FORM 51-102F4

BUSINESS ACQUISITION REPORT

ITEM 1 IDENTITY OF COMPANY

1.1 Name and Address of Company

Fortis Inc. ("Fortis" or the "Corporation")
Suite 1201, 139 Water Street
St. John's, Newfoundland and Labrador A1B 3T2

1.2 Executive Officer

The following senior officer of Fortis is knowledgeable about the significant acquisition and this report:

Barry V. Perry
Vice President, Finance and Chief Financial Officer
(709) 737-2800

ITEM 2 DETAILS OF ACQUISITION

2.1 Nature of Business Acquired

Terasen Inc. ("Terasen") is a holding company headquartered in Vancouver, British Columbia with subsidiaries carrying on the business of natural gas distribution in British Columbia. The natural gas distribution business of Terasen is one of the largest in Canada. With more than 900,000 customers in 125 communities, Terasen's subsidiaries provide service to over 95% of gas users in British Columbia in a service area extending from Vancouver to the Fraser Valley, the interior of British Columbia, the area along the Sunshine Coast, as well as Whistler, Squamish and Vancouver Island. Prior to the closing of the Acquisition, Terasen divested itself of the petroleum transportation operations that were formerly part of its business, leaving only the natural gas distribution business operated by Terasen Gas (as defined below) (the "Pre-Closing Reorganization").

The natural gas distribution business of Terasen is carried on by Terasen Gas Inc. ("TGI"), Terasen Gas (Vancouver Island) Inc. ("TGVI") and Terasen Gas (Whistler) Inc. ("TGWI"). Terasen also owns a 30% interest in CustomerWorks Limited Partnership ("CWP"). CWP is a non-regulated shared services business operated in partnership with Enbridge Inc. ("Enbridge") that provides customer service contact, meter reading, billing, support and credit and collection services primarily to Terasen Gas (as defined below) and Enbridge Gas Distribution Inc. ("Enbridge Gas"). CWP outsources these services to a company owned and operated by Accenture Inc. ("Accenture"). In this Business Acquisition Report ("BAR"), TGI, TGVI, TGWI and CWP are collectively referred to as "Terasen Gas".

A detailed description of the business of Terasen is set out in Schedule A hereto.

2.2 Date of Acquisition

May 17, 2007.

2.3 Consideration

On May 17, 2007, Fortis completed the acquisition (the "Acquisition") of all of the issued and outstanding shares of Terasen, formerly a wholly owned subsidiary of Kinder Morgan, Inc. ("Kinder Morgan"), for aggregate consideration of $3.7 billion, consisting of approximately $1.24 billion of cash (the "Cash Purchase Price") and the assumption of approximately $2.46 billion of consolidated indebtedness of Terasen.

Fortis financed a significant portion of the Cash Purchase Price for the Acquisition through the public offering of 44,275,000 subscription receipts (the "Subscription Receipts") for gross proceeds of $1,151,150,000, which was completed on March 15, 2007. Upon the closing of the Acquisition on May 17, 2007, the Subscription Receipts were automatically exchanged into common shares ("Common Shares") of Fortis and the holders of Subscription Receipts received, without payment of additional consideration, one Common Share for each Subscription Receipt plus an amount equal to $0.21 per Subscription Receipt, representing the equivalent of the second-quarter dividend declared on the Common Shares by Fortis. Fortis financed the remainder of the Cash Purchase Price for the Acquisition by drawing approximately $125 million from its existing credit facilities.

2.4 Effect on Financial Position

Fortis does not have any current plans for material changes in its business affairs or the affairs of Terasen which may have a significant effect on the results of operations and financial position of Fortis.

2.5 Prior Valuations

Not applicable.

2.6 Parties to Transaction

The Acquisition was not a transaction with an informed person, associate or affiliate of Fortis (as such terms are defined in National Instrument 51-102 – *Continuous Disclosure Obligations*).

2.7 Date of Report

June 13, 2007.

ITEM 3 FINANCIAL STATEMENTS

The following financial statements and Management's Discussion and Analysis are included as schedules to this BAR:

Schedule B

Audited consolidated financial statements of Terasen as at December 31, 2006 and December 31, 2005, together with the Auditors' Report to the Shareholder

Schedule C

Unaudited interim consolidated financial statements of Terasen for the three months ended March 31, 2007

Schedule D

Unaudited *pro forma* consolidated financial statements of Fortis as at March 31, 2007 and for the three months ended March 31, 2007 and the year ended December 31, 2006

Schedule E

Management's Discussion and Analysis of Terasen for the year ended December 31, 2006

Schedule F

Interim Management's Discussion and Analysis of Terasen for the three months ended March 31, 2007

DATED this 13th day of June, 2007.

by (Signed) *Barry V. Perry*

Barry V. Perry
Vice President, Finance
and Chief Financial Officer

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The BAR contains forward-looking statements which reflect management's expectations regarding the future growth, results of operations, performance, and business prospects and opportunities of Fortis Inc. Wherever possible, words such as "anticipate", "believe", "expect", "intend" and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk, uncertainties and assumptions. A number of factors could cause actual results, performance or achievements to differ materially from the results discussed or implied in the forward-looking statements. These factors should be considered carefully and prospective investors should not place undue reliance on the forward-looking statements. Although the forward-looking statements contained in the BAR are based upon what management believes to be reasonable assumptions, the Corporation cannot assure prospective purchasers that actual results will be consistent with these forward-looking statements. These forward-looking statements are made as of the date of the BAR, and the Corporation assumes no obligation to update or revise them to reflect new events or circumstances.

SCHEDULE A

THE ACQUIRED BUSINESSES

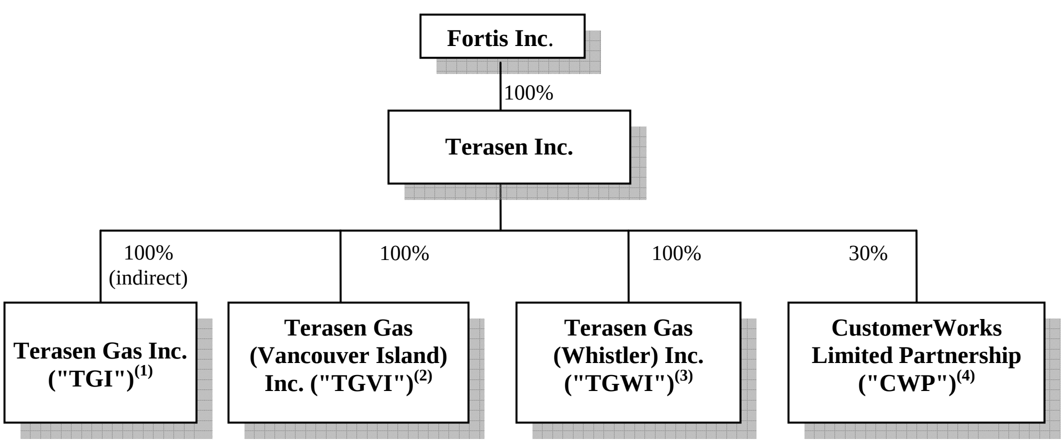
Terasen Inc.

Terasen is a holding company headquartered in Vancouver, British Columbia operating the business of natural gas distribution. Terasen was incorporated on August 15, 1985 under the *Company Act* (British Columbia), a predecessor to the *Business Corporations Act* (British Columbia). On April 25, 2003, its name was changed from BC Gas Inc. to Terasen Inc. Terasen has approximately 20 employees principally involved with finance, tax and legal matters. For further information on Terasen, reference is made to the audited consolidated financial statements of Terasen for the years ended December 31, 2006 and 2005 and related Management Discussion and Analysis of financial condition and results of operations, and the unaudited consolidated financial statements of Terasen for the three months ended March 31, 2007 and March 31, 2006 and related Management Discussion and Analysis of financial condition and results of operations, which are included in this BAR.

As part of the Pre-Closing Reorganization, Terasen Inc. was required to divest its petroleum transportation assets. In connection with this divestiture, on February 16, 2007 Terasen Inc. amalgamated with Terasen Pipelines (Trans Mountain) Inc., formerly a wholly owned subsidiary of Terasen Inc., and 0731297 BC Ltd., a holding company that was formerly the direct parent of Terasen Inc., with the amalgamated corporation continuing under the name "Terasen Inc.". It is the amalgamated corporation that is represented in the Terasen Inc. unaudited interim consolidated financial statements as at March 31, 2007 and for the three months ended March 31, 2007 and 2006. Post-amalgamation, Terasen Inc. continues to own the gas distribution business operated by Terasen Gas.

As a result of this amalgamation, the Terasen Inc. consolidated financial statements as at December 31, 2006 and for the years ended December 31, 2006 and 2005 do not reflect the same entity as, and are not directly comparable with, the unaudited interim consolidated financial statements as at March 31, 2007 and for the three months ended March 31, 2007 and 2006 that relate to the amalgamated corporation. The effect of the amalgamation is described in greater detail in note 1 of the Terasen Inc. unaudited interim consolidated financial statements on page C-6 of Schedule C hereto, and in note 2[o] to the Fortis *pro forma* financial statements on page D-9 of Schedule D hereto.

The chart below sets out the material subsidiaries of Terasen following the closing of the Acquisition.



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(1) Terasen Gas Inc. provides gas distribution services to approximately 735,000 residential and 82,000 commercial and industrial customers in a service area extending from Vancouver to the Fraser Valley and the interior of British Columbia.

(2) Terasen Gas (Vancouver Island) Inc. owns a combined distribution and transmission system and serves approximately 88,000 residential, commercial and industrial customers along the Sunshine Coast and in various communities on Vancouver Island, including Victoria and surrounding areas.

(3) Terasen Gas (Whistler) Inc. owns and operates the propane distribution system in the Whistler area of British Columbia and provides service to approximately 2,400 residential and commercial customers.

(4) CustomerWorks Limited Partnership is a non-regulated shared services business operated in partnership with Enbridge Inc. that provides customer service contact, meter reading, billing, credit, support and collection services primarily to the natural gas distribution operations of Terasen and Enbridge Gas Inc.

Terasen Gas Service Territory

Terasen Gas is one of the largest natural gas distribution businesses in Canada. With more than 900,000 customers in 125 communities, Terasen Gas provides service to over 95% of gas users in British Columbia. Its service area extends from Vancouver to the Fraser Valley, the interior of British Columbia, the area along the Sunshine Coast, as well as Whistler, Squamish and Vancouver Island.

Terasen Gas Inc.

TGI provides service to more than 100 communities in British Columbia with a service territory that has an estimated population of approximately 4,000,000. As at December 31, 2006, TGI and its subsidiaries transported and distributed natural gas to approximately 735,000 residential and 82,000 commercial and industrial customers, representing approximately 87% of the natural gas users in British Columbia. TGI's service area extends from Vancouver to the Fraser Valley and the interior of British Columbia. The transmission and distribution business is carried on under statutes and franchises or operating agreements granting the right to operate in the municipalities or areas served. TGI is regulated by the British Columbia Utilities Commission (the "BCUC"). The average rate base of TGI approved by the BCUC for 2007 is approximately $2,474 million.

TGI provides natural gas distribution services to residential, small commercial and industrial heating customers predominantly on a non-contractual basis, whereby the customers are charged based on general services provided. Larger commercial and industrial customers are normally provided with services on a contractual basis.

As of December 31, 2006, 18,700 commercial and industrial customers had arranged for some or all of their own gas supply and used TGI's transportation services for delivery. Notwithstanding shifts over time between utility supply and direct purchases, TGI's earnings remain unaffected since TGI's margins remain substantially the same whether or not customers choose to buy natural gas from TGI or arrange their own supply. Customers arranging for their own supply in fact reduce the credit risk to TGI. See "– Unbundling" below.

Of TGI's industrial customers, approximately 150 are on interruptible service. The majority of these customers are capable of switching to alternative fuels. Of the various industries that comprise TGI's industrial market, the pulp and paper and wood products industries combined comprise approximately 47% of total consumption. All other industries individually represent less than 10% of total consumption.

Gas Purchase Agreements

In order to acquire supply resources that ensure reliable natural gas deliveries to its customers, TGI purchases supply from a select list of producers, aggregators and marketers by adhering to strict standards of counterparty creditworthiness and contract execution/management procedures. TGI contracts for approximately 140 petajoules ("PJ") of baseload and seasonal supply, of which 95 PJ is delivered off the Spectra Energy Gas Transmission system (the "Spectra Pipeline System"), and 25 PJ is comprised of Alberta-sourced supply transported into British Columbia via the Alberta and British Columbia systems of TransCanada Pipelines Limited ("TransCanada"). The remaining 20 PJ of baseload and seasonal supply is sourced at Sumas, British Columbia. The majority of supply contracts in the current portfolio are one year in length or less, with the exception of one long-term contract expiring in October 2009. In order to recover its costs, TGI obtains approval, in advance of gas flow, from the BCUC for proposed supply agreements.

Peak Shaving Arrangements

TGI incorporates peak shaving and gas storage facilities into its portfolio to: (i) manage the load factor of baseload supply contracts throughout the year; (ii) eliminate the risk of supply shortages during a peak throughput day; (iii) reduce the cost of gas during winter months; (iv) balance daily supply and demand on the distribution system; and (v) supplement its baseload supply sources at times when the demand for natural gas is greatest. TGI's peak shaving and storage assets and contracts for 2007 include up to 30 PJ in storage capacity at various locations throughout British Columbia, Alberta and the Pacific Northwest United States. These facilities can deliver a maximum daily rate of approximately 585 terajoules ("TJ") on a combined basis.

Unbundling

Over the past several years, TGI, the BCUC and a number of interested parties have laid the groundwork for the introduction of natural gas commodity unbundling. As of November 1, 2004, commercial customers of TGI became eligible to sign up to buy their natural gas commodity supply directly from third-party suppliers. TGI continues to provide delivery of the natural gas. Approximately 79,000 commercial customers are eligible to participate in commodity unbundling.

On August 14, 2006, the BCUC released a decision to open a portion of British Columbia's residential natural gas market to competition, allowing homeowners to sign long-term fixed-price contracts for natural gas with companies other than TGI. The BCUC decision was released in response to a proposal from TGI filed with the BCUC on April 18, 2006 and following several weeks of public hearings and submissions from TGI, natural gas marketers and stakeholders. Effective May 2007, as a result of the BCUC decision, independent marketing companies, known as gas marketers, are allowed to offer long-term, fixed-price contracts for natural gas for a period of time ranging from one year to five years. TGI continues to deliver the gas to the final consumer, charge for delivery and provide all billing and other services to all customers.

The choice of natural gas suppliers is only available to TGI's residential customers in the Lower Mainland and the interior of British Columbia. It is not available on Vancouver Island, the Sunshine Coast, Powell River or Whistler. The opening of a portion of British Columbia's residential natural gas market to competition does not affect TGI's earnings since TGI's margins remain substantially the same whether or not customers choose to buy natural gas from TGI or arrange their own supply.

Transmission Services

TGI serves Greater Vancouver and the Fraser Valley through a transmission and distribution system that connects to the Spectra Pipeline System near Huntingdon, British Columbia. This transmission system also supplies gas to TGVI for delivery to the Sunshine Coast, Vancouver Island and Squamish, British Columbia. In addition, TGI is connected at Huntingdon to Northwest Pipeline to facilitate gas movement both north and south.

In the interior of British Columbia, TGI serves municipalities with numerous connections to the Spectra Pipeline System. Communities in the East Kootenay region of British Columbia are served through connections with the British Columbia system of TransCanada. TGI is connected to TransCanada's British Columbia system through TGI's Southern Crossing Pipeline between Yahk and Oliver. TGI also operates a propane distribution system in Revelstoke, British Columbia.

