsible for establishing and maintaining disclosure controls and procedures (“DC&P”) and internal controls over financial reporting (“ICFR”), as those terms are defined in NI 52-109 Certification of Disclosure in Issuers’ Annual and Interim Filings.

The CEO and CFO have designed, or caused to be designed under their supervision, DC&P to provide reasonable assurance that material information relating to the Corporation is made known to the CEO and CFO on a timely basis and that information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by the Corporation under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation. The CEO and CFO have evaluated, or caused to be evaluated under their supervision, the effectiveness of Terra’s DC&P and have concluded that Terra’s DC&P are effective as at March 31, 2010 based on that evaluation.

Internal control over financial reporting is a process designed to provide reasonable assurance that all assets are safeguarded, transactions are appropriately authorized and to facilitate the preparation of relevant, reliable and timely information. The CEO and CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Corporation’s financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation’s internal controls over financial reporting as at the three month period ended March 31, 2010, and concluded that the Corporation’s internal controls over financial reporting are effective for the foregoing purpose. The Corporation’s CEO and CFO are required to cause the Corporation to disclose any change in the Corporation’s internal controls over financial reporting that occurred during the three months ended March 31, 2010 that has materially affected, or is reasonably likely to materially affect, the Corporation’s internal controls over financial reporting. No material changes in the Corporation’s internal controls over financial reporting were identified during such period that have materially affected, or are reasonably likely to materially affect, the Corporation’s internal controls over financial reporting. It should be noted that a control system, including the Corporation’s disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

RESULTS OF OPERATIONS

Production

Three months ended March 31	2010 Average	2009 Average	Growth %
Oil (bbl/d)	681	176	286.9
Natural Gas (Mcf/d)	32,777	27,900	17.5
Liquids (bbl/d)	1,043	1,058	(1.4)
Combined boe/d	7,187	5,884	22.1

Operations

Three months ended March 31 (in thousands, except per share and boe amounts)	2010 \$	2009 \$	2010 (\$/boe)	2009 (\$/boe)	Growth %
Revenue Before Royalties	22,577	16,236	34.91	30.66	13.8
Royalties	(4,663)	(3,447)	(7.21)	(6.51)	10.7
Revenue After Royalties	17,914	12,789	27.70	24.15	14.7
Production Expenses	(6,346)	(5,067)	(9.81)	(9.57)	2.5
Operating Netback	11,568	7,722	17.89	14.58	22.7
General & Administrative Expenses	(1,715)	(1,139)	(2.65)	(2.15)	23.3
Interest Expense	(604)	(128)	(0.93)	(0.24)	287.5
Realized Foreign Exchange Gain	72	-	0.11	-	-
Non-cash Expenses	(9,234)	(7,416)	(14.28)	(14.01)	1.9
Income (Loss) Before Income Taxes and Other Income	87	(961)	0.14	(1.82)	107.7
Gain on Disposition of Other Assets	63	-	0.10	-	-
Income Tax Recovery (Expense)	(155)	37	(0.24)	0.07	442.9
Net Loss	(5)	(924)	-	(1.75)	-
Per Share – Basic	-	(0.01)			
Per Share – Diluted	-	(0.01)			

Revenue

Three months ended March 31 (in thousands)	2010 \$	2009 \$	2010 (\$/boe)	2009 (\$/boe)	Growth %
Gross Revenue	24,245	16,236	37.48	30.66	22.2
Realized Gain on Financial Instruments	288	-	0.45	-	-
Unrealized Gain (Loss) on Financial Instruments	(1,956)	-	(3.02)	-	-
Revenue Before Royalties	22,577	16,236	34.91	30.66	13.9

Gross revenue increased 49.3% to \$24,244,658 for the three month period ended March 31, 2010 compared to \$16,236,381 for the same period ended March 31, 2009. This was primarily due to a 22.2% increase in the average price received per BOE as well as a 22.1% increase in production.

Financial Instruments

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 on the balance sheet. Furthermore, during each period end, the prior periods mark to market is reversed and a new mark to market adjustment is calculated with the difference being recorded to unrealized gain (loss) on financial instruments on the statement of operations and comprehensive income. The periodic cash settlement of these various financial instruments is recorded in realized gain (loss) on financial instruments on the statement of operations and comprehensive income.

For the three month period ended March 31, 2010, the Corporation’s financial statements reflect an unrealized loss of \$1,955,900 on financial instruments. This is the result of the reversal of the December 31, 2009 mark to market liability of \$153,889 on financial instruments and a new mark to market liability of \$2,109,789 at March 31, 2010.

For the three month period ended March 31, 2010, the Corporation’s financial statements reflect a financial instrument asset of \$240,785 resulting from an unrealized gain on foreign exchange contracts.

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

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

Three months ended March 31	2010	2009	Growth %
Crude Oil (\$ / bbl)	72.72	39.37	84.7
Natural Gas Liquids (\$ / bbl)	46.21	25.97	77.9
Natural Gas (\$ / Mcf)	5.13	5.21	(1.5)

Royalties

Three months ended March 31 (in thousands)	2010 \$	2009 \$	2010 (\$/boe)	2009 (\$/boe)	Growth %
Charge for the period	4,663	3,447	7.21	6.51	10.7
Royalties as a percentage of gross revenue	19.2%	21.2%			

Royalties increased 35.3% to \$4,662,907 for the three month period ended March 31, 2010 compared to \$3,446,924 for the same period ended March 31, 2009 primarily as a result the Corporation’s increased production. Royalties on a per unit of production increased by 10.7% to \$7.21 for the three month period ended March 31, 2010 compared to \$6.51 for the same period ended March 31, 2009. Royalties as a percentage of gross revenues decreased to 19.2% from 21.2% as a result of the royalty rate reduction program on British Columbia wells.

Production Expenses

Three months ended March 31 (in thousands)	2010 \$	2009 \$	2010 (\$/boe)	2009 (\$/boe)	Growth %
Production Expenses	6,346	5,067	9.81	9.57	2.5

Production expenses increased 25.5% to \$6,346,426 for the three month period ended March 31, 2010 compared to \$5,067,504 for the same period ended March 31, 2009 reflecting higher production volumes. Production expenses on a per unit of production basis increased 2.5% to \$9.81 for the three month period ended March 31, 2010 compared to \$9.57 for the same period ended March 31, 2009 primarily due to increased fixed costs related to the acquisition of the Peace River Arch assets, which include higher cost oil production.

General and Administrative Expenses

Three months ended March 31 (in thousands)	2010 \$	2009 \$	2010 (\$/boe)	2009 (\$/boe)	Growth %
General and Administrative Expenses	1,715	1,139	2.65	2.15	23.3

General and administrative expenses increased 50.6% to \$1,715,586 for the three month period ended March 31, 2010 compared to \$1,139,437 for the same period ended March 31, 2009 primarily due to increased staffing levels to support the growth of the Corporation.

General and administrative expenses on a per unit of production basis increased 23.3% to \$2.65 for the three month period ended March 31, 2010 compared to \$2.15 for the same period ended March 31, 2009.

Interest Expense

Three months ended March 31 (in thousands)	2010 \$	2009 \$	2010 (\$/boe)	2009 (\$/boe)	Growth %
Interest Expense	604	128	0.93	0.24	287.5

Interest expense increased 370.2% to \$604,483 for the three month period ended March 31, 2010 compared to \$128,564 for the same period ended March 31, 2009 due to an increase in the long term financing in relation to the acquisition of the Peace River Arch properties.

Non Cash Expenses

Three months ended March 31 (in thousands)	2010 \$	2009 \$	2010 (\$/boe)	2009 (\$/boe)	Growth %
Depletion, Depreciation and Amortization	8,768	6,464	13.56	12.21	11.1
Accretion Expense	215	114	0.33	0.22	50.0
Stock Based Compensation	491	837	0.76	1.58	(51.9)
Unrealized Foreign Exchange Loss (Gain)	(240)	1	(0.37)	-	-
Non Cash Items	9,234	7,416	14.28	14.01	1.9

Non cash expenses increased 24.5% to \$9,234,105 for the three month period ended March 31, 2010 compared to \$7,415,249 for the same period ended March 31, 2009. The majority of the change in non cash expenses is attributable to an increase in depletion, depreciation and amortization offset by lower stock based compensation. The \$2,304,614 increase in depletion, depreciation and amortization in the period ending March 31, 2010 compared to the same period ending March 31, 2009 is the result of the addition of the Peace River Arch properties to the depletable base in July, 2009. Stock based compensation decreased by \$345,907 in the current period compared to the prior period due to replacement stock options granted in the first quarter of 2009. On a per unit of production basis, non cash expenses increased 1.9% to \$14.28 for the three month period ended March 31, 2010 compared to \$14.01 for the same period ended March 31, 2009.