In addition, TGI provides high-pressure transmission services to customers, such as TGVI, which moves natural gas from the Spectra Pipeline System or the TransCanada system across TGI's system to customers' own facilities. Transportation tolls on the Spectra Pipeline System and the TransCanada system are regulated by the National Energy Board. TGI pays both fixed and variable charges for use of the pipelines, which are recovered through rates paid by TGI's customers.

Properties

As of December 31, 2006, TGI owned approximately 2,400 kilometers of natural gas transmission pipelines and approximately 36,400 kilometers of natural gas distribution pipelines. In addition to the pipelines, TGI owns properties and equipment utilized for service shops, warehouses, metering and regulating stations, as well as its main operations center in Surrey, British Columbia.

Title to Properties

TGI's pipelines are constructed for the most part under highways and streets pursuant to permits or orders from the appropriate authorities, franchise or operating agreements entered into with municipalities and rights-of-way held directly or jointly with British Columbia Hydro & Power Authority ("BC Hydro"). Compressor stations and major regulator stations are located on freehold land, rights-of-way owned by TGI or properties shared with BC Hydro.

Franchise and Operating Agreements

TGI currently holds franchise or operating agreements with most of the incorporated municipalities in which it distributes gas in the Greater Vancouver and Fraser Valley service areas, other than Richmond, British Columbia, and with most of the incorporated municipalities in which it distributes gas in the interior of British Columbia. TGI has the right to serve all end users within its franchise area pursuant to these operating agreements. The terms of the operating agreements range from 10 years to 21 years, where fixed, and otherwise will only end upon agreement by both parties to terminate the agreement.

Historically, approximately one quarter of the franchise agreements relating to the interior of British Columbia contained a provision enabling the municipality to purchase the distribution system at the end of the term of the agreement. Some of these agreements have expired and TGI has negotiated or is currently negotiating renewals and extensions of others whereby TGI enters into an arrangement whereby the relevant municipality leases TGI's gas distribution assets within the municipality's boundaries for a term of 35 years for an initial cash payment paid by the municipality to TGI. TGI, in turn, enters into a 17-year operating lease with the municipality whereby TGI operates the gas distribution assets and has the option to terminate the lease of the assets to the municipality at the end of the 17-year term in exchange for a payment to the municipality equal to the unamortized portion of prepaid rent initially paid by the municipality. As at December 31, 2006, TGI had entered into such arrangements having a total value of approximately $153 million.

Capital Program

The 2007 revenue requirements approved by the BCUC for TGI include annual capital expenditures of $129.7 million. Capital expenditures relating to customer growth represent approximately 22% of the annual capital budget forecast, while the remaining amount relates to capital betterments, replacements and life extensions.

Operations

As part of its multi-year Performance-Based Rate ("PBR") agreement, TGI is required to meet several service quality targets. These target measures include indicators such as emergency response time, speed of answering calls, system integrity, customer satisfaction, meter exchange appointment activity, number of customer complaints to the BCUC and number of prior period adjustments. TGI's operations meet or exceed these target measures.

Environment

In order to minimize impacts from its operations, TGI has developed an Environmental Management System based on a framework, purposes and objectives so as to be compliant with the International Standard ISO 14001. TGI's operations meet or exceed legislative standards and environmental protection requirements.

TGI is an active participant in Canada's Voluntary Climate Change Challenge and Registry ("VCR") and its successor, the Canadian GHG Challenge Registry. For seven consecutive years, TGI has received gold-level reporting status in recognition of its efforts to manage and reduce greenhouse gas emissions. TGI received the VCR Leadership Award in 2001 and 2003, the only company in its sector to have received this award twice. The VCR ranking acknowledges TGI's efforts to develop specific measures and voluntarily set reduction targets.

Employees

As at March 31, 2007, TGI had approximately 1,100 full-time equivalent employees. Its organized employees are represented by the Canadian Office and Professional Employees Union ("COPEU") and the International Brotherhood of Electrical Workers ("IBEW"). The collective agreement with IBEW expires on March 31, 2011. The collective agreement with COPEU expired on

March 31, 2007. TGI and COPEU have recently reached a new tentative five-year agreement, subject to ratification by the union membership in June 2007.

Tax Assessment

TGI has received a Notice of Assessment dated July 31, 2006 from the British Columbia Social Service Tax authority (the "BC Tax Authority") for the payment of $37.1 million of additional provincial sales tax and interest on the Southern Crossing Pipeline which was completed in 2000 (the "Assessment"). In October 2006, TGI made a payment of $10 million pending its appeal of the Assessment as a good faith payment to forestall an order from the BC Tax Authority to provide full payment or security. On October 26, 2006, TGI filed an objection to the Assessment with the BC Tax Authority. The BCUC has allowed TGI regulatory deferral account treatment of the $10 million payment pending resolution of TGI's objection to the Assessment. On March 26, 2007, the British Columbia Minister of Small Business and Revenue and Minister Responsible for Regulatory Reform (the "Minister") issued a decision reducing the amount of the Assessment to $7 million including interest. The *Social Service Tax Act* (British Columbia) allows for a further appeal to the courts that must be commenced within 90 days of the Minister's decision. TGI is reviewing its options with respect to the appeal process.

Terasen Gas (Vancouver Island) Inc.

TGVI owns and operates the natural gas transmission pipeline from the Greater Vancouver area across the Georgia Strait to Vancouver Island and the distribution system on Vancouver Island and along the Sunshine Coast of British Columbia. TGVI is supported by the Vancouver Island Natural Gas Pipeline Agreement ("VINGPA"), as discussed in more detail below.

TGVI and its predecessor companies have been operating for almost 15 years. Its combined system consists of approximately 615 kilometers of natural gas transmission pipelines and 3,250 kilometers of distribution mains. The combined system has a designed throughput capacity of 144 million cubic feet per day (155 TJ per day). TGVI serves approximately 88,000 residential, commercial and industrial customers along the Sunshine Coast and in various communities on Vancouver Island including Victoria and surrounding areas. TGVI's largest customers are the Vancouver Island Gas Joint Venture, representing seven large pulp and paper mills on Vancouver Island and the Sunshine Coast, and BC Hydro's contracted gas-fired electricity cogeneration facility at Elk Falls, Vancouver Island. During 2006, TGVI delivered approximately 27.7 PJ of gas through its system. The average rate base of TGVI approved by the BCUC for 2007 is approximately $482 million.

TGVI's natural gas supply is transported through TGI's pipeline system. All natural gas flows to TGVI are from this single source on the mainland and are dependent on the use of two undersea high-pressure transmission pipes.

Vancouver Island Natural Gas Pipeline Agreement

The transmission line to Vancouver Island and the distribution systems on Vancouver Island that are currently owned by TGVI were originally constructed between 1989 and 1991 with financial support, which included repayable contributions of an aggregate of $75 million, provided by the provincial and federal governments (the "Repayable Contributions"). In December 1995, the financial support arrangements with the governments were restructured under several agreements, including VINGPA which was entered into between the predecessors of Terasen and TGVI and the Province of British Columbia (the "Province").

Under VINGPA, which runs through to December 31, 2011, the Province has agreed to provide TGVI with financial support in the form of gas royalties on deemed volumes of natural gas transported through the Vancouver Island pipeline from 1996 through 2011, which decreases the cost of purchased gas by approximately 40%. The royalty payment recognized in 2006 was approximately $36.3 million.

In turn, under VINGPA, Terasen is required to provide financial support of up to $120 million over the period from 1996 to 2011 to finance the principal amount of the revenue deficiencies incurred by TGVI. Annual revenue deficiencies are calculated as the difference between the approved cost of service and revenue actually received. This funding can be by way of subscription for Class A Instruments (redeemable preferred shares of TGVI) or Class B Instruments (promissory notes issued by TGVI) ("Class B Instruments"), as determined by the BCUC.

Prior to 2003, rates charged by TGVI to its customers were insufficient to recover the cost of service of TGVI in aggregate, meaning that revenues from the sale and transportation of natural gas resulted in an annual revenue deficiency. Terasen and TGVI's former shareholder funded these annual revenue deficiencies in accordance with VINGPA. The aggregate of the annual revenue deficiencies was funded with Class B Instruments bearing interest at a rate of 275 basis points over the applicable five-year Canada bond rate. The accumulated revenue deficiency resulting from overall revenues being below the cost of service has been recorded in a Revenue Deficiency Deferral Account ("RDDA"). Since 2003, the aggregate annual revenues have exceeded the full cost of service and therefore TGVI has been in a revenue surplus position. The revenue surplus is used, in part, to pay down the RDDA balance as well as to pay the interest on the Class B Instruments described above. The BCUC has been directed to include in the cost of service an amount to amortize the RDDA balance over the shortest period reasonably possible, having regard to competitive energy sources and the desirability of rates. As at December 31, 2006, TGVI had issued and outstanding approximately $48.7 million of Class B Instruments.

As part of the December 1995 restructuring discussed above and concurrently with the entering into of VINGPA, the predecessor to TGVI entered into the Pacific Coast Energy Pipeline Agreement (the "PCEPA") with the Government of Canada and the Province, which set out the mechanism for the repayment of the $75 million Repayable Contributions owed to the federal and provincial governments. The PCEPA provides for scheduled repayments but also contemplates earlier non-scheduled prepayments in certain circumstances. Repayments on the $75 million Repayable Contributions go towards increasing the rate base on a dollar-for-dollar basis.

Vancouver Island Gas Joint Venture Transportation Agreement

TGVI provides gas transportation service to the seven pulp and paper mills under the long-term Vancouver Island Gas Joint Venture Transportation Service Agreement that was amended effective January 1, 2005 to extend it beyond the original renewal period by two years to December 31, 2012. The maximum daily volume of firm transportation service under the agreement was 20 TJ per day for 2005. In 2006, the maximum daily volume changed to 12.5 TJ per day and was subsequently reduced to 9.1 TJ per day on April 1, 2007 for the remainder of the renewal period. The committed volume can be reduced to 8 TJ on 12 months' notice at any time.

Contractual Arrangements

TGVI has entered into a firm transportation agreement with BC Hydro to serve BC Hydro's gas supply needs at a gas-fired cogeneration plant at Elk Falls, Vancouver Island. The agreement, for 45 TJ per day, expires on December 31, 2007. BC Hydro has an option to extend the agreement for one year. BC Hydro has indicated that it is considering changing the Elk Falls facility from a baseload facility to a dispatchable facility, which will change the transportation agreement from firm to interruptible. Accordingly, there is no certainty with respect to the terms under which the firm transportation agreement with BC Hydro may be extended beyond 2007. Failure to extend the agreement will result in a reduction in TGVI's transportation revenues of approximately $13 million, which would be expected to be recovered through increased rates approved by the BCUC.

On February 16, 2005, the BCUC approved the construction by TGVI of a $100 million liquid natural gas storage facility, subject to several conditions including the execution of a long-term Transportation Service Agreement with BC Hydro backed by the capacity demand requirements of the Duke Point generation project. On June 17, 2005, BC Hydro announced its intention to abandon the Duke Point generation project on Vancouver Island as a result of a continuing appeal process. As a result, the expected construction timeline for TGVI's proposed storage facility has been delayed and, pending re-evaluation, will require BCUC approval prior to proceeding.

Gas Purchase Agreements

In order to acquire effective supply resources that ensure reliable natural gas deliveries to its customers, TGVI purchases supply from a select list of producers, aggregators and marketers by adhering to strict standards of counterparty credit worthiness and contract execution/management procedures. TGVI contracted for approximately 38 TJ per day of seasonal supply to meet load during the months from November 2006 to March 2007. TGVI further contracted 9.5 TJ per day of seasonal supply to meet the higher loads during the winter months from December 2006 to February 2007. Fifteen TJ per day of supply is contracted to meet the load requirement during summer from April 2007 to October 2007. The supply contracts in the current portfolio are for one season in length, i.e., either November to March for winter supply or April to October for summer supply.

TGVI Liquefied Natural Gas Facility

On June 5, 2007, TGVI filed an application with the BCUC seeking approval to construct and operate a natural gas storage facility on Vancouver Island, British Columbia, estimated to cost between $175 million and $200 million. The proposed storage facility will help Terasen Gas meet current and future gas demands, both on Vancouver Island and across the Lower Mainland of British Columbia by storing liquefied natural gas. The natural gas storage facility, if approved by the BCUC, is expected to come into service by late 2011.

Capital Program

TGVI's capital projects for the upcoming years are primarily associated with the expansion of the distribution system and the addition of new customers. The capital expenditures are expected to increase the rate base and expand the customer base. The 2007 revenue requirements approved by the BCUC for TGVI include capital expenditures of $53.7 million, which include $20.8 million for the Whistler pipeline. The capital expenditures relating to customer growth on Vancouver Island represent approximately 9.1% of the capital budget for 2007, while the remaining amount relates to system expansion, capital betterments, replacements and life extensions.

On June 28, 2006, TGVI and TGWI received final approval from the BCUC to extend natural gas service to Whistler. Under the proposed arrangements, TGVI will extend its transmission system to serve TGWI by the construction of a 50-kilometer pipeline lateral from Squamish to Whistler. It is expected that the pipeline will cost $42.8 million and TGVI's contribution to the pipeline costs, including system conversion, will be approximately $20.8 million. TGWI will pay the remainder of the costs of the pipeline.

Employees

As at March 31, 2007, TGVI had approximately 105 full-time equivalent employees. Its organized employees are represented by COPEU and IBEW under the TGI Collective Agreements. See "Terasen Gas Inc. – Employees" above.

Terasen Gas (Whistler) Inc.

TGWI has owned and operated the propane distribution system at Whistler since 1987. TGWI provides service to approximately 2,400 residential and commercial customers in the Whistler area of British Columbia. TGWI owns and operates two propane storage and vaporization plants and approximately 130 kilometers of distribution pipelines serving customers in the Whistler area. The propane distribution system in Whistler has grown far beyond original expectations and beyond the size and scale of other similar propane distribution systems in British Columbia and Canada. Today, with annual deliveries exceeding 750,000 gigajoules, TGWI's propane system is unique in terms of the size of the customer base it serves and the scale of the facilities required by its continued operations. The average rate base of TGWI for 2006 was approximately $17.0 million.

On June 28, 2006, TGVI and TGWI received final approval from the BCUC to extend natural gas service to Whistler. Under the proposed arrangements, TGVI will extend its transmission system to serve TGWI by the construction of a 50-kilometer pipeline lateral from Squamish to Whistler and TGWI will convert its current piped propane system to natural gas. The pipeline, which is scheduled for completion in 2008 and will be co-ordinated with the current Sea-to-Sky Highway upgrade project, will allow TGWI to better service future demand. It is expected that the pipeline will cost $42.8 million and TGWI's contribution to the pipeline costs, including system conversion, will be approximately $22.0 million. TGVI will pay the remainder of the cost of the pipeline. Customer, management and operations services are provided to TGWI by TGI.

Non-Regulated – CustomerWorks Limited Partnership

CWP is a partnership between Terasen and Enbridge that provides shared customer services primarily to the companies' respective regulated operations, Terasen Gas and Enbridge Gas. Enbridge owns a 70% interest in CWP and Terasen owns a 30% interest.

The provision of services by CWP is governed by a customer service agreement dated January 1, 2002, as amended (the "Customer Service Agreement"). The Customer Service Agreement was initially entered into between BC Gas Utility Ltd. (the predecessor of TGI) and CWP and was subsequently amended, among other things, to provide for the outsourcing of the services by CWP to Accenture Business Services for Utilities Inc., a company indirectly owned and operated by Accenture, and to extend the provision of services to TGVI and TGWI. The Customer Service Agreement was entered into for a five-year term, renewable for additional one-year terms.

The services provided under the Customer Service Agreement include customer contact, meter reading, billing, support, and credit and collection services. The Customer Service Agreement has been approved by the BCUC. The rates under the Customer Service Agreement have both a fixed and service volume based component, include minimum service standards and penalties and are based on market prices. In providing these services, CWP uses a customer information services system under a licence from Enbridge Commercial Services, a subsidiary of Enbridge. During 2006, TGI paid approximately $44.6 million to CWP under the Customer Service Agreement.

Regulation

The Terasen Gas natural gas distribution system operates wholly within British Columbia. Gas utilities which operate wholly within British Columbia are subject to the regulatory jurisdiction of the BCUC which derives its powers from the *Utilities Commission Act* (British Columbia). In addition to approving the rate base and new financings of gas utilities, the BCUC also approves the rates charged to customers. These rates are designed to recover the utilities' costs of providing service and allow the opportunity to meet financial commitments and earn a reasonable and fair ROE. The BCUC has jurisdiction to regulate and approve the terms and conditions under which gas utilities provide service.

As part of the establishment of the rates that a gas utility charges its customers, the BCUC establishes a rate base, approves a capital structure with which to finance such rate base, and is responsible for setting a reasonable and fair rate of return on the debt and equity in the approved capital structure. Rate base is the aggregate of the depreciated cost of property, plant and equipment that is used or useful in serving the public, certain deferral accounts and a reasonable allowance for working capital. The fair rate of return is established by determining the cost of individual components of the capital structure, including return on equity ("ROE"), and weighting such costs to determine an aggregate rate of return on rate base. The rates that are established and the terms and conditions of service are contained in a schedule of published and public tariffs. Before any tariff can be put into effect, it must be filed with the BCUC. The BCUC has jurisdiction to approve or refuse any amendment submitted for filing and to determine the rates which should be charged by a utility for its services. The BCUC is required to have due regard, among other things, to fixing rates that are not unjust or unreasonable. In fixing rates the BCUC must determine that such rates reflect a fair and reasonable charge for service of the nature and quality furnished by the utility to its customers and that such rates are sufficient to yield the utility fair and reasonable compensation for its services and a fair and reasonable rate of return on its rate base.

The BCUC uses a future test year in the establishment of rates for a utility. Pursuant to this method, the BCUC forecasts the volume of gas that will be sold and transported, together with all of the costs of the utility (including the rate of return) that the utility will incur in the test year. Rates are fixed to permit the utility to collect all of its costs (including the rate of return) if the forecast sales and transportation volumes are achieved. The forecast sales volumes assume normal weather. Certain costs are fixed and will be incurred regardless of the actual volume of gas sold. Accordingly, if the actual volumes of gas sales are less than those forecast in the test year, the utility might not recover all of the fixed costs. Interest expense, taxes other than income taxes, depreciation and amortization, certain operations and maintenance costs, the portion of the cost of gas that is fixed, such as demand charges or reservation fees, and the fixed portion of transportation costs have the effect of being virtually fixed costs.

In addition to application for approval of interim and annual rate changes, the gas utilities may apply from time to time to the BCUC for rate changes to give effect to the changes in costs beyond the control of the utilities.

The table below summarizes regulatory information pertaining to decisions made by the BCUC with respect to TGI and TGVI.

	Regulated Values				
	2007[(1)]	2006	2005	2004	2003
TGI					
Rate base ($M)	2,474	2,447	2,406	2,310	2,281
Deemed common equity component of total capital structure (%)	35	35	33	33	33
Allowed ROE (%)	8.37	8.80	9.03	9.15	9.42
TGVI					
Rate base ($M)	482	467	453	441	437
Deemed common equity component of total capital structure (%)	40	40	35	35	35
Allowed ROE (%)	9.07	9.50	9.53	9.65	9.92

(1) As approved by the BCUC

Terasen Gas Inc.

TGI's allowed ROE is determined annually based on a formula that applies a risk premium to a forecast of long-term Government of Canada Bond yields. On June 30, 2005, TGI applied to the BCUC to increase the deemed equity components from 33% to 38%. The application also requested an increase in allowed ROEs from the levels that result from the then-current formula, which would have yielded 8.29% for TGI in 2006. The BCUC rendered its decision on the application on March 2, 2006, to be effective as of

January 1, 2006. The generic ROE formula for a benchmark utility in British Columbia was changed such that it will be reset annually from a forecast of 30-year Canada Bonds plus a 3.90% risk premium when the forecast yield on 30-year Government of Canada Bonds is 5.25%. The risk premium is adjusted annually by 75% of the difference between 5.25% and the forecast yield on 30-year Government of Canada Bonds. For 2007, the forecast 30-year Canada Bond yield is 4.22% resulting in an ROE for TGI of 8.37%. The deemed equity component of TGI's capital structure for 2007 is 35%.

Two mechanisms to mitigate unanticipated changes in costs and sales volumes, such as changes caused by weather, have been implemented specifically for TGI. The first relates to the recovery of all gas costs through deferral accounts which capture all variances (overages and shortfalls) from forecasts. Balances are either refunded to or recovered from customers as determined by the BCUC. The deferral accounts are called the Commodity Cost Reconciliation Account ("CCRA") and the Midstream Cost Reconciliation Account ("MCRA"). The second mechanism, called the Revenue Stabilization Adjustment Mechanism ("RSAM"), seeks to stabilize delivery revenues from residential and commercial customers through a deferral account that captures variances in the forecast-versus-actual customer use throughout the year. In February 2001, the BCUC issued guidelines for quarterly calculations to be prepared to determine whether customer rate adjustments are needed to reflect prevailing market prices for natural gas and to ensure that rate stabilization account balances are recovered on a timely basis. The balance in the RSAM account at December 31, 2006 was approximately $36 million and the BCUC has approved $11.5 million of this balance to be recovered in 2007 through a rate rider.

The RSAM and CCRA/MCRA accounts reduce TGI's earnings exposure to risks associated with volatility of gas costs and consumer demand. Variances in demand by large volume, industrial transportation customers are not covered by these deferral accounts as their usage is more predictable and less likely to be significantly affected by weather.

The net balances of the RSAM and CCRA/MCRA accounts increased to a receivable of approximately $142.8 million as at December 31, 2006 from a payable of approximately $9.0 million as at December 31, 2005. In order to ensure that the balances in the CCRA/MCRA accounts are recovered on a timely basis, TGI prepares and files quarterly calculations with the BCUC to determine whether customer rate adjustments are needed to reflect prevailing market prices for natural gas costs.

TGI also has in place deferral accounts to absorb short-term and long-term interest rate fluctuations. The interest rate deferral accounts which were in place during 2006 effectively fixed the interest expense on short-term funds attributable to TGI's regulated assets at 4.00% during 2006. The effective fixed short-term interest rate for 2007 has been set at 4.75%. Any variations from these rates throughout the year are recorded in deferral accounts and are subsequently either refunded to or recovered from customers as determined by the BCUC.

In 2003, TGI received BCUC approval of a Negotiated Settlement of a 2004-2007 PBR Plan (the "TGI Settlement"). The TGI Settlement, which took effect January 1, 2004, establishes a process for determining TGI's delivery charges and incentive mechanisms for improved operating efficiencies. The four-year agreement includes incentives for TGI to operate more efficiently through sharing of the benefits of cost reductions among TGI and its customers. It includes ten service quality indicators designed to ensure TGI provides appropriate service levels and sets out the requirements for an annual review process which will provide a forum for discussion between TGI and interested parties regarding TGI's current performance and future activities. In January 2007, TGI made application to the BCUC to extend the TGI Settlement to 2009, which was approved by the BCUC on March 23, 2007.

Operation and maintenance costs and base capital expenditures are subject to an incentive formula which permits recovery of increasing costs due to customer growth and inflation. Operating costs are subject to an adjustment factor based on 50% of inflation during the first two years and 66% of inflation during the last two years. Base capital expenditure amounts are a function of customer numbers and projected customer additions. During the annual review process, non-controllable expenses and extraordinary capital expenditures can be added to or subtracted from revenue requirements under the terms of the TGI Settlement.

The TGI Settlement provides for a 50/50 customer/shareholder sharing mechanism of earnings above or below the allowed ROE. When TGI's earned ROE is greater than 150 basis points above or below the allowed ROE for two consecutive years, the PBR mechanism may be reviewed. The following table sets out the allowed ROE, the earned ROE (before sharing) and the customer share under the sharing mechanism.

TGI Earned ROEs and Shared Earnings through PBR

	2006	2005	2004
Allowed ROE (%)	8.80	9.03	9.15
Earned ROE (%)	10.47	10.78	9.34
Customer share (pre-tax)($M)	10.7	10.5	1.1

Terasen Gas (Vancouver Island) Inc.

Pursuant to BCUC orders from 2003 onwards, TGVI's rates have been set so as to fully recover its cost of service plus an amount for the timely amortization of the RDDA in accordance with the government directives. To permit recovery of the outstanding balance in the RDDA, TGVI's rates for residential and commercial customers are set at levels in excess of TGVI's cost of service, but are effectively capped at a comparable price of competitive alternative fuels. TGVI renewed its regulatory settlement in late 2005 for a two-year period, effective January 1, 2006. It provides for a continuation of the operation and maintenance cost incentive arrangements previously in place. The allowed ROE for TGVI was 9.50% for 2006 compared to 9.53% in 2005. TGVI's ROE for 2007 has been set at 9.07% and TGVI's deemed equity component of its capital structure for 2007 is 40%.

TGVI's approved rate design methodology provides, in effect, that to the extent that cost of service inputs change over time, TGVI's rates will reflect a variable RDDA amortization. The rates generally are set to be equivalent to 90% of comparable electricity price. The RDDA amortization was approximately $12.4 million in 2005 and approximately $6.7 million in 2006. The RDDA has been amortized from approximately $87.9 million as at December 31, 2002 to approximately $42.0 million as at December 31, 2006.

In November 2005, TGVI received BCUC approval of a Negotiated Settlement (the "TGVI Settlement") of 2006-2007 revenue requirements. The two-year TGVI Settlement, which took effect as of January 1, 2006, establishes a process for determining TGVI's delivery charges and offers incentive mechanisms for improved operating efficiencies. TGVI is permitted to retain 100% of earnings from savings of controllable operating and maintenance expenses from forecast and TGVI will not be provided any relief from increased controllable operating and maintenance expenses. The operating and maintenance expense forecast is based on actual 2005 costs, adjusted for changes outside of management's control, expected savings from operational synergies with TGI, 66% of inflation and customer growth. TGVI has managed actual operating and maintenance expenses close to forecast. In January 2007, TGVI made an application to the BCUC to extend the TGVI Settlement to 2009, which was approved by the BCUC on March 22, 2007.

Competition

Natural gas has maintained a competitive advantage in terms of pricing when compared with alternative sources of energy in British Columbia, despite the significant increase in natural gas commodity prices since 1999. Regulated electricity prices in British Columbia are currently set based on the historical average production costs which are lower than the market price of electricity. Current regulated electricity prices are only marginally higher than comparable, market-based natural gas prices. A further sustained increase in natural gas commodity prices could cause natural gas in British Columbia to be priced at or above electricity, thereby decreasing the use of natural gas by customers.

Hedging

Derivative instruments are used to hedge exposure to fluctuations in natural gas prices and interest rates. The majority of the natural gas supply contracts have floating, rather than fixed, prices. Natural gas price swap contracts are used to fix the effective purchase price. Any differences between the effective cost of natural gas purchased and the price of natural gas included in rates are recorded in deferral accounts (MCRA and CCRA) and, subject to BCUC approval, passed through to customers in future rates.

TGI's short-term borrowings and variable rate long-term debt are exposed to interest rate risk which TGI manages through the use of interest rate derivatives. Any resulting gains or losses are recorded in interest rate deferral accounts and, subject to BCUC approval, passed through to consumers in future rates.

Financing Arrangements

Debentures

Terasen has issued and outstanding two series of unsecured medium term note debentures ("Terasen MTN Debentures"), which are governed by a Trust Indenture dated November 21, 2001 between Terasen (as successor to BC Gas Inc.) and CIBC Mellon Trust Company (the "2001 Indenture"), as amended and supplemented by a First Series Supplement dated November 22, 2001 (the "First Supplement"). The aggregate principal amount of debentures that may be issued under the 2001 Indenture is unlimited, subject to the restrictions set forth therein. As at March 31, 2007, Terasen had issued and outstanding $200 million principal amount of 6.30% Series 1 MTN Debentures due December 1, 2008 and $125 million principal amount of 5.56% Series 3 MTN Debentures due September 15, 2014. The First Supplement includes a positive covenant of Terasen that, so long as any MTN Debentures remain outstanding, it shall not create, assume, issue or otherwise incur or become liable for any Funded Indebtedness unless immediately thereafter the Funded Indebtedness of Terasen and its subsidiaries will not be in excess of 75% of Total Consolidated Capitalization. Funded Indebtedness means indebtedness that matures more than 18 months after such indebtedness was incurred, except for non-recourse debt to finance specific assets or subordinated debt. Total Consolidated Capitalization means the sum of: (a) the principal amount of consolidated Funded Indebtedness of Terasen and its subsidiaries; (b) the total capital of Terasen; (c) the principal amount of all subordinated debt of Terasen; (d) the sum of consolidated contributed or capital surplus and retained earnings of Terasen; and (e) provision for future income taxes of Terasen.

On April 19, 2000, Terasen issued $125 million of 8.0% unsecured capital securities (the "Capital Securities") with a term to maturity of 40 years. The Capital Securities were issued under the terms of a Trust Indenture dated April 19, 2000 between Terasen (as successor to BC Gas Inc.) and CIBC Mellon Trust Company (the "2000 Indenture"). Terasen may elect to defer payments on the Capital Securities for extension periods not exceeding 10 consecutive semi-annual periods. Terasen may settle such deferred payments in either cash or common shares and has the option to settle principal at maturity through the issuance of common shares at 90% of their market price. The 2000 Indenture provides that if Terasen defers any interest payment on the Capital Securities, it is not permitted to pay dividends on, or purchase or redeem, its common shares for so long as such interest payments are deferred. The Capital Securities are exchangeable at the option of the holder on or after April 19, 2010 for common shares of Terasen at a price equal to the greater of $1 per share and 90% of the market price. Terasen may, at its option, redeem the Capital Securities in whole at a redemption price which, if the Capital Securities are redeemed prior to April 19, 2010, is equal to the greater of Canada Yield Price (as defined in the 2000 Indenture) and 100% of the principal amount of the Capital Securities, together in each case with accrued and unpaid interest, or if the Capital Securities are redeemed on or after April 19, 2010, at a price that is equal to 100% of the principal amount outstanding plus any accrued and unpaid interest.

TGI has issued and outstanding unsecured debentures and medium-term note debentures which are governed by a Trust Indenture dated November 1, 1977 between TGI (as successor to Inland Natural Gas Co. Ltd.) and CIBC Mellon Trust Company (as successor to National Trust Company, Limited), as amended and supplemented (the "1977 Indenture"). The aggregate principal amount of debentures that may be issued under the 1977 Indenture is unlimited, subject to the restrictions set forth therein. As at March 31, 2007, TGI had issued and outstanding $59.9 million principal amount of 10.75% debentures, Series E due June 8, 2009, and an aggregate of $1,008 million of medium-term note debentures with fixed rates of interest ranging from 5.55% to 6.95% or with floating interest rates, and maturities of not less than one year. The Fourth Supplemental Indenture dated June 1, 1989 and the Tenth Supplemental Indenture dated November 15, 1993 contain certain restrictions on the ability of TGI to issue any debt securities with maturities of more than 18 months, unless certain financial tests are met and subject to certain exceptions.