Income Taxes

Three months ended March 31 (in thousands)	2010 \$	2009 \$	2010 (\$/boe)	2009 (\$/boe)	Growth %
Future Tax Expense (Recovery)	155	(37)	0.24	(0.07)	442.9
Income Taxes (Recovery)	155	(37)	0.24	(0.07)	442.9

Income tax expense of \$154,803 for the three month period ended March 31, 2010 was recorded compared to a recovery of \$37,135 for the same period ended March 31, 2009. The increase in income tax expense is consistent with the increase in income before income taxes. On a per unit of production basis, the future income tax expense was

\$0.24 for the three month period ended March 31, 2010 compared to a recovery of \$0.07 for the same period ended March 31, 2009.

LIQUIDITY AND CAPITAL RESOURCES

The Corporation defines liquidity as its ability to generate cash and to meet existing known and reasonably likely future cash requirements. Cash flow from operations is a measure of the Corporation's ability to generate cash in order to meet these requirements. Cash flow from operations for the three months ended March 31, 2010 has increased 74.5% to \$10,946,691 from \$6,274,320 for the same period in 2009. This increase reflects the increase in petroleum and natural gas commodity prices during the period.

The current economic environment has made access to debt and equity markets more difficult. The cost of capital has increased while the availability of capital has decreased. The Corporation is in the financial position to weather the economic storm with \$29,014,513 in unutilized credit facility at March 31, 2010 and \$10,946,691 in cash flow from operations for the period ended March 31, 2010. As the majority of the Corporation's capital expenditure program is focused on reserve development and production volumes, the existing capital structure will provide sufficient cash resources to meet its existing and future cash requirements. The Corporation has no immediate requirement for additional capital but may re-evaluate its position if opportunities arise.

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 a reconciliation of Cash flow from operations to Cash flow – operating activities for the periods noted:

Three months ended March 31 (\$ thousands)		2010	2009
Non-GAAP	Cash flow from operations	10,947	6,275
	Change in non-cash working capital	2,858	2,534
GAAP	Cash flow – operating activities	13,805	8,809

For the three month period ended March 31, 2010, the Corporation generated cash flows from operations of \$10,946,691 (\$0.12 per basic and diluted share), an increase of 74.5% compared to \$6,274,320 (\$0.09 per basic and diluted share) for the three month period ended March 31, 2009.

Capital expenditures, net debt and working capital are measures of the known and reasonably likely future cash requirements.

Three months ended March 31 (\$ thousands)	March 31, 2010	December 31, 2009	% Growth
Working Capital Deficiency	15,151	2,601	482.5
Less: Financial Instruments	(1,869)	(154)	1,113.6
Long-Term Financing	37,703	54,390	(30.7)
Net Debt	50,985	56,837	(10.3)

The working capital deficiency at March 31, 2010 was \$15,150,793 compared to a deficiency of \$2,600,974 at December 31, 2009. The increase in the working capital deficiency was driven by an increase in accrued liabilities relating to an increase in exploration and development activity in the first quarter of 2010. A working capital deficiency is a normal

event in the oil and gas industry with liquidity being maintained by drawing from the unutilized credit facility as needed and then repaying it periodically through production revenues.

Net debt at March 31, 2010 was \$50,985,487 compared to \$56,836,964 at December 31, 2009. The decrease in net debt was a result of repayment on the long-term credit facility from proceeds received on a “bought-deal” financing agreement in the first quarter of 2010.

Terra Energy’s long-term financing is an \$80.0 million 364 day revolving bank syndicated 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, 2010, Terra Energy was in compliance with all of its bank covenants.

At March 31, 2010, the Corporation’s available credit, net of working capital deficiency, was \$29,014,513 compared to \$23,163,036 at December 31, 2009.

Capital Expenditures

Capital expenditures increased by 53.4% to \$19,429,587 before property acquisitions for the three month period ended March 31, 2010 compared to \$12,666,593 for the same period ended last year. Terra Energy financed its capital expenditures for the period through a combination of cash flow from operations, equity financing and long-term financing. Capital expenditures in the future are largely discretionary and will be contingent upon management’s assessment of the financial condition of the Corporation and the current economic climate and it’s impact on access to capital and debt markets.

During the three months ended March 31, 2010, the Corporation completed an asset exchange arrangement involving the exchange of oil & gas assets, with cash forming no part of the consideration. Under the terms of the Arrangement, the Corporation has acquired approximately 170 gross (70 net) sections of land located in several key areas of high activity in northeast British Columbia. In consideration for the assets acquired, the Corporation assigned and conveyed to the counterparty all of its rights and interest in a specified resource play which has been under development by the Corporation for more than two years.