TGI also has issued and outstanding Series A and Series B Purchase Money Mortgages (the "Purchase Money Mortgages"), which are secured equally and rateably by a first fixed and specific mortgage and charge on TGI's gas distribution system in the Lower Mainland of British Columbia that was acquired by TGI from BC Hydro. The Purchase Money Mortgages are governed by a Trust Indenture dated December 3, 1990 between TGI (as successor to B.C. Gas Inc.), Inland Energy Corp. and CIBC Mellon Trust Company (as successor to National Trust Company), as amended and supplemented (the "1990 Indenture"). The aggregate principal amount of Purchase Money Mortgages that may be issued under the 1990 Indenture is limited to $425 million. As at March 31, 2007, TGI had issued and outstanding $74.9 million aggregate principal amount of 11.80% Series A Purchase Money Mortgages due September 30, 2015 and $200 million aggregate principal amount of 10.30% Series B Purchase Money Mortgages due September 30, 2016.

Credit Facilities

On May 5, 2006, Terasen entered into a Credit Agreement with The Toronto-Dominion Bank, as administrative agent, and the institutions named therein, as lenders (the "Terasen Credit Agreement"). The Terasen Credit Agreement provides a committed $450 million revolving credit facility which matures on May 5, 2009. The interest rate payable on advances under the credit facility varies based on the type of advance. The credit facility can be used for Terasen's general corporate purposes. The Terasen Credit Agreement contains customary representations and warranties and positive and negative covenants, including a requirement that Terasen maintain a total debt-to-capitalization ratio not higher than 0.75:1 and an interest coverage ratio not less than 1.25:1. The Terasen Credit Agreement contains customary events of default.

On June 21, 2006, TGI entered into a Credit Agreement with Canadian Imperial Bank of Commerce, as administrative agent, lead arranger and sole bookrunner, The Bank of Nova Scotia, as syndication agent and the other lenders identified therein (the "TGI Credit Agreement"). The TGI Credit Agreement provides a committed $500 million revolving credit facility. The interest rate payable on accommodations under the TGI Credit Agreement varies based on the type of accommodation. The facility can be used for refinancing indebtedness of TGI and for general corporate purposes, including as back-up for TGI's commercial paper program. The TGI Credit Agreement is extendible annually for an additional 365 days at the option of the lenders and matures on June 21, 2009. The TGI Credit Agreement contains customary representations and warranties and positive and negative covenants, including a requirement that TGI maintain a total debt-to-capitalization ratio not higher than 0.75:1. The TGI Credit Agreement contains customary events of default.

On January 13, 2006, TGVI entered into a Credit Agreement with Royal Bank of Canada, as administrative agent, RBC Capital Markets, as lead arranger and bookrunner, National Bank Financial, as syndication agent, and The Bank of Nova Scotia, as documentation agent, and the other lenders identified therein (the "TGVI Credit Agreement"). The TGVI Credit Agreement provides for a five-year unsecured, committed, revolving credit facility of $350 million. A portion of the facility was used to refinance TGVI's term facility of $209.5 million. While the borrowings under this facility are short-term bankers' acceptances, the underlying credit facility on which the advances are provided is committed through to January 2011 and the borrowings are primarily to support the longer-term rate base assets of TGVI. The facility can be used for refinancing indebtedness of TGVI and for general corporate purposes, including for capital expenditures. The TGVI Credit Agreement contains customary representations and warranties and positive and negative covenants, including a requirement that TGVI maintain a ratio of institutional indebtedness-to-total capitalization not higher than 0.70:1 and a ratio of earnings-to-interest expense of at least 2.0:1. The TGVI Credit Agreement contains customary events of default, including a cross default under VINGPA and certain other agreements.

Concurrently with the TGVI Credit Agreement, TGVI also entered into a $20 million, seven-year unsecured, committed, non-revolving credit facility with Royal Bank of Canada which is to be used only for purposes of funding up to 65% of each repayment of the Repayable Contributions under the PCEPA. The terms of this facility are substantially similar to those contained in the TGVI Credit Agreement. This facility ranks junior to repayment of the Class B Instruments held by Terasen. See "– Terasen Gas (Vancouver Island) Inc. – Vancouver Island Natural Gas Pipeline Agreement" above.

The following summary outlines the total credit facilities of Terasen, TGI and TGVI as at March 31, 2007.

(in millions of dollars)	Terasen[(1)]	TGI	TGVI	Total
Total credit facilities	450	500	370	1,320
Credit facilities utilized borrowings	(76)	(137)	(304)	(517)
Letters of credit outstanding	(75)	(43)	—	(118)
Credit facilities available	299	320	66	685

(1) On June 1, 2007, the Terasen Inc. operating credit facilities were decreased from $450 million to $130 million.

Acquisition Agreement

Indemnities Relating to the Acquisition

Under the agreement dated February 26, 2007 between Fortis, 3211953 Nova Scotia Company ("3211953") and Kinder Morgan providing for the Acquisition (the "Acquisition Agreement"), KM Canada Holdings ULC, as the assignee of the rights and obligations of 3211953 as vendor (the "Vendor") has agreed, subject to certain limits, to indemnify and save harmless Fortis and its affiliates, and Fortis has agreed, subject to certain limits, to indemnify and save harmless the Vendor and its affiliates in respect of all losses sustained or incurred by the other resulting from (i) certain misrepresentations or breaches of warranty relating to title to the shares of Terasen and Terasen Gas, organization, corporate status, authority to enter into the Acquisition Agreement, and no breach of constating documents or any laws (the "Title Warranties"), (ii) any breach of the covenants or obligations to be performed following the closing of the Acquisition contained in the Acquisition Agreement, (iii) the Pre-Closing Reorganization and the operations of the petroleum transportation business of Terasen, in the case of indemnification by the Vendor, and (iv) in the case of indemnification by Fortis, the operations of the Terasen and Terasen Gas businesses (provided that the facts giving rise to the losses do not constitute a breach of the representations and warranties of the Vendor). The indemnities provided by the Vendor or Fortis, as the case may be, with respect to breaches of covenants and obligations to be performed following the closing of the Acquisition are limited in that claims may only be made when (i) the losses suffered exceed $500,000 in each instance or (ii) the aggregate of all such losses exceeds 2.5% of the Cash Purchase Price and, in the latter case, only to the extent of such excess. The maximum amount that can be claimed by Fortis under the indemnity provisions of the Acquisition Agreement is limited to 10% of the Cash Purchase Price with respect to claims for any breach of the covenants or obligations of the Vendor following the closing of the Acquisition, and 100% of the Cash Purchase Price with respect to claims for breaches of the Title Warranties. The maximum amount that can be claimed by the Vendor under the indemnity provisions of the Acquisition Agreement is limited to 10% of the Cash Purchase Price with respect to claims for any breach of the covenants or obligations of Fortis following the closing of the Acquisition contained in the Acquisition Agreement and 100% of the Cash Purchase Price with respect to claims for breaches of the Title Warranties. Claims sustained or incurred by Fortis as a result of the Pre-Closing Reorganization and the operations of the petroleum transportation business of Terasen, and by the Vendor in respect of the operations of the Terasen and Terasen Gas businesses, are not subject to any minimum or maximum limits.

The obligations of the Vendor under the Acquisition Agreement, including in respect of indemnification, are irrevocably and unconditionally guaranteed by Kinder Morgan.

Risk Factors

The following is a summary of the significant business risks relating to the operations of Terasen Gas.

Regulation

The regulated operations of Terasen Gas are subject to the normal uncertainties faced by regulated companies. These uncertainties include regulatory approval of customer rates which permit a reasonable opportunity to recover on a timely basis the estimated costs of providing services, including a fair rate of return on rate base. Upgrades of existing facilities and the addition of new facilities require the approval of the BCUC. There is no assurance that capital projects perceived as required by the management of Terasen Gas will be approved or that conditions to such approval will not be imposed. Capital cost overruns relative to approvals granted might not be recoverable. The ability of Terasen Gas to recover the actual costs of providing services and to earn the approved rates of return depends on achieving the forecasts established in the rate-setting process. Fair regulatory treatment by the BCUC that allows Terasen Gas the opportunity to earn a risk-adjusted ROE comparable to that available on alternative, similar investments is essential for maintaining service quality, as well as for ongoing capital attraction and growth.

The ROEs of Terasen Gas are determined annually by a formula based upon a forecast of long-term interest rates. The ability of Terasen Gas to earn the approved ROEs depends on the accuracy of the forecast for the test year. Actual required ROEs may differ from approved ROEs based on forecast long-term interest rates.

Rate applications that establish revenue requirements may be subject to negotiated settlement procedures. Failing a negotiated settlement, rate applications may be pursued through public hearing processes. There can be no assurance that the rate orders issued will permit Terasen Gas to recover all costs actually incurred and to earn the allowed ROE. A failure to obtain acceptable rate orders may adversely affect the business carried on by Terasen Gas, the undertaking or timing of proposed expansion projects, the issue and sale of securities, ratings assigned by rating agencies, and other matters which may, in turn, negatively impact Terasen Gas' results of operations or financial position, as well as those of the Corporation.

The TGI Settlement includes incentive mechanisms that provide TGI with an opportunity to earn ROEs in excess of the allowed ROEs determined by the BCUC. While the BCUC has approved an extension of the TGI Settlement to 2009, there is no certainty as to whether the TGI Settlement will be extended beyond 2009, whether and how the terms may be modified, or what the terms of an extended, or new, settlement might be.

Traditionally, British Columbia's regulatory framework was generally based on traditional cost of service methodologies for designing and setting rates. Since 1996, however, incentive-based regulation has been used in the rate setting process. Although Fortis considers the regulatory frameworks in British Columbia to be fair and balanced, uncertainties do exist.

Forecasting Accuracy

Through the forecasting process, it is intended that any changes in cost of service, regardless of whether they are caused by inflation or by level of business activity, would be reflected in new rates approved for that fiscal year based on the anticipated distribution volume. However, as rates are established in advance, based on anticipated distribution volume by class of customer, forecasting accuracy is a risk. Forecasts are also made for the future cost of capital, including the yield rate for long-term Canada Bonds used in the determination of the allowed ROE.

Asset Maintenance

The asset base for Terasen Gas requires maintenance, improvement and expansion. The utility could experience service disruptions and increased costs if it is unable to maintain and replace its assets. The failure to carry out capital expenditure programs could have a material adverse effect on Terasen Gas. Large capital projects can proceed only with the approval of the BCUC. If actual costs exceed the costs forecast in obtaining the approval, it is uncertain as to whether any cost overruns will be approved and recovered.

Operational Risks

The business of Terasen Gas is exposed to various operational risks, such as pipeline leaks, accidental damage to or fatigue cracks in mains and service lines, corrosion in pipes, pipeline or equipment failure, other issues that can lead to outages and leaks, and any other accidents involving natural gas, which could result in significant operational and environmental liability. The facilities of Terasen Gas are also exposed to the effects of severe weather conditions and other acts of nature. In addition, many of these facilities are located in remote areas, which makes access for repair of damage due to weather conditions and other acts of nature difficult. Terasen Gas operates facilities in a terrain with a risk of loss or damage from earthquakes, forest fires, floods, washouts, landslides, avalanches and similar acts of nature. Terasen Gas has insurance which provides coverage for business interruption, liability and property damage, although the coverage offered by this insurance is limited. In the event of a large uninsured loss caused by severe weather conditions or other natural disasters, application will be made to the BCUC for the recovery of these costs through higher rates to offset any loss. However, there can be no assurance that the BCUC would approve any such application. Losses resulting from any operational accidents or failures or natural disasters could substantially exceed insurance coverage and actual recovery from increased rates approved by the BCUC. Furthermore, Terasen Gas could be subject to claims from its customers for damages caused by the failure to transmit or distribute gas to them in accordance with its contractual obligations. Thus, any major damage to Terasen Gas' facilities could result in lost revenues, repair costs and customer claims that are substantial in amount, which amount could have a material adverse effect on Terasen Gas.

Natural Gas Prices

Prior to 2000, natural gas consistently had a substantial competitive advantage when compared with alternative sources of energy in British Columbia. However, with the increasing price of natural gas, the price of electricity is now only marginally higher than the comparable price for natural gas for residential customers in British Columbia. There is no assurance that natural gas will continue to maintain a competitive price advantage in the future.

If natural gas pricing becomes uncompetitive with electricity pricing, Terasen Gas' ability to add new customers could be impaired, and existing customers could reduce their consumption of natural gas or eliminate its usage altogether as furnaces, water heaters and other appliances are replaced. This may result in higher rates and, in an extreme case, could ultimately lead to an inability to fully recover Terasen Gas' cost of service in rates charged to customers.

The ability of Terasen Gas to add new customers and sales volumes could also be affected by lower prices of other competitive energy sources as some commercial and industrial customers have the ability to switch to an alternative fuel.

Terasen Gas employs a number of tools to reduce its exposure to natural gas price volatility. These include purchasing gas for storage and adopting hedging strategies to reduce price volatility and ensure, to the extent possible, that natural gas commodity costs remain competitive with electricity rates. Activities related to the hedging of gas prices are currently approved by the BCUC and gains or losses effectively accrue entirely to customers. Future BCUC determinations could materially impact the ability of Terasen Gas to recover the future cost of the natural gas it delivers to its customers.

Weather and Seasonality

Weather during the year has a significant impact on distribution volume as a major portion of the gas distributed by Terasen Gas is ultimately used for space heating. Because of natural gas consumption patterns, the natural gas distribution operations of Terasen Gas normally generate quarterly earnings that vary by season and may not be a representative indicator of annual earnings. Typically, higher net earnings are experienced in the first and fourth quarters, but are offset by net losses in the second and third quarters. See "The Acquired Business – Regulation".

Risks Related to Terasen Gas (Vancouver Island) Inc.

TGVI is a franchise under development in the price-competitive service area of Vancouver Island, with a customer base and revenue that is insufficient to meet its current cost of service and to recover revenue deficiencies from prior years. Recovery of the accumulated deficit puts gas at a cost disadvantage relative to electricity.

To assist with competitive rates during franchise development, VINGPA provides royalty revenues from the provincial government which currently cover approximately 20% of the current cost of service. These revenues are due to expire at the end of 2011, after which TGVI's customers will be required to absorb the full commodity cost of gas and the recovery of any remaining accumulated deficit. When VINGPA expires in 2011, the $75 million non-interest-bearing senior government debt which is currently treated as a government contribution against rate base will become repayable. As this debt is repaid, the cost of the higher rate base will increase the cost of service and customer rates making gas less competitive with electricity on Vancouver Island.

Industrial load accounts for more than 65% of the system's throughput for which approximately two-thirds is contracted on a year-to-year basis with no long-term commitment. A loss of industrial customers will increase the cost of service to be recovered from residential and commercial customers which may impact the competitiveness of rates.

While the BCUC has approved a rate-setting mechanism for TGVI whereby customer rates are set at levels in excess of TGVI's cost of service to recover amortization of the RDDA, the amount of recovery is limited by the price of competitive alternative fuels. Significant RDDA amortization was recovered in both 2005 and 2006. However, RDDA recovery is sensitive to the relative pricing of natural gas and electricity in TGVI's service area, as well as to margin generated under TGVI's firm transportation agreements discussed below. There is no certainty that TGVI will be able to charge rates that will be sufficient to fully recover the RDDA prior to the expiry of the provincial royalty payments at the end of 2011. Failure by TGVI to recover the RDDA by 2011 may result in an increase in the cost of service.