For the three month period ended March 31, 2010, Terra Energy incurred \$19,429,587 in capital expenditures before acquisitions broken down as:

Three months ended March 31 (\$ thousands)	2010	2009
Exploration	(1,469)	4,726
Development	17,143	1,876
Undeveloped Land	2,916	2,427
Geological / Geotechnical	835	1
Facilities	(253)	3,517
Other Assets	257	120
Total Capital Expenditures	19,429	12,667
Net Property Acquisitions	6,764	-
Net Capital Expenditures	26,193	12,667

Capital Resources

The Corporation’s share capital is as follows:

	March 31, 2010		December 31, 2009	
	No. of Shares #	Amount \$	No. of Shares #	Amount \$
(thousands)				
Common Shares	99,045	105,952	87,989	84,636

During the three month period ended March 31, 2010, the Corporation issued 5,000,000 common shares at \$1.80 and 6,250,000 flow-through common shares at \$2.16 for aggregate gross proceeds of \$22,500,000.

During the three month period ended March 31, 2010, 61,400 common shares were issued on the exercise of stock options for cash proceeds received of \$81,872.

During the three month period ended March 31, 2010, 255,300 common shares were repurchased under normal course issuer bid by the Corporation for \$419,700 at an average price of \$1.64 per common share. The Corporation recorded \$245,572 as a reduction of share capital and the excess of \$174,128 charged to retained earnings.

As at March 31, 2010, 11,000 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. At May 12, 2010, the Corporation has 99,065,278 common shares outstanding and 9,248,000 stock options issued.

COMMITMENTS AND CONTINGENCIES

The Corporation had outstanding letters of credit to various parties for a total of \$605,744 (December 31, 2009 - \$605,744). The amounts expire at various dates during 2010.

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 AND FINANCIAL INSTRUMENTS

The Corporation has not entered into any off-Balance Sheet transactions.

The Corporation is party to certain derivative instruments, including crude oil and natural gas contracts, which are entered into in order 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, 2010, the Corporation had entered into derivative contracts, the terms of which are summarized as follows:

Contract Type	Price	Volumes Per Day	Contract Term
Financial	Buy \$5.37 per GJ	5,000 GJ	April 1, 2010 to October 31, 2010
Financial	Sell \$0.39 basis per mmbtu	12,000 mmbtu	April 1, 2010 to October 31, 2010

The mark to market value of the above commodity product transactions of \$2,109,789 has been recorded in current liabilities as at March 31, 2010.

In addition, at March 31, 2010, the Corporation held a foreign exchange contract to sell \$10 million USD at an exchange rate of 1.0526 until January, 2012. The mark to market value of \$240,785 has been recorded in current assets as at March 31, 2010.

Subsequent to March 31, 2010 the Corporation entered into additional financial instruments.

RELATED PARTY TRANSACTIONS

The Corporation entered into transactions with the following related parties:

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

Three months ended March 31 (\$ thousands)	2010	2009
Expenses		
Legal Consulting – Borden Ladner Gervais LLP	77	145
	77	145
Other		
Recorded as part of oil and gas properties – Borden Ladner Gervais LLP	24	-
	24	-

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

SUBSEQUENT EVENTS

- (a) Subsequent to March 31, 2010, the Corporation entered into the following financial commodity contract, which in effect offsets a “Sell” contract in place at March 31, 2010:

Contract Type	Price	Volumes per day	Contract Term
Financial	Buy \$0.39 basis per mmbtu	12,000 mmbtu	April 1, 2010 to October 31, 2010

- (b) Subsequent to March 31, 2010, the Corporation entered into a foreign exchange contract to sell \$7 million USD at an exchange rate of 1.0152 until May, 2011.

OUTLOOK

In light of the changing market conditions and increased competition in our industry, the Company is confident in the strategies that it is pursuing. Focusing on resource plays and slowly shifting the balance of production over time in our conventional business closer towards a long term target of 50%-50% in our oil to gas ratio, are strategies that will ensure success for the Company in years to come. The Asset Exchange Agreement, which was announced by the Company during the first quarter of 2010, was a significant step in this direction. This transaction was the result of many months of intense negotiation with an industry partner. The decision by the Company to swap one resource style play in return for increasing the overall size of our Montney play has resulted in Terra Energy being one of the dominant land owners in the Montney Fairway in northeastern British Columbia. This transaction was followed by the announcement of a farm-in deal with another industry partner involving ten more prospective sections of Montney lands. In addition, the Company continues to seek out new opportunities to enhance its position in the unconventional Montney gas play.

From an operations standpoint, the first quarter drilling activity resulted in conventional production being maintained at the 7,100 plus boed level. More importantly, the Company did experience reasonable success with the first two unconventional Montney wells which were drilled and completed with an industry partner in the Groundbirch area of northeast British Columbia. These wells tested initial production rates in the 6 Million to 7 Million Mcf per day range, rates which are well in excess of those targeted in the Company’s economic model for Montney wells. The Company has also succeeded in drilling its first 100% horizontal well. This horizontal well is located in the Altares area of northeast British Columbia, where the Company has over 17 net sections of undeveloped land. The completion of this 100% horizontal well is expected to take place during the month of June after road bans are lifted in the area, and will be released as soon as practical. It is hoped that this horizontal well and other operations taking place in the Altares area this year will position the Company to move forward on full commercial development.

Notwithstanding the current downward trend in natural gas prices, the Company is utilizing every opportunity to increase its strength this year. The main objective for the Company is to advance the unconventional Montney gas play where the Company owns more than 100 net sections of land in the prospective Montney Fairway and a total of more than one half million net acres of undeveloped land. It is expected that achieving this objective will result in an increase in the overall reserves of the Company, the preparation of a resource study for part or parts of this play, the commercial development of the Groundbirch field, the advancement of the Altares field to commercial development stage, and the necessary work involved in advancing infrastructure development associated with all of the above. A secondary objective

will be to continue our search for an oil resource play or plays for future development. Other objectives include taking advantage of market opportunities to strengthen and enhance the Company's asset base given the current market conditions and numerous asset packages which are becoming available.

In the weeks and months to come, the Company hopes to report on its progress towards achieving many of these objectives. The success of the Company will be a function of how well the Company embraces science and technology, and how strong the Company's engineering and geotechnical teams prove to be. The Company continues to both build its internal strengths in this regard and to build relations with partners in industry who have demonstrated capabilities. The Company remains confident in its ability to compete in the changing landscape of our industry and to be a low-cost producer. The Company also remains confident that natural gas prices in North America will recover to more sustainable levels. Natural gas is the solution to many of our energy needs, and as such gas-weighted producers such as Terra Energy have much to be optimistic about.

SIGNIFICANT ACCOUNTING POLICIES

International Financial Reporting Standards ("IFRS")

In February 2008, the CICA's Accounting Standards Board confirmed that IFRS will replace Canadian GAAP in 2011 for profit oriented Canadian publicly accountable enterprises. Terra Energy will be required to report its results in accordance with IFRS beginning in 2011. The Corporation has developed a changeover plan to complete the transition to IFRS by January 1, 2011 including the preparation of required comparative information.

The Corporation expects the transition to IFRS to impact accounting, financial reporting, internal control over financial reporting, taxes, information systems and processes as well as certain contractual arrangements. The Corporation continues to evaluate the impact of the new standards with detailed assessment being performed in those areas expected to have a significant impact on the consolidated financial statements. The corporation has deployed resources, project management practices and governance to ensure timely conversion to IFRS.

Key Activity	Target Completion Date	Progress to March 31, 2010
Project Team Governance Project Team	Q1 2009	Project team has been formed to manage changeover plan and provide quarterly reports to Audit Committee. External advisors have been retained to assist management.
Financial Statement Preparation Identification of differences in policies Selection of IFRS policies Selection of IFRS I accounting policy choice Quantification of IFRS I disclosures for 2010 Financial statement format Changes in note disclosure	Q4 2010	Significant Canadian and IFRS differences have been identified. Criteria for accounting policy selection has been established. Cash Generating Units (CGU) defined IFRS I policy selections have been reviewed and recommendations are in progress. In progress In progress In progress
Information Technology System changes to support IFRS requirements	Q2 2010	Reviewed key accounting and other reporting systems. Implementation of system update is in progress.
Internal Controls over Financial Reporting Assess changes to ICFR	Q4 2010	Design, implementation and testing are ongoing
Training and Communications Training key finance staff	Q2 2010	Resource requirements identified and initial training completed; in-depth training ongoing
Education of operations staff and Audit Committee	Q2 2010	Scheduled for Q2 2010
Education of external stakeholders	Q4 2010	Scheduled for Q4 2010

The significant areas of impact continue to include property, plant & equipment (“PP&E”), impairment testing, asset retirement obligation, stock-based compensation, business combinations and income taxes.

Property, Plant and Equipment

Under Canadian GAAP, Terra follows the CICA guideline on full cost accounting in which all costs directly associated with the acquisition of, the exploration for, and the development of natural and crude oil reserves are capitalized on a country-by-country basis. Upon transition to IFRS, Terra will be required to adopt new accounting policies for upstream activities, including pre-exploration costs, exploration and evaluation costs and development costs.

Pre-exploration costs are those expenditures incurred prior to obtaining the legal right to explore and must be expensed under IFRS. Currently, Terra capitalizes and depletes pre-exploration costs.