Government Permits

The acquisition, ownership and operation of gas businesses and assets require numerous permits, approvals and certificates from federal, provincial and local government agencies. Terasen Gas may not be able to obtain or maintain all required regulatory approvals. If there is a delay in obtaining any required regulatory approval or if Terasen Gas fails to maintain or obtain any required approval or fails to comply with any applicable law or regulation, or condition of approval, the operation of its assets and its distribution of gas could be prevented or become subject to additional costs, any of which could have a material adverse effect on Terasen Gas.

Impact of Changes in Economic Conditions

New customer additions at Terasen Gas are typically a result of population growth and new housing starts, which are affected by the state of the British Columbia economy. Terasen Gas is also affected by changes in trends in housing starts from single-family dwellings to multi-family dwellings, for which natural gas has a lower penetration rate. While new housing starts have increased in British Columbia in 2006, growth of new multi-family housing starts continues to significantly outpace that of new single-family housing starts. In addition, more efficient building construction and consistent customer conservation efforts place downward pressure on annual average consumption of natural gas. Prevailing economic conditions also impact sales and transportation service to large-volume commercial and industrial customers.

Natural Gas Supply

Terasen Gas is dependent on a limited selection of pipeline and storage providers, particularly in the Vancouver, Fraser Valley and Vancouver Island service areas where the majority of Terasen Gas' natural gas distribution customers are located. As a result, regional market prices have been higher from time to time than prices elsewhere in North America as a result of insufficient seasonal and peak storage and pipeline capacity to serve the increasing demand for natural gas in British Columbia.

In addition, Terasen Gas is critically dependent on a single-source transmission pipeline. In the event of a prolonged service disruption on the Spectra Pipeline System, Terasen Gas' residential customers could experience outages, thereby affecting revenues and incurring costs to safely relight customers.

Access to Capital and Credit Ratings

In order to meet the capital investment and debt repayment requirements of its business, Terasen Gas must have reliable access to sufficient and cost-effective capital. The ability to arrange sufficient and cost-effective financing is subject to numerous factors, including the regulatory environment in British Columbia, the results of operations and financial position of Terasen Gas, conditions in the capital and bank credit markets, the ratings assigned by rating agencies and general economic conditions. There can be no assurance that sufficient capital will be available on acceptable terms to fund such capital expenditures and to repay existing debt.

An inability to maintain an investment-grade credit rating could materially adversely impact Terasen Gas' access to debt financing. In addition, a downgrade of Terasen Gas below investment grade by any of the major credit rating agencies could trigger margin calls and other cash requirements under Terasen Gas' gas purchase and commodity derivative contracts.

Interest Rates

Terasen Gas is exposed to the interest rate risks associated with floating rate debt. Terasen Gas has hedging programs in place to reduce its interest rate risks. The allowed ROEs for TGI and TGVI are determined by formulae that result in lower allowed ROEs if long-term Canada Bond yields decline.

Counterparty Credit Risk

Terasen Gas is exposed to credit risk in the event of non-performance by counterparties to derivative instruments. Terasen Gas is also exposed to significant credit risk on physical off-system sales.

Potential Undisclosed Liabilities Associated with the Acquisition

In connection with the Acquisition, there may be liabilities that the Corporation failed to discover or was unable to quantify in its due diligence which it conducted prior to the completion of the Acquisition and the Corporation may not be indemnified for some or all of these liabilities. The discovery or quantification of any material liabilities could have a material adverse effect on the Corporation's business, financial condition or future prospects. In addition, the Acquisition Agreement limits the amount for which the Corporation is indemnified. See "Acquisition Agreement – Indemnities Relating to the Acquisition".

Labour Relations

The organized employees of TGI and TGVI are members of labour unions which have entered into collective bargaining agreements with TGI. The provisions of such collective bargaining agreements affect the flexibility and efficiency of the business carried on by TGI, TGVI and TGWI (which depends on TGI for its customer, management and operation services). TGI considers its relationships with its labour unions to be satisfactory, but there can be no assurance that current relations will continue in future negotiations or that the terms under the present collective bargaining agreements will be renewed. The inability to maintain, or to renew the collective bargaining agreements on acceptable terms, could result in increased labour costs or service interruptions arising from labour disputes for TGI that are not provided for in approved orders, which could have an adverse effect on the results of operations, cash flow and net income of Terasen Gas.

Underinsured and Uninsured Losses

Fortis and Terasen Gas maintain at all times insurance coverage in respect of potential liabilities and the accidental loss of value of certain of their assets from risks, in amounts, with such insurers, as is considered appropriate, taking into account all relevant factors including the practices of owners of similar assets and operations. It is anticipated that such insurance coverage will be maintained. However, not all risks are covered by insurance and no assurance can be given that insurance will be consistently available or will be consistently available on economically feasible terms or that the amounts of insurance will be sufficient to cover losses or claims that may occur involving the assets or operations of Fortis or Terasen Gas.

Environmental Matters

Terasen Gas is subject to numerous laws, regulations and guidelines governing the management, transportation and disposal of hazardous substances and other waste materials and otherwise relating to the protection of the environment and health and safety. Potential environmental damage and costs could arise due to a severe weather event, natural disaster or a major equipment failure.

However, there can be no assurance that such costs will be recoverable and, if substantial, unrecovered costs may have a material effect on the business, results of operations and prospects of Terasen Gas.

Terasen Gas is exposed to environmental risks that property owners in British Columbia generally face. These risks include the responsibility of any property owner for the site remediation of any properties determined to be contaminated, whether or not such contamination was actually caused by the owner. Most of Terasen Gas' distribution and transmission facilities have been in place for many years with no apparent adverse environmental impact. However, as facilities are upgraded and as new facilities are added, environmental assessments and regulatory approvals will be required in the ordinary course.

Applicable environmental and safety laws make owners, operators and persons in charge of management and control of facilities subject to prosecution or administrative action for breaches of environmental and safety laws, including the failure to obtain certificates of approval for the discharge of contaminants causing an adverse effect. Terasen Gas has not been notified of any such regulatory action in regard to its operation or occupation of its facilities. However, it is not possible to predict with absolute certainty the position that a regulatory authority will take regarding matters of non-compliance with environmental and safety laws. Changes in environmental, health and safety regulations could also lead to significant increases in costs to Terasen Gas.

First Nations' Lands

Terasen Gas provides service to customers on First Nations reserves in British Columbia and maintains gas distribution facilities on lands that are subject to land claims by various First Nations. A treaty negotiation process involving various First Nations and the Government of British Columbia is underway in British Columbia but the basis upon which settlements might be reached in Terasen Gas' service area is not clear. Furthermore, not all First Nations are participating in the process. To date, the policy of the Government of British Columbia has been to endeavour to structure settlements without prejudicing existing rights held by third parties such as Terasen Gas. However, there can be no certainty that the settlement process will not adversely affect the business of Terasen Gas.

Results of Operations and Financing Risks

Management of the Corporation believes, based on its expectations as to the Corporation's future performance, that the cash flow from its operations and funds available to it under its credit facilities will be adequate to enable the Corporation to finance its operations, execute its business strategy and maintain an adequate level of liquidity. However, expected revenue and the costs of planned capital expenditures are only estimates. Moreover, actual cash flows from operations are dependent on regulatory, market and other conditions that are beyond the control of the Corporation. As such, no assurance can be given that management's expectations as to future performance will be realized. In addition, management's expectations as to the Corporation's future performance reflect the current state of its information about Terasen Gas and its operations and there can be no assurance that such information is correct and complete in all material respects.

Management of Expanding Operations

As a result of the Acquisition, significant demands will be placed on the Corporation's managerial, operational and financial personnel and systems. No assurance can be given that the Corporation's systems, procedures and controls will be adequate to support the expansion of the Corporation's operations resulting from the Acquisition. The Corporation's future operating results will be affected by the ability of its officers and key employees to manage changing business conditions and to implement and improve its operational and financial controls and reporting systems.

SCHEDULE B

Terasen Inc.

Consolidated Financial Statements
Years ended December 31, 2006 and 2005

Together with Auditors' Report

(see attached)

(PRICEWATERHOUSECOOPERS LOGO)

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AUDITORS' REPORT TO THE SHAREHOLDER

We have audited the consolidated statements of financial position of Terasen Inc. as at December 31, 2006 and the consolidated statements of earnings, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Company's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements of the Company as at December 31, 2005 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated February 3, 2006, except as to note 19(b) which is as of March 2, 2006 and note 19(c) which is as of March 31, 2006.

(Signed) PricewaterhouseCoopers LLP
Chartered Accountants
Vancouver, Canada
March 29, 2007

TERASEN INC.

CONSOLIDATED STATEMENTS OF EARNINGS

	Years ended December 31	
	2006	**2005**
	In millions of Canadian dollars	
Revenues		
Natural gas distribution	**$ 1,741.1**	$ 1,678.0
Petroleum transportation	**242.4**	227.8
Other activities	**44.2**	46.7
	2,027.7	1,952.5
Expenses		
Cost of natural gas	**1,117.9**	1,063.7
Cost of revenues from other activities	**27.1**	28.9
Operation and maintenance	**292.4**	320.7
Depreciation and amortization	**145.2**	142.6
Property and other taxes	**74.5**	71.9
	1,657.1	1,627.8
Operating Income	**370.6**	324.7
Financing costs (note 13)	**179.5**	191.4
Earnings before share of earnings of equity investments, discontinued operations and income taxes	**191.1**	133.3
Equity earnings from Clean Energy net of disposition costs (note 3(b))	**—**	2.5
Share of earnings of Express System	**24.5**	21.9
Earnings before income taxes and discontinued operations	**215.6**	157.7
Income taxes (note 14)	**68.4**	51.6
Earnings before discontinued operations	**147.2**	106.1
Loss from discontinued operations, net of income taxes (note 3(a))	**(17.5)**	(4.9)
NET EARNINGS	**$ 129.7**	$ 101.2

The accompanying notes are an integral part of these consolidated financial statements.

TERASEN INC.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

	Years ended December 31 2006	Years ended December 31 2005
	In millions of Canadian dollars	
Retained earnings, beginning of year	**$ 425.0**	$ 418.9
Net earnings	**129.7**	101.2
	554.7	520.1
Dividends on common shares	**—**	95.1
Retained earnings, end of year	**$ 554.7**	$ 425.0

The accompanying notes are an integral part of these consolidated financial statements.

TERASEN INC.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	As at December 31 2006	As at December 31 2005
	In millions of Canadian dollars	
Assets		
Current assets		
Cash and short-term investments	**$ 11.2**	$ 79.4
Accounts receivable	**336.5**	468.1
Inventories of gas in storage and supplies	**189.5**	205.7
Prepaid expenses	**12.6**	14.1
Current portion of rate stabilization accounts (note 6)	**134.5**	28.4
Current assets held for sale (note 3(a))	**—**	54.8
	684.3	850.5
Property, plant and equipment (note 5)	**4,194.7**	3,907.9
Long-term investment	**260.9**	238.3
Goodwill	**76.4**	76.4
Rate stabilization accounts (note 6)	**48.3**	48.3
Other assets (note 7)	**113.2**	98.6
Long-lived assets held for sale (note 3(a))	**—**	109.9
	$ 5,377.8	$ 5,329.9
Liabilities and shareholder's equity		
Current liabilities		
Short-term notes	**$ 556.0**	$ 681.0
Accounts payable and accrued liabilities	**523.8**	433.8
Income and other taxes payable	**29.3**	30.8
Current portion of rate stabilization accounts (note 6)	**—**	47.9
Current portion of long-term debt (note 8)	**285.9**	398.2
Due to parent company	**8.9**	0.4
Current liabilities held for sale (note 3(a))	**—**	24.5
	1,403.9	1,616.6
Long-term debt (note 8)	**2,117.6**	2,012.9
Other long-term liabilities and deferred credits (note 9)	**198.4**	182.3
Future income taxes (note 14)	**76.5**	88.7
Long-term liabilities held for sale (note 3(a))	**—**	13.7
	3,796.4	3,914.2
Shareholder's equity		
Common shares (note 10)	**904.9**	904.9
Contributed surplus (note 11)	**172.7**	137.5
Retained earnings	**554.7**	425.0
Cumulative currency translation adjustment	**0.1**	(0.7)
	1,632.4	1,466.7
Less cost of common shares held by Terasen Pipelines (Trans Mountain) Inc	**51.0**	51.0
	1,581.4	1,415.7
	$ 5,377.8	$ 5,329.9

The accompanying notes are an integral part of these consolidated financial statements.

Approved by the Board:

(Signed) JAMES M. STANFORD
Director

(Signed) R.L. (RANDY) JESPERSEN
Director

TERASEN INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	In millions of Canadian dollars 2006	2005
Cash flows provided by (used for)		
Operating activities		
Earnings before discontinued operations	**$ 147.2**	$ 106.1
Adjustments for non-cash items		
Depreciation and amortization	**145.2**	142.6
Equity earnings from Clean Energy	**—**	(2.5)
Share of earnings from long-term investments, in excess of cash distributions	**(22.6)**	(19.4)
Future income taxes	**(22.7)**	2.9
Other	**18.8**	18.7
	265.9	248.4
Decrease in rate stabilization accounts	**7.9**	10.1
Changes in working capital	**61.8**	(68.3)
	335.6	190.2
Investing activities		
Property, plant and equipment	**(377.1)**	(214.7)
Proceeds on sale of Clean Energy (note 3(b))	**—**	43.0
Disposal of discontinued operations, net of cash disposed	**114.6**	(30.9)
Proceeds on sale of natural gas distribution assets (note 9)	**—**	7.2
Other assets and deferred credits	**(13.5)**	(11.2)
	(276.0)	(206.6)
Financing activities		
(Decrease) increase in short-term notes	**(125.0)**	433.0
Increase in long-term debt	**419.7**	601.5
Reduction of long-term debt	**(431.0)**	(884.9)
Advances from parent company	**8.5**	0.4
Issue of common shares, net of issue costs (note 10)	**—**	20.9
Dividends on common shares	**—**	(95.1)
	(127.8)	75.8
Net (decrease) increase in cash	**(68.2)**	59.4
Cash at beginning of year	**79.4**	20.0
Cash at end of year	**$ 11.2**	$ 79.4
Supplemental cash flow information		
Interest paid in the year	**$ 182.0**	$ 187.6
Income taxes paid in the year	**42.0**	48.4
Non-cash transactions		
Mark to market on certain gas derivatives deferred in rate-stabilization accounts	**161.9**	21.2
Government loan capitalized in property, plant and equipment	**3.7**	—
Property, plant and equipment purchases included in accounts payable and accrued liabilities	**49.3**	—

Cash is defined as cash or bank indebtedness.

The accompanying notes are an integral part of these consolidated financial statements.

TERASEN INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions of Canadian dollars, except where stated otherwise)
YEARS ENDED DECEMBER 31, 2006 AND 2005

Terasen Inc. ("Terasen" or the "Company") provides energy transportation and utility asset management services. Terasen operated in three primary business segments which were separately managed to assess operational performance.

(a) Natural gas distribution operations involve the transmission and distribution of natural gas and propane for residential, commercial, institutional, and industrial customers in British Columbia. The operations are conducted through Terasen Gas Inc. ("Terasen Gas"), serving the Lower Mainland and interior of British Columbia, Terasen Gas (Vancouver Island) Inc. ("TGVI"), serving Vancouver Island and the Sunshine Coast, Terasen Gas (Whistler) Inc., and Terasen Gas (Squamish) Inc.

(b) Petroleum transportation operations are carried out through Terasen Pipelines (Trans Mountain) Inc. ("Trans Mountain"), which owns and operates a common carrier pipeline system for crude and refined petroleum products transported from Edmonton, Alberta to Vancouver, British Columbia and Washington State, Terasen Pipelines (Corridor) Inc. ("Corridor"), which owns a pipeline in northern Alberta transporting diluted bitumen, and the one-third owned entities Express Pipeline LP and Express US Holdings LP ("the Express System"). The Express System transports crude oil from Hardisty, Alberta, through the Rocky Mountain region of the United States and on to Wood River, Illinois.