Exploration and evaluation costs are those expenditures for an area or a project for which technical feasibility and commercial viability have not yet been determined. Under IFRS, Terra will initially capitalize these costs as Exploration and Evaluation assets on the balance sheet. When the area or project is determined to be technically feasible and commercially viable, the costs will be transferred to PP&E. Unrecoverable exploration and evaluation costs associated with an area or project will be expensed.

Development costs include those expenditures for areas or projects where technical feasibility and commercial viability has been determined. Under IFRS, Terra will continue to capitalize these costs within PP&E on the balance sheet.

IFRS requires the development costs to be depleted on a unit-of-production basis over a smaller production unit instead of the country cost centre level currently utilized under Canadian GAAP. Canadian GAAP requires proved reserves to be used for the depletion calculation. Under IFRS, Terra will have the option to calculate the depletion using the depletion base of either proved reserves or proved and probable reserves. Terra plans to use proved and probable reserves for the depletion calculation.

Under IFRS, upstream divestitures will generally result in a gain or loss recognized in net earnings. Under Canadian GAAP, proceeds of divestitures are normally deducted from the full cost pool without recognition of gain or loss unless the deduction would result in a change to depletion rate of 20 percent or greater, in which case a gain or loss is recorded.

Terra plans to adopt the IFRS I exemption, which allows the Corporation to deem its January 1, 2010 IFRS upstream asset costs to be equal to its Canadian GAAP historical upstream net book value. On January 1, 2010, the IFRS exploration and evaluation costs will be equal to the Canadian GAAP unproved properties balance and IFRS development costs will be equal to the full cost pool balance. Terra will allocate this upstream full cost pool to the underlying assets prorated using reserves volumes at January 1, 2010.

Asset Retirement Obligation

Under Canadian GAAP, asset retirement obligation (ARO) is measured as the estimated fair value of the retirement and decommissioning expenditures expected to be incurred. Existing liabilities are not re-measured using current discount rates. Under IFRS, ARO is measured as the best estimate of the expenditure to be incurred and requires use of current discount rates at each measurement date. Generally, the change in discount rates results in a balance being added to or deducted from PP&E.

As a result of Terra’s intended use of the IFRS I exemption for decommissioning liabilities, the Corporation is required to revalue its January 1, 2010 ARO balance and recognize the adjustment in retained earnings.

Impairment

Under Canadian GAAP, Terra is required to recognize an impairment loss if the carrying value exceeds the undiscounted cash flow from proved reserves for the country cost centre. If an impairment loss is to be recognized, it is then measured at the amount the carrying value exceeds the sum of the fair value of the proved and probable reserves and the costs of unproved properties.

Under IFRS, Terra is required to recognize an impairment loss if the carrying value exceeds the recoverable amount for a cash generating unit. Under IFRS, the recoverable amount is the higher of fair value less cost to sell and value in use. Impairment losses, other than goodwill, are reversed under IFRS when there is an increase in the recoverable amount. A cash generating unit is defined as the smallest identifiable asset or group of assets that generate largely independent cash flows. Terra has identified two CGUs. This could change as the corporation continues its growth.

Stock Based Compensation

IFRS 2 Stock Based Compensation requires for options given to employees to be fair valued using a model such as the Black-Scholes-Merton model. IFRS also requires the use of an estimated forfeiture rate. Under Canadian GAAP, Terra currently uses actual forfeiture rate in calculating fair value.

Terra intends to use the IFRS 1 exemption under which stock options vested prior to January 1, 2010 are not required to be restated.

Business Combinations

Under IFRS 3 Business Combinations, the determination of fair value of share consideration differs from the determination under current Canadian GAAP. Any difference in fair value calculation would have a resulting impact on the carrying amount of net assets acquired, non-controlling interest and any goodwill. The Corporation plans to make the election under IFRS 1, to be exempt from restating business combinations prior to the transition date to IFRS.

Income Taxes

The Corporation expects the treatment of flow-through shares to be different under IFRS. Terra continues to assess the impact that IFRS income tax principles may have on the Corporation.

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 the Canadian Securities Administrator's 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. 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 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.

The most recently completed oil and gas reserve estimate was completed as at December 31, 2009 and on that basis, the undiscounted future development costs associated with proved reserves is approximately \$21.3 million compared to \$401.1 million in expected cash flow. Estimated future development costs for probable reserves is \$32.3 million compared to \$237.8 million in expected cash flow. In either event, estimated future development costs will be funded from the Corporation's unutilized credit facility or from cash flow from operations. The cost of funding estimated future

development costs will not make the development of a property uneconomic or have an impact on disclosed reserves or future cash flow from the production of proved reserves.