(c) Water and utility services operations includes providing water and wastewater treatment services, water distribution and wastewater collection, meter reading, meter fleet management and installation services as well as product sales related to the water, sewer and irrigation markets. These operations are provided through Terasen Waterworks (Supply) Inc., Terasen Utility Services Inc., Terasen Utility Services (U.S.) Inc. (collectively "Terasen Water and Utility Services"), and the Company's 50% interest in Fairbanks Sewer and Water Inc. ("FSW"). These operations were reclassified to Discontinued Operations at December 31, 2005 and were sold during 2006 as described in Note 3(a).

(d) Other activities include international consulting activities, the Company's 30% interest in CustomerWorks LP ("CWLP"), corporate financing costs and administration charges, and the Company's 40% interest in Clean Energy Fuels Corp. ("Clean Energy"), which was proportionately consolidated until the first quarter of 2005 and was then equity-accounted for until the investment was sold on October 31, 2005 (Note 3(b)).

The Company operates in Canada and the United States, but at the present time the United States operations are not of sufficient size to be reportable as either operating or geographic segments.

On November 30, 2005, all of the shares of the Company were acquired by Kinder Morgan, Inc. ("KMI") pursuant to a Combination Agreement dated as of August 1, 2005. The Company's shareholders were able to elect, for each Terasen share held, either (i) $35.75 in cash, (ii) 0.3331 shares of KMI common stock, or (iii) $23.25 in cash plus 0.1165 shares of KMI common stock. In the aggregate, approximately 12.5 million shares of KMI common stock was issued together with cash payments of approximately $2.49 billion to Terasen security holders. The Company charged to earnings after-tax costs of $42.9 million in 2005 associated with the transaction, mainly from pre-tax investment banking costs of $14.7 million, severance and employee-related costs of $14.4 million, share option costs of $3.6 million as described in Note 11, and the write-off of approximately $15.3 million of income tax expense related to restricted tax loss carry-forwards. There were no such costs charged in 2006.

1. SIGNIFICANT ACCOUNTING POLICIES

The preparation of these consolidated financial statements in conformity with Canadian generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the financial statements, as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

In the opinion of management, these consolidated financial statements have been properly prepared within reasonable limits of materiality and reflect the following summary of significant accounting policies.

(a) BASIS OF PRESENTATION

The consolidated financial statements include the accounts of the Company, its subsidiaries, and its proportionate share of the accounts of jointly-controlled entities. Investments in entities which are not subsidiaries or joint ventures, but over which the Company exercises significant influence, are accounted for using the equity method.

Certain of the prior year comparative figures have been reclassified to conform with the current year's presentation.

(b) FOREIGN CURRENCY TRANSLATION

The Company's US-based petroleum transportation operations are integrated and are translated into Canadian dollars using the temporal method. Under this method, monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date, with the exception of certain long-term debt in the Express System, which is considered to be a hedge of U.S. dollar denominated revenues in the Express System. Non-monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect on the dates the assets were acquired or liabilities assumed. Revenues and expenses are translated at the average rates of exchange prevailing during the month the transactions occurred. Under this method, exchange gains and losses on translation are reflected in income when incurred.

The Company translates its self-sustaining US dollar denominated water and utility service businesses' and Clean Energy's financial statements into Canadian dollars using the current rate method of foreign currency translation. Under this method, assets and liabilities are translated at the rate of exchange in effect at the balance sheet date, revenue and expense items are translated at average rates of exchange for the period, and the exchange gains and losses arising on the translation of the financial statements are recorded in the cumulative currency translation adjustment account in Shareholders' equity.

(c) REGULATION

The natural gas distribution companies are subject to the regulation of the British Columbia Utilities Commission ("the BCUC"), an independent regulatory authority. Both Terasen Gas and TGVI have multi-year agreements that will expire at the end of 2007. These multi-year agreements are cost-of-service based agreements with allowed rates of return on approved rate base set by the BCUC. On March 2, 2006 a decision was issued by the BCUC approving changes to Terasen Gas' and TGVI's deemed equity components from 33% to 35% and from 35% to 40%, respectively, with effect from January 1, 2006. The same decision also modified the previously existing generic return on equity ("ROE") reset formula resulting in an increase in allowed ROE's from the levels that would have resulted from the old formula. The changes increased the allowed ROE for 2006 from 8.29% to 8.80% for Terasen Gas and from 8.79% to 9.50% for TGVI. For 2007, the allowed ROE for Terasen Gas is 8.37% and for TGVI is 9.07%.

The allowed rates of return are based on a notional debt-equity ratio of 65% debt and 35% equity for Terasen Gas and 60% debt and 40% equity for TGVI. The entities have annual review processes for rate approvals, and the allowed rates of return are reset annually unless directed differently by the BCUC.

The Trans Mountain and Express System operations are governed by contractual arrangements with shippers and are regulated in Canada by the National Energy Board and, in the United States, tariff matters are regulated by the Federal Energy Regulatory Commission. Both of these regulatory authorities are independent bodies. Trans Mountain has entered into a new agreement with shippers which will expire at the end of 2010. The Express System has firm service agreements that extend until 2015.

Corridor's operations are governed by contractual arrangements with shippers and are subject to regulation by the Alberta Energy and Utilities Board ("the AEUB"), an independent regulatory authority. Corridor's rates are cost-of-service based and determined using formulas embedded in agreements with shippers.

FSW is regulated by the Regulatory Commission of Alaska, an independent regulatory authority. FSW has a cost-of-service based agreement with allowed rates of return set by the Regulatory Commission. Until our sale, FSW was operating on an interim rate basis.

Over 95% of the Company's operations are subject to rate regulation by independent regulatory agencies. These regulatory authorities exercise statutory authority over such matters as rates of return, construction and operation of facilities, accounting practices, rates and tolls, and contractual agreements with customers.

In order to recognize the economic effects of regulation, the timing of recognition of certain revenues and expenses in these operations may differ from that otherwise expected under generally accepted accounting principles for non-regulated businesses.

Regulatory assets represent amounts that are expected to be recovered from customers in future periods through rates. Regulatory liabilities represent amounts that are expected to be refunded to customers in future periods through rates. In the absence of rate regulation, GAAP would not permit the recognition of regulatory assets or liabilities and the earnings impact would be recorded in the period the expenses are incurred or revenues are earned. Long-term regulatory assets are recorded in other assets whereas current regulatory assets are recorded in accounts receivable. Regulatory liabilities are recorded in other long-term liabilities and deferred credits.

The impacts of rate regulation on the Company's operations for the twelve months ending December 31, 2006 and as at December 31, 2006 are described in these Significant Accounting Policies, and in Note 5 "Property, Plant and Equipment", Note 6 "Rate Stabilization Accounts", Note 7 "Other Assets", Note 9 "Other Long-Term Liabilities and Deferred Credits", Note 12 "Employee Benefit Plans", Note 13 "Financing Costs", and Note 14 "Income Taxes".

(d) INVENTORIES

Inventories of gas in storage are valued at weighted-average cost. The cost of gas in storage is recovered from customers in future rates. Supplies and other inventories are valued at the lower of cost and net realizable value.

(e) LONG-TERM INVESTMENTS

Investments in entities, when the Company exercises significant influence on their activities, are accounted for under the equity method and are presented in long-term investments in the consolidated balance sheets. Other long-term investments where we do not have significant influence are carried at cost and are presented in other assets in the consolidated balance sheets.

When the carrying value exceeds the fair value and the decline in fair value is other than temporary, long-term investments are written-down to their fair value.

(f) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are recorded at cost less accumulated depreciation and unamortized contributions in aid of construction. Cost includes all direct expenditures for system expansions, betterments and replacements, an allocation of overhead costs and an allowance for funds used during construction. When allowed by the regulators, regulated operations capitalize an allowance for equity funds used during construction at approved rates.

Depreciation of regulated assets is recorded on a straight-line basis over their useful lives. Depreciation rates for regulated assets are approved by the respective regulator, and for non-regulated assets require the use of management estimates of the useful lives of assets. Depreciation of non-regulated equipment is recorded using the declining balance method.

The cost of regulated depreciable property retired, together with removal costs less salvage, is charged to accumulated depreciation, as is any gain or loss incurred on disposal.

(g) IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

(h) ASSET RETIREMENT OBLIGATIONS

The Company recognizes the fair value of a future asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that results from the acquisition, construction, development, and/or normal use of the assets. The Company concurrently recognizes a corresponding increase in the carrying amount of the related long-lived asset that is depreciated over the remaining life of the asset. The fair value of the asset retirement obligation is estimated using the expected cash flow approach that reflects a range of possible outcomes discounted at a credit-adjusted risk-free interest rate. Subsequent to the initial measurement, the asset retirement obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation.

Changes in the obligation due to the passage of time are recognized in income as an operating expense using the interest method. Changes in the obligation due to changes in estimated cash flows are recognized as an adjustment of the carrying amount of the related long-lived asset that is depreciated over the remaining life of the asset.

As the fair value of future removal and site restoration costs for the Company's natural gas distribution and petroleum transportation systems are not currently determinable, the Company has not recognized an asset retirement obligation as at December 31, 2006 and 2005. For regulated operations there is a reasonable expectation that asset retirement costs would be recoverable through future rates or tolls.

(i) RATE STABILIZATION ACCOUNTS

TGVI maintains a BCUC approved Revenue Deficiency Deferral Account ("RDDA") to accumulate unrecovered costs of providing service to customers or to drawdown such costs where earnings exceed an allowed return as set by the BCUC. The RDDA has accumulated the allowed earnings in excess of achieved earnings prior to 2003 and is to be recovered through future rates. During the years ended December 31, 2006 and 2005, the RDDA has decreased as achieved earnings have exceeded the allowed return.

Terasen Gas is authorized by the BCUC to maintain rate stabilization accounts which mitigate the effect on its earnings of unpredictable and uncontrollable factors, namely volume volatility caused principally by weather and natural gas cost volatility. The Revenue Stabilization Adjustment Mechanism ("RSAM") accumulates the margin impact of variations in the actual versus forecast volume use for residential and commercial customers.

The Commodity Cost Reconciliation Account ("CCRA") and the Midstream Cost Reconciliation Account ("MCRA") accumulate differences between actual natural gas costs and forecast natural gas costs as recovered in base rates. The two accounts segregate costs that are allocable to all sales customers (MCRA) and all residential customers and certain commercial and industrial customers for whom Terasen Gas acquires gas supply (CCRA). TGVI has a Gas Cost Variance Account ("GCVA") which mitigates the effect on its earnings of natural gas cost volatility. The GCVA is recoverable in rates from customers in TGVI's service areas in future periods.

All rate stabilization account balances for both TGVI and Terasen Gas are amortized and recovered through rates as approved by the BCUC.

(j) DEFERRED CHARGES

The Company defers certain costs which the regulatory authorities or contractual arrangements require or permit to be recovered through future rates or tolls. Deferred charges are amortized over various periods as approved by the regulator and depending on the nature of the costs.

Deferred charges include long-term debt issue costs which are amortized over the term of the related debt.

Deferred charges not subject to regulation relate to projects which are expected to benefit future periods and will be capitalized on completion, expensed on project abandonment, or amortized over their useful lives.

(k) GOODWILL

Goodwill represents the excess of an investment over the fair value of the net assets acquired. Goodwill is not amortized and is tested annually for impairment by comparing the book value with the fair value of the goodwill of the reporting unit to which the goodwill is attributable. Any deficiency in the book value compared to the fair value will be recognized as an impairment loss.

(l) REVENUE RECOGNITION

The Company recognizes revenues when products have been delivered or services have been performed.

The natural gas distribution utilities record revenues from natural gas sales on the basis of regular meter readings and estimates of customer usage since the last meter reading date to the end of the year and are adjusted for the RSAM and other BCUC approved orders.

For the petroleum transportation operations, revenues are recorded when products are delivered and adjusted according to terms prescribed by toll settlements with the shippers and approved by the respective regulator.

For the water and utility services operations revenues are recorded when services have been performed or products have been delivered.

(m) DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilizes derivatives and other financial instruments to manage its exposure to changes in foreign currency exchange, interest rates and energy commodity prices.

A derivative must be designated and effective to be accounted for as a hedge. The Company designates each derivative instrument as a hedge of specific assets or liabilities on the balance sheet, specific firm commitments or anticipated transactions. The Company also assesses, both at inception and on an ongoing basis, whether the derivative instruments that are used in each hedging transaction are highly effective in offsetting changes in fair values or cash flows of the hedged items. Derivatives accounted for as a hedge are not recognized in the consolidated financial statements at December 31, 2006 and 2005.

Derivative financial instruments not designated as effective as a hedge are recorded at fair value at the balance sheet date. The carrying amount of these derivatives, which comprise unrealized gains and losses, are included in accounts receivable in the case of contracts in a gain position and accounts payable and accrued liabilities in the case of contracts in a loss position. The offsetting gain/loss is recorded in the rate stabilization accounts, as realized gains/losses are passed on to customers when realized.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions.

As approved by the regulator, derivatives are used to manage natural gas commodity price risk in the natural gas distribution operations. The majority of natural gas supply contracts have floating, rather than fixed prices. The Company uses natural gas price swap contracts to fix the effective purchase price. Any differences between the effective cost of natural gas purchased and the price of natural gas included in rates are recorded in deferral accounts (CCRA and MCRA), and subject to regulatory approval, are passed through in future rates to customers.

Foreign currency risk in natural gas distribution operations relates mainly to purchases and sales of natural gas denominated in U.S. dollars, and is thereby managed through regulatory deferral accounts.

The Company's short-term borrowings and variable rate long-term debt are exposed to interest rate risk. The Company manages interest rate risk through the use of interest rate derivatives with payments and receipts under interest rate swap contracts being recognized as adjustments to financing costs.

The Company's earnings from the U.S. portion of Trans Mountain's crude oil pipeline system and the Company's investment in the Express System are subject to foreign currency risk. The Company manages some of these foreign currency exposures through the use of foreign currency derivatives.

Unless otherwise approved by regulation, if a derivative instrument is terminated or ceases to be effective prior to maturity, the gain or loss at that date is deferred and recognized in income concurrently with the hedged item. Any subsequent changes in the value of the derivative instrument are reflected in income.

Non-hedge derivatives not subject to regulation are marked to market at the balance sheet date with fluctuations in value charged to earnings.

(n) POST-EMPLOYMENT BENEFIT PLANS

The Company sponsors a number of employee benefits plans. These plans include both defined benefit and defined contribution pension plans, and various other post-retirement benefit plans.

The cost of pensions and other post-retirement benefits earned by employees is actuarially determined as the employee provides service, except when the regulator requires costs to be expensed as paid. The Company uses the projected benefit method based on years of service and management's best estimates of expected returns on plan assets, salary escalation, retirement age of employees, mortality and expected future health-care costs. The discount rate used to value liabilities is based on AA Corporate bond yields. The Company accrues the cost of defined benefit pensions and post- employment benefits as the employee provides services, except when the regulator requires costs to be expensed as paid.

The expected return on plan assets is based on management's estimate of the long-term expected rate of return on plan assets and a market-related value of plan assets. The market-related value of assets as of December 31, 2006 is calculated as the average of the market value of invested assets at December 31, 2006 and two actuarially determined extrapolated market values of invested assets at December 31, 2006. The two extrapolated market values are calculated by using the market value of invested assets at December 31, 2004 rolled forward to December 31, 2006 using 2005 and 2006 net contributions and assumed investment returns, and the market value of invested assets at December 31, 2005 rolled forward to December 31, 2006 using 2006 net contributions and assumed investment returns. These three amounts are then averaged to determine the market-related value of plan assets used in calculating net benefit expense.

Adjustments, in excess of 10% of the greater of the accrued benefit obligation and plan asset fair value, that result from plan amendments, changes in assumptions and experience gains and losses, are amortized over the expected average remaining service life of the employee group covered by the plan. Experience will often deviate from the actuarial assumptions resulting in actuarial gains and losses.

Defined contribution plan costs are expensed by the Company as contributions are payable.

(o) INCOME TAXES

The Company's regulated gas and petroleum operations account for and recover income tax expense in rates as prescribed by their respective regulators. This includes accounting for income taxes by the taxes payable method and accounting for certain deferral and rate stabilization accounts on a net of realized tax basis. Therefore, future income taxes related to temporary differences are not recorded.

The taxes payable method is followed as there is a reasonable expectation that all future income taxes will be recovered in rates when they become payable.

The Company's non-regulated operations follow the asset and liability method of accounting for income taxes. Future income tax assets and liabilities are determined based on temporary differences between the tax bases of assets and liabilities and their carrying values for accounting purposes. Future income tax assets and liabilities are measured at the tax rate that is expected to apply when the temporary differences reverse.

(p) STOCK-BASED COMPENSATION

Prior to November 30, 2005, the Company had a Share Option Plan whereby officers, directors and certain key employees may be granted options to purchase common shares. The Company uses the fair value based method for valuing stock options granted on or after January 1, 2003. Under the fair value based method, compensation cost is measured at the fair value at the date of grant and is expensed over the award's vesting period.

Prior to January 1, 2003, the Company used the settlement method of accounting for stock options, whereby any consideration paid by employees on the exercise of stock options was credited to common shares and no compensation expense was recognized.

The Company's Share Option Plan was discontinued on November 30, 2005 as a result of the acquisition of the Company by KMI.

The Company issued Deferred Share Units ("DSU's") to senior management and Board members under long-term compensation programs and also as an optional form of compensation to Board members. The DSU's were marked-to-market at the end of each quarter and gains or losses were recognized in earnings. The DSU's notionally earned dividends that were reinvested as additional DSU's when dividends were paid, and were paid out in cash only on retirement or termination of the individual receiving them. The DSU's were paid out in cash upon the acquisition of the Company by KMI on November 30, 2005.

(q) VARIABLE INTEREST ENTITIES

Effective January 1, 2005, the Company adopted the Canadian Institute of Chartered Accountants (CICA) Handbook Accounting Guideline 15 "Consolidation of Variable Interest Entities". The Company has performed a review of the entities with whom it conducts business and determined that under the definitions in the Guideline the Company's investment in Express US Holdings LP, part of the Express System, is deemed to be a variable interest entity. As the Company has not been identified as the primary beneficiary of Express US Holdings LP, the Company continues to account for its investment in the Express System on an equity basis. The Company's future exposure to loss regarding its investment is represented by the carrying value of the investment.

2. SEGMENT DISCLOSURES

2006

	Natural gas distribution	Petroleum transportation	Other activities	Total
Revenues	**$ 1,741.1**	**$ 242.4**	**$ 44.2**	**$ 2,027.7**
Cost of natural gas	**1,117.9**	**—**	**—**	**1,117.9**
Cost of revenues from other activities	**—**	**—**	**27.1**	**27.1**
Operation and maintenance	**197.5**	**83.8**	**11.1**	**292.4**
Depreciation and amortization	**102.1**	**37.6**	**5.5**	**145.2**
Property and other taxes	**49.4**	**25.1**	**—**	**74.5**
	1,466.9	**146.5**	**43.7**	**1,657.1**
Operating income	**274.2**	**95.9**	**0.5**	**370.6**
Financing costs	**123.3**	**26.8**	**29.4**	**179.5**
Share of (earnings) of Express System	**—**	**(24.5)**	**—**	**(24.5)**
Income taxes (recovery) on earnings	**55.4**	**17.4**	**(4.4)**	**68.4**
Net earnings (loss) before discontinued operations	**95.5**	**76.2**	**(24.5)**	**147.2**
Loss from discontinued operations	**—**	**—**	**(17.5)**	**(17.5)**
Net earnings (loss)	**95.5**	**76.2**	**(42.0)**	**129.7**
Total assets	**3,698.5**	**1,639.4**	**39.9**	**5,377.8**
Goodwill	**76.4**	**—**	**—**	**76.4**
Capital expenditures	**147.4**	**229.4**	**0.3**	**377.1**

2005

	Natural gas distribution	Petroleum transportation	Other activities	Total
Revenues	$ 1,678.0	$ 227.8	$ 46.7	$ 1,952.5
Cost of natural gas	1,063.7	—	—	1,063.7
Cost of revenues from other activities	—	—	28.9	28.9
Operation and maintenance	195.8	82.3	42.6	320.7
Depreciation and amortization	96.7	37.6	8.3	142.6
Property and other taxes	47.4	24.6	(0.1)	71.9
	1,403.6	144.5	79.7	1,627.8
Operating income	274.4	83.3	(33.0)	324.7
Financing costs	129.2	31.7	30.5	191.4
Share of (earnings) of Express System	—	(21.9)	—	(21.9)
Income taxes (recovery) on earnings	54.4	9.0	(11.8)	51.6
(Earnings) from Clean Energy net of disposition costs	—	—	(2.5)	(2.5)
Net earnings (loss) before discontinued operations	90.8	64.5	(49.2)	106.1
Loss from discontinued operations	—	—	(4.9)	(4.9)
Net earnings (loss)	90.8	64.5	(54.1)	101.2
Total assets	3,663.6	1,404.2	262.1	5,329.9
Goodwill	76.4	—	—	76.4
Capital expenditures	176.3	37.4	1.0	214.7

The segmented disclosures in these consolidated financial statements report the water and utility services business as discontinued operations. Terasen's 30% share of CWLP is included in other activities.

3. DISCONTINUED OPERATIONS AND DISPOSITIONS

(a) In January 2006, the Company entered into an agreement to sell Terasen Water and Utility Services, including the Company's 50% equity interest in FSW, to a consortium of external third parties and Terasen Water and Utility Services senior management. The sale does not include the Company's interest in CWLP. The sale was completed on May 19, 2006.

The Company has classified, at December 31, 2005, the assets and liabilities of the entities being sold as assets and liabilities held for sale. The revenue and expense items for 2005 and 2006 have been classified as loss from discontinued operations. The 2005 pre-tax income includes a charge to earnings of $7.2 related to currency translation losses arising on the Company's investment in self-sustaining foreign operations.

(b) On October 31, 2005, the Company sold its 40.38% ownership in Clean Energy for proceeds of approximately U.S. $35.9 million. The sale, together with equity earnings of Clean Energy for the nine months ended September 30, 2005, resulted in a gain of $2.5 million, including the recognition of all unrealized gas forward contract gains of Clean Energy in 2005 totaling $10.9 million and the recognition of currency translation losses previously included in shareholders' equity totaling $8.4 million.

4. INVESTMENTS IN JOINTLY-CONTROLLED ENTITIES

As at December 31, 2006, the Company has a 30% interest in CWLP for which it uses the proportionate consolidation method of accounting. The Company's proportionate interest in the assets and liabilities of FSW are excluded from the table below as they are classified as assets and liabilities held for sale at December 31, 2005. The Company's proportionate interest in FSW at December 31, 2005 includes $52.8 million of assets and $16.0 million of liabilities, all of which are classified as held for sale.

The Company's proportionate share of assets, liabilities, revenues, expenses, and cash flows related to this entity proportionately consolidated is summarized as follows:

	2006	2005
Current assets	**$ 9.9**	$ 10.2
Long-term assets (including property, plant and equipment and goodwill)	**29.6**	35.6
Current liabilities	**27.6**	39.4
Revenues	**43.0**	43.5
Expenses (including financing costs and income tax)	**35.8**	36.4
Net earnings from continuing operations	**7.2**	7.1
Earnings from discontinued operations	**—**	1.7
Cash flows from operating activities	**0.6**	13.9
Cash flows from investing activities	**(0.9)**	(0.1)
Cash flows from financing activities	**—**	—

5. PROPERTY, PLANT AND EQUIPMENT

	2006 Weighted average depreciation rate	Cost	Accumulated depreciation	Net book Value
Natural gas distribution systems	**2.37%**	**$ 3,232.9**	**$ 679.8**	**$ 2,553.1**
Petroleum pipeline systems	**2.53%**	**1,597.2**	**363.6**	**1,233.6**
Plant, buildings and equipment	**8.29%**	**466.5**	**209.8**	**256.7**
Land and land rights	**0.04%**	**154.1**	**2.8**	**151.3**
		$ 5,450.7	**$ 1,256.0**	**$ 4,194.7**

	2005 Weighted average depreciation rate	Cost	Accumulated depreciation	Net book Value
Natural gas distribution systems	2.31%	$ 3,093.9	$ 596.7	$ 2,497.2
Petroleum pipeline systems	2.59%	1,329.5	329.7	999.8
Plant, buildings and equipment	9.13%	427.4	167.0	260.4
Land and land rights	0.15%	153.2	2.7	150.5
		$ 5,004.0	$ 1,096.1	$ 3,907.9

As allowed by the regulators, during the year ended December 31, 2006, the Company capitalized an allowance for equity funds during construction at approved rates of $1.2 million (2005 — $1.0 million) and approved capitalized overhead of $32.0 million (2005 — $31.1 million), with offsetting inclusions in earnings.

6. RATE STABILIZATION ACCOUNTS

	2006	2005
Current Assets		
RDDA	**$ 7.3**	$ 12.8
RSAM	**11.3**	13.0
CCRA	**81.3**	—
MCRA	**25.5**	—
Gas Cost Variance Account (TGVI)	**9.1**	2.6
	134.5	28.4
Long-Term Assets		
RDDA	**23.6**	22.4
RSAM	**24.7**	25.9
	48.3	48.3
Current Liabilities		
CCRA	**—**	(21.3)
MCRA	**—**	(26.6)
	—	(47.9)
Net rate stabilization accounts	**$ 182.8**	$ 28.8

The current portion of the rate stabilization accounts represents the amounts expected to be recovered or refunded in rates over the next year. Actual recoveries/(refunds) will vary depending on actual natural gas consumption and recovery amounts approved by the BCUC. Rate stabilization accounts are presented net of tax, where applicable.

The RSAM account is anticipated to be recovered in rates over three years. Recovery of the RSAM balance is dependent upon annually approved rates and actual gas consumption volumes. The MCRA and CCRA accounts are anticipated to be fully recovered or paid within the next fiscal year. The RDDA has accumulated the allowed earnings in excess of achieved earnings prior to 2003 and is to be recovered through future rates. During the years ended December 31, 2006 and 2005, the RDDA has decreased as achieved earnings have exceeded the allowed return.

In the absence of rate regulation, the costs in the rate stabilization accounts above would have been expensed as incurred which would have resulted in decreased margin of $240.6 million (2005 — increased $31.0 million), increased natural gas distribution revenues of $4.3 million (2005 — $0.1 million) decreased income taxes expense of $75.9 million (2005 — increased $15.4 million) and increased net income of $6.4 million (2005 — 15.5 million) related to the RDDA.

7. OTHER ASSETS

	2006	2005
Deferred charges		
Subject to rate regulation and approval for recovery in rates		
Income taxes recoverable on post-employment benefits	**$ 13.1**	$ 10.6
Long-term debt issue costs	**8.7**	9.5
Commercial commodity unbundling costs	**2.5**	3.2
Replacement transportation agreement	**2.2**	3.2
Other items included approved for recovery in rates	**9.6**	12.2
Subject to rate regulation but not yet approved for recovery in rates		
Deferred development costs for capital projects	**25.3**	19.5
Southern Crossing Pipeline PST Reassessment	**10.0**	—
Corporate capital tax deferrals	**7.6**	7.5
Other items subject to rate regulation but not yet approved	**0.2**	1.7
Included in non-regulated entities		
Long-term debt issue costs	**1.1**	1.0
Other items included in non-regulated entities	**2.5**	2.7
	82.8	71.1
Pension assets (Note 12)	**17.5**	13.8
Investments	**1.7**	2.2
Long-term receivables	**11.2**	11.5
	$ 113.2	$ 98.6

Amortization of these deferred charges in rates for the year ended December 31, 2006 totalled $4.9 million (2005 — $11.3 million).

The deferral account for income taxes on post-employment benefits relates to income tax amounts on post employment benefit expense. The BCUC allows post-employment benefits to be collected from customers through rates calculated on the accrual basis, rather than a cash paid basis, which produces timing differences for income tax purposes. Since Terasen Gas accounts for income taxes using the taxes payable basis of accounting, the tax effect of this timing difference is included in other assets, and will be reduced as cash payments for post-employment benefits exceed required accruals and amounts collected from customers in rates.

Long-term debt issue costs are amortized over the terms of the related debt, whose maturity dates are provided in Note 8 "Long-Term Debt".

The commercial commodity unbundling costs deferred are costs incurred to develop a third-party marketer alternative for commercial customers to purchase natural gas from suppliers other than Terasen Gas. The BCUC has approved the recovery of these costs in rates over a five-year period, of which three years remain at December 31, 2006.

The deferral account for the replacement transportation agreement relates to amounts that Terasen Gas is allowed to recover from customers in rates in order to cover any shortfall in revenues relative to a minimum amount approved by the BCUC on the Company's Southern Crossing Pipeline. The deferral account is being amortized and recovered in rates over a five-year period, of which three years remain at December 31, 2006.

Deferred development costs for capital projects include costs for projects under development that are expected to be added to regulated rate-base in future periods. These costs include approximately $22.3 million (2005 — $16.2 million) for Trans Mountain Expansion ("TMX") costs and $3.0 million (2005 — $3.3 million) for capital projects that are currently in progress by the natural gas distribution operations.

The deferral account for the Southern Crossing Pipeline PST reassessment relates to a payment made in regards to an assessment of additional provincial sales tax on the Southern Crossing Pipeline (see Note 17). The Company made a payment of $10 million pending resolution of the appeal as a good faith payment in order to forestall an order from the Province of British Columbia ("the Province") to provide full payment or security. Depending on the success of the appeal, the Company will either be refunded this payment from the Province or alternatively expects to recover the costs from customers in future rates.

The deferral for corporate capital tax relates to tax payments that were made to the Province related to assessments for corporate capital tax for TGVI and Terasen Gas. In November 2006, the Supreme Court of BC decided in favour of the Company in respect of some of the significant issues under appeal. The Province appealed the decision but withdrew its appeal subsequent to year end. Amounts will be refunded to customers in future rates.

On October 6, 2005, the BCUC issued a decision that denied recovery of approximately $5.4 million of costs that Terasen Gas incurred to develop the Inland Pacific Connector pipeline project that is planned to bring new gas transmission capacity to the Lower Mainland of British Columbia when economic conditions make the project viable. Terasen Gas recorded an after-tax provision of $3.7 millio n at December 31, 2005. The Company still intends to proceed with the project when market conditions are supportive and intends to keep all existing permits and land right approvals in place that have already been granted. The Company will again seek to recover such costs in the future when it proceeds with the project.

Deferred charges for rate regulated entities that have been aggregated in the table above and in the table in "Other Long-term Liabilities and Deferred Credits" in Note 9 relate to more than 50 deferral accounts, none of which exceed $2.0 million individually. All of these accounts have been approved by regulators in prior annual rate approvals or orders and are being amortized over various periods depending on the nature of the costs.