Ceiling Test

Under the Canadian Institute of Chartered Accountants (CICA) full cost accounting guidelines, the Corporation calculates a ceiling test at each reporting period whereby the carrying value of petroleum and natural gas properties is compared to estimated future cash flow from the production of proved reserves. If the future cash flows are lower than the carrying costs, the properties are written down to their fair value. Fair value is estimated using present value calculations, which incorporates risks and other uncertainties as well as the future value of reserves when determining estimated cash flows. These estimates are subject to measurement uncertainty and the impact on the financial statements could be material. Any impairment loss would be charged as an additional depletion and depreciation expense. For the purposes of interim financial statements, the Corporation has reviewed the carrying amount of its assets relative to their recoverable amount, and determined whether there are indications that events or circumstances may have caused an impairment since the end of the most recently completed fiscal year.

At March 31, 2010, the Corporation calculated the ceiling test using AcG 16 and considered the March 31, 2010 GLJ price forecast without any material adverse impact on the Corporation's financial position or results of operations. The following table outlines benchmark prices considered in the impairment test at April 1, 2010:

	WTI Crude Oil US\$/Bbl	Exchange Rate US\$/CDN\$	Edm Light Crude CDN\$/bbl	AECO Natural Gas CDN \$/GJ
2010	80.00	0.950	83.26	4.49
2011	83.00	0.950	86.42	5.26
2012	86.00	0.950	89.58	5.95
2013	89.00	0.950	92.74	6.42
2014	92.00	0.950	95.90	6.79
2015	93.84	0.950	97.84	7.05
After 2020 (inflation %)	2%/yr	0%/yr	2%/yr	2%/yr

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 favour, 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

The Corporation 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

To determine the charge for stock based compensation, the Corporation calculates the fair value of the options granted and share purchase warrants issued using assumptions regarding the life of the option, dividend yields, interest rates and volatility. The assumptions used could differ from actual fair value of the stock options at any time.

Income Taxes

The determination of the Corporation'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 despite 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. The Corporation can make no representations, warranties or guarantees 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.

Global Economic Conditions

Recent market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions, have caused significant volatility to commodity prices. These conditions began in 2008, continued in 2009 and still currently persist causing a loss of confidence in the broader U.S. and global credit and financial markets and which has resulted in the collapse of, and government intervention in, major banks, financial institutions and insurers and thereby creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding

various actions by governments to address the global financial crisis, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions continue to cause uncertainty both in the credit and capital markets. These factors may continue to negatively impact corporate valuations and may impact the performance of the global economy going forward. Petroleum prices are expected to remain volatile for the near future as a result of market uncertainties over the supply and demand of these commodities due to the current state of the world economies, OPEC actions and the ongoing global credit and liquidity concerns.

However, in 2009 and continuing into 2010 the Corporation significantly increased production volumes and maintained cash flows from operations. This, in combination with an \$80.0 million revolving line of credit which was drawn by \$37.7 million at March 31, 2010, gives the Corporation the financial flexibility to manage through these uncertain times.

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 the Corporation 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.

British Columbia Royalty Regime

Under the British Columbia royalty regime, a temporary 2% gas royalty program was introduced effective September 1, 2009 whereby all natural gas wells with a spud date after August 31, 2009 and before July 1, 2010 are eligible for the 2% gas royalty, for a 12 month period, provided they commence continuous production before December 31, 2010.

The Corporation's assets are located primarily in British Columbia, however, with the acquisition of the PRA assets, the Corporation has increased exposure to the new Alberta royalty regime. The new Alberta royalty regime and drilling credit program and the British Columbia royalty regime may have an impact on decisions that the Corporation will make in determining where to focus its drilling activities in the future.

Alberta Royalty Regime

Under the Alberta royalty regime, the Government implemented "The New Royalty Framework" (the "NRF") on October 25, 2008 with an effective date of January 1, 2009. On November 19, 2008, in response to the significant reduction in activity and the global economic crisis, the Government of Alberta announced that for wells that commenced drilling after this date companies can elect, on a well by well basis to either have the NRF apply to the

production from that well or have the old, pre-NRF rates apply for new wells between 1,000 and 3,500 meters in depth. This five-year transitional royalty system is designed to help stimulate drilling in Alberta.

On March 3, 2009, the Government of Alberta announced a three-point incentive program to stimulate new and continued economic activity in Alberta which included a drilling royalty credit for new conventional oil and natural gas wells and a new well royalty incentive program.

On June 25, 2009, the Government announced that the drilling royalty credit for qualifying wells and the new well incentive program would be extended by one year to March 2011.

On March 11, 2010, the Government of Alberta announced a plan to modify the current royalty framework for natural gas and conventional oil for all production effective January 1, 2011. Under the modified royalty framework, the maximum royalty rate will be reduced from the current levels of 50 percent to 40 percent for conventional oil and to 36 percent for natural gas, effective January 1, 2011. All royalty curves will be finalized and announced by May 31, 2010.

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 the Corporation'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.

Capital Markets

As a result of the weakened global economic situation, Terra Energy, along with all other oil and gas entities, may have restricted access to capital, bank debt and equity, and is likely to face increased borrowing costs. Although Terra Energy's business and asset base have not changed, the lending capacity of all financial institutions has diminished and risk premiums have increased. As future capital expenditures will be financed out of funds generated from operations, borrowings and possible future equity sales, Terra Energy's ability to do so is dependent on, among other factors, the

overall state of capital markets and investor appetite for investments in the energy industry and Terra Energy's securities in particular.

To the extent that external sources of capital become limited or unavailable or available on onerous terms, Terra Energy's ability to make capital investments and maintain existing assets may be impaired, and its assets, liabilities, business, financial condition and results of operations may be materially and adversely affected as a result.

Based on current funds available and expected funds generated from operations, Terra Energy believes it has sufficient funds available to fund its projected capital expenditures. However, if funds generated from operations are lower than expected or capital costs for these projects exceed current estimates, or if Terra Energy incurs major unanticipated expenses related to development or maintenance of its existing properties, it may be required to seek additional capital to maintain its capital expenditures at planned levels. Failure to obtain any financing necessary for Terra Energy's capital expenditure plans may result in a delay in development or production on Terra Energy's properties.

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 labour 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

The Corporation's 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 are 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 "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. 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 Petroleum Consultants Ltd. ("GLJ"), the independent reserves evaluator, has prepared a report effective December 31, 2009 (the "GLJ Report") using 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, the Corporation 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 Alberta Business Corporations Act.

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. An inability of the Corporation to deal with this growth could have a material adverse impact on its business, operations and prospects.

Permits and Licenses

The operations of Terra Energy may require licenses and permits from various governmental authorities. There can be no assurance that Terra Energy will be able to obtain all necessary licenses 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 effect 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 affected by the Canadian/U.S. dollar exchange rate, which will fluctuate over time. In recent years, the Canadian dollar has fluctuated materially in value against the United States dollar. Such fluctuations in the value of the Canadian dollar have materially impacted Terra Energy's operating entities production revenues. Further material fluctuations in the value of the Canadian dollar could exacerbate this impact. This fluctuation 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 material 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.

Climate Change

In December 2009, the United Nations Climate Change Conference was held in Copenhagen and resulted in the Copenhagen Accord, which contains international principles, objectives and funding commitments, but no legally binding emissions reductions targets. Canada has since filed documents with the United Nations pursuant to the Copenhagen Accord setting a domestic greenhouse gas emissions reductions target of 17% below 2005 levels by 2020, in line with U.S. domestic targets. 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 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.

In British Columbia, a carbon tax was introduced in 2008 that applied to virtually all hydrocarbon-based fuels. The tax applies to all emissions of greenhouse gases and to the purchase and use of hydrocarbons used as fuels. The tax starts at a rate of \$10 per tonne of carbon greenhouse emissions, and is increasing by \$5 per tonne each year until 2012.

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 possible to predict the final form these requirements will take or the impact on Terra Energy and its operations and financial condition at this time.

Conflicts of Interest

Directors and officers of Terra Energy may also be 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.

Dilution

Terra Energy may make future acquisitions or enter into financings or other transactions involving the issuance of securities of Terra Energy which may be dilutive.

Project Risks

Terra Energy will manage a variety of small and large projects in the conduct of its business. Project delays may delay expected revenues from operations. Significant project cost over-runs could make a project uneconomic. Terra's ability to execute projects and market oil and natural gas will depend upon numerous factors beyond Terra's control, including:

- the availability of processing capacity;
- the availability and proximity of pipeline capacity;
- the availability of storage capacity;
- the supply of and demand for oil and natural gas;
- the availability of alternative fuel sources;
- the effects of inclement weather;
- the availability of drilling and related equipment;
- unexpected cost increases;
- accidental events;
- currency fluctuations;
- changes in regulations;
- the availability and productivity of skilled labour; and
- the regulation of the oil and natural gas industry by various levels of government and governmental agencies.

Because of these factors, Terra Energy could be unable to execute projects on time, on budget or at all, and may not be able to effectively market the oil and natural gas that it produces.