In the absence of rate regulation, the deferred charges in the above table would have been expensed, except for the costs related to deferred development costs for capital projects, the Inland Pacific Connector development costs and the investment balances. This would have resulted in increased income taxes of $2.5 million (2005 — $2.2 million), decreased financing costs of $0.7 million (2005 — increased $0.3 million), increased operation and maintenance costs of $6.3 million (2005 — decreased $12.0 million) and increased property and other taxes of $0.1 million (2005 — decreased $0.2 million).

8. LONG-TERM DEBT

	2006	2005
Terasen Inc.		
(a) Medium Term Note Debentures:		
6.30% Series 1, due December 1, 2008	**$ 200.0**	$ 200.0
4.85% Series 2, due May 8, 2006	**—**	100.0
5.56% Series 3, due September 15, 2014	**125.0**	125.0
(b) 8% Capital Securities, due April 19, 2040	**125.0**	125.0
	450.0	550.0
Terasen Gas Inc.		
(c) Purchase Money Mortgages:		
11.80% Series A, due September 30, 2015	**74.9**	74.9
10.30% Series B, due September 30, 2016	**200.0**	200.0
(d) Debentures and Medium Term Note Debentures:		
9.75% Series D, due December 17, 2006	**—**	20.0
10.75% Series E, due June 8, 2009	**59.9**	59.9
6.20% Series 9, due June 2, 2008	**188.0**	188.0
6.95% Series 11, due September 21, 2029	**150.0**	150.0
6.50% Series 13, due October 16, 2007	**100.0**	100.0
6.15% Series 16, due July 31, 2006	**—**	100.0
6.50% Series 18, due May 1, 2034	**150.0**	150.0
5.90% Series 19, due February 26, 2035	**150.0**	150.0
Floating Rate Series 20, interest rate of 4.25% (2005 — 3.36%) due October 24, 2007	**150.0**	150.0
5.55% Series 21, due September 25, 2036	**120.0**	—
Obligations under capital leases, at 5.62% (2005 — 6.07%)	**7.2**	8.8
	1,350.0	1,351.6
Terasen Gas (Vancouver Island) Inc.		
(e) Syndicated credit facility at short-term floating rates, weighted average interest rate of 4.88% (2005 — 3.88%) which matures in 2011. (Note 17)	**299.7**	209.5
(f) Government repayable loan due 2007 (Note 17)	**3.8**	—
	303.5	209.5
Terasen Pipelines (Corridor) Inc.		
(g) Debentures:		
4.24% Series A, due February 2, 2010	**150.0**	150.0
5.033% Series B, due February 2, 2015	**150.0**	150.0
	300.0	300.0
Total long-term debt	**2,403.5**	2,411.1
Less: current portion of long-term debt	**285.9**	398.2
	$ 2,117.6	$ 2,012.9

(a) TERASEN INC. MEDIUM TERM NOTE DEBENTURES:

The Company's Medium Term Note Debentures are unsecured obligations but are subject to the restrictions of the Trust Indenture dated November 21, 2001.

(b) TERASEN INC. CAPITAL SECURITIES:

On April 19, 2000, the Company issued $125.0 million of 8.0% Capital Securities with a term to maturity of 40 years for gross proceeds of $123.7 million. The Company may elect to defer payments on these securities and settle such deferred payments in either cash or common shares, and has the option to settle principal at maturity through the issuance of common shares. The securities are exchangeable at the option of the holder on or after April 19, 2010 for common shares of the Company at 90% of the market price, subject to the right of the Company to redeem the securities for cash.

(c) TERASEN GAS INC. PURCHASE MONEY MORTGAGES:

The Series A and Series B Purchase Money Mortgages are secured equally and rateably by a first fixed and specific mortgage and charge on Terasen Gas' Coastal Division assets, and are subject to the restrictions of the Trust Indenture dated December 3, 1990. The aggregate principal amount of Purchase Money Mortgages that may be issued under the Trust Indenture is limited to $425 million.

(d) TERASEN GAS INC. DEBENTURES AND MEDIUM TERM NOTE DEBENTURES:

Terasen Gas' debentures are unsecured obligations but are subject to the restrictions of the Trust Indenture dated November 1, 1977, as amended and supplemented.

(e) TERASEN GAS (VANCOUVER ISLAND) INC. BANK SYNDICATE:

On January 13, 2006, TGVI entered into a five-year $350 million unsecured committed revolving credit facility with a syndicate of banks. TGVI issued bankers' acceptances under this facility to completely refinance TGVI's former term facility. The bankers' acceptances have terms not to exceed 180 days at the end of which time they are replaced by new bankers' acceptances. The facility can also be utilized to finance working capital requirements and for general corporate purposes. The terms and conditions are similar to those of the previous facility and common for such term credit facilities. Concurrently with executing this facility, TGVI entered into a $20 million seven-year unsecured committed non-revolving credit facility with one bank. This facility will be utilized for purposes of refinancing any annual prepayments that TGVI may be required to make on non-interest bearing government contributions. The terms and conditions are primarily the same as the aforementioned TGVI facility except this facility ranks junior to repayment of TGVI's Class B subordinated debt, which is held by its parent, the Company. While the bankers' acceptances are short term, the underlying credit facility on which the bankers' acceptances are committed is open through January 2011. Accordingly, under the $350 million credit facility, borrowings outstanding at December 31, 2006 of $269 million have been classified as long-term debt and an estimated $27.0 million as current maturities. Borrowings outstanding against the $20 million credit facility at December 31, 2006 were $3.7 million.

(f) TERASEN PIPELINES (CORRIDOR) INC. DEBENTURES PAPER:

On February 1, 2005, Corridor issued $150 million Series A Debentures and $150 million Series B Debentures. The debentures are unsecured and subject to restrictions of the Trust Indenture. The proceeds were used to repay a portion of Corridor's outstanding commercial paper.

Concurrent with the debenture issuance, Corridor entered into an operating credit facility which has annual renewal provisions. The credit facility is unsecured and will backstop Corridor's commercial paper issuance.

The Company's Series 1 and Series 3 Medium Term Note Debentures and Capital Securities, Terasen Gas' Series B Purchase Money Mortgages, Series E Debentures, and Series 11, Series 13, Series 18, Series 19 and Series 21 Medium Term Note Debentures, and Corridor Series A and Series B Debentures are redeemable in whole or in part at the option of the Company at a price equal to the greater of the Canada Yield Price, as defined in the applicable Trust Indenture, and the principal amount of the debt to be redeemed, plus accrued and unpaid interest to the date specified for redemption. The Canada Yield Price is calculated as an amount that provides a yield slightly above the yield on an equivalent maturity Government of Canada bond.

Required principal repayments over the next five years are as follows:

2007	$ 285.9
2008	389.4
2009	61.4
2010	151.4
2011	270.5

9. OTHER LONG-TERM LIABILITIES AND DEFERRED CREDITS

	2006	2005
Pension and other post-employment benefit liabilities (Note 12)	**$ 65.2**	$ 53.5
Deferred gains on sale of natural gas distribution assets	**54.8**	59.2
Deferred payment	**38.3**	36.0
Deferred credits		
Subject to rate regulation and approved for refund in rates		
Earnings Sharing Mechanism	**12.6**	8.8
SCP Net Mitigation Revenue	**3.8**	0.8
Large Corporation Tax Elimination	**3.1**	—
Deferred Interest Mechanism	**0.4**	2.4
Other items included approved for repayment in rates	**7.7**	6.0
Other deferred credits in entities subject to rate regulation	**0.5**	1.7
Other deferred credits/liabilities	**12.0**	13.9
	$ 198.4	$ 182.3

The deferred gains on sale of natural gas distribution assets occurred upon the sale and leaseback of pipeline assets to certain municipalities in 2001, 2002, 2004 and 2005. The pre-tax gains of $70.5 million on combined cash proceeds of $141.1 million are being amortized over the 17-year terms of the operating leases that commenced at the time of the sale transactions. These operating lease commitments are included in the table in Note 17.

The deferred payment resulted from the Company's acquisition of TGVI effective January 1, 2002. The deferred payment has a face value of $52.0 million but was discounted at January 1, 2002 to a present value of $28.2 million. The payment is due on December 31, 2011 or sooner if TGVI realizes revenues from transportation revenue contracts to serve power-generating plants which may be constructed in TGVI's service area. If any part of the deferred payment is paid prior to December 31, 2011, the difference between the payment and the carrying value of the debt will be treated as contingent consideration for the acquisition of TGVI and will be added to the cost of the purchase at that time.

The Earnings Sharing Mechanism is a mechanism agreed to in Terasen Gas' multi-year agreement to share, on a 50/50 basis, amounts earned by Terasen Gas on its regulated activities that exceed or are less than amounts allowed by the BCUC in the cost-of-service allowed return calculations. These amounts are shared on an after-tax basis, and are returned to customers in rates.

The SCP Net Mitigation Revenue is revenue that is received from third parties for the use of the SCP transportation capacity that has not been utilized by the firm transportation agreement customers. This account is used to record differences between actual revenues from SCP mitigation and what has been approved in the current revenue requirement. Amounts are being amortized to income over 5 years.

The large corporation tax elimination costs resulted from the British Columbia government eliminating the tax on large corporations in 2006. The BCUC allows large corporation tax to be recovered from customers through rates. These costs were collected from customers through rates in 2006 and now are owed back to customers in future rates upon the elimination of the large corporation tax. The costs will be returned to customers in rates over a three-year period beginning January 1, 2007.

Terasen Gas has a deferred interest mechanism which has been approved by the BCUC which requires that variances due to differences in long-term borrowings and long-term and short-term interest rates from those that have been approved in rates be returned to customers in future rates. The impact of this mechanism was to decrease financing costs for the year ended December 31, 2006 by $0.6 million (2005 — increase by $2.0 million) from what otherwise would be reported. The balance of the deferred interest account is being amortized on a straight-line basis over three years.

Other deferred credits/liabilities include amounts resulting from the Company's acquisition of TGVI effective January 1, 2002.

Amortization of deferred credits in entities that are subject to rate regulation in rates for the year ended December 31, 2006 totalled $4.1 million (2005 — $4.5 million).

In the absence of rate regulation, the other long-term liabilities and deferred credits in the above table would have been expensed, aside for the pension and other post-employment benefit liabilities and the deferred payment. This would have resu lted in decreased operation and maintenance costs of $1.0 million (2005 — $1.6 million), increased financing costs of $2.0 million (2005 — $0.1 million) and decreased property and other taxes of $3.1 million (2005 — nil).

10. SHARE CAPITAL

AUTHORIZED SHARE CAPITAL

The Company is authorized to issue 750,000,000 common shares, 100,000,000 first preference shares and 100,000,000 second preference shares, all without par value.

COMMON SHARES

Changes in the issued and outstanding common shares are as follows:

	2006		**2005**	
	Number	**Amount**	**Number**	**Amount**
Outstanding, beginning of year	**115,643,162**	**$ 904.9**	114,355,665	$ 883.4
Issued under:				
Share option plan	—	—	1,283,146	21.3
Employee share purchase plan	—	—	4,351	0.2
	115,643,162	**$ 904.9**	115,643,162	$ 904.9
Less common shares held by Trans Mountain	**9,184,188**		9,184,188	
Outstanding, end of year	**106,458,974**		106,458,974	

As at December 31, 2006, Trans Mountain owned 7.9% (2005 — 7.9%) of the common shares of Terasen Inc. The cost of these shares is shown as a deduction from shareholder's equity.

All of the shares outstanding at December 31, 2006 are owned by KMI.

11. SHARE OPTION PLAN AND STOCK-BASED COMPENSATION

SHARE OPTION PLAN

The Company had a Share Option Plan whereby officers and certain key employees could be granted options to purchase a maximum of 12,600,000 unissued common shares with terms up to ten years. There were two categories of options which were issued under the Share Option Plan, Regular Share Options and Performance Based Share Options. The option exercise price was the closing sale price of the common shares on the Toronto Stock Exchange on the trading day prior to the date the option was granted. The Share Option Plan was discontinued on November 30, 2005 as a result of the acquisition of the Company by KMI.

REGULAR SHARE OPTIONS

Since 2000, the Company had granted options with eight-year terms which were exercisable on a cumulative basis and vested at one-third per year on the anniversary of the option grant date. Prior to 2000, the Company granted options with ten-year terms which were exercisable on a cumulative basis at 20% per year.

REGULAR SHARE OPTIONS OUTSTANDING

	Shares under option	Weighted-average exercise price
Outstanding, January 1, 2005	565,868	$ 15.53
Options granted during the year	5,000	29.45
Options exercised	(287,165)	15.15
Options forfeited, cancelled and expired	(82,991)	11.59
Options purchased by KMI and cancelled	(200,712)	18.12
Outstanding & exercisable, December 31, 2005	—	$ —
Outstanding & exercisable, end of year December 31, 2006	—	$ —

PERFORMANCE BASED SHARE OPTIONS

The Company had granted performance based share options with eight-year terms. The options vested at one-third per year on the anniversary of the option grant dates, subject to the market price of the Company's common shares reaching 125% of the option's exercise price for at least 10 out of 15 consecutive trading days within four years of the option grant date. If the market price requirement was not attained within four years of grant date, the participant was still eligible to exercise two-thirds of the granted options if the common share price reached 125% of the option's exercise price for at least 10 out of 15 consecutive trading days during the subsequent four years.

PERFORMANCE BASED SHARE OPTIONS OUTSTANDING

	Shares under option	Weighted-average exercise price
Outstanding, January 1, 2005	2,339,619	$ 19.28
Options granted during the year	850,200	29.45
Options exercised	(995,981)	16.96
Options forfeited, cancelled and expired	(262,574)	17.09
Options purchased by KMI and cancelled	(1,931,264)	25.12
Outstanding & exercisable, December 31, 2005	—	$ —
Outstanding & exercisable, end of year December 31, 2006	—	$ —

STOCK-BASED COMPENSATION

In 2005, 855,200 stock options were granted at an average exercise price of $29.45 under the Company's Share Option Plan. The Company has applied the fair value based method of accounting for stock options granted after January 1, 2003. Reported earnings for 2005 include a compensation charge of $2.0 million representing the fair value of options granted in 2003, 2004 and 2005 amortized over their respective vesting periods, with a corresponding increase to contributed surplus. Just prior to the acquisition of the Company by KMI, any outstanding but not yet exercisable options became immediately exercisable and an additional pre-tax charge of $3.6 million was recorded to recognize the accelerated vesting of the remaining options. The options were then purchased by KMI and subsequently cancelled.

A Black-Scholes model was used to calculate stock option fair values. The weighted average fair value of options granted in 2005 was $4.33. Significant assumptions in valuing the options were as follows:

	2005	
	Regular Options	Performance Based
Interest rate	3.6%	3.7%
Expected volatility	16.5%	16.5%
Expected life	5 years	6 years

12. EMPLOYEE BENEFIT PLANS

The Company is a sponsor of pension plans for eligible employees. The plans include registered defined benefit pension plans, supplemental unfunded arrangements, which provide pension benefits in excess of statutory limits, and defined contributory plans. The Company also provides post-employment benefits other than pensions for retired employees. The following is a summary of each type of plan:

DEFINED BENEFIT PLANS

Retirement benefits under the defined benefit plans are based on employees' years of credited service and remuneration. Company contributions to the plan are based upon independent actuarial valuations. The most recent actuarial valuations of the defined benefit pension plans for funding purposes were at December 31, 2004 and December 31, 2005 and the date of the next required valuations are December 31, 2007 and December 31, 2008. The expected weighted average remaining service life of employees covered by the defined benefit pension plans is 10.8 years (2005 — 11.8 years).

DEFINED CONTRIBUTION PLAN

Effective in 2000 for Terasen Gas and 2003 for petroleum transportation operations, all new non-union employees become members of defined contribution pension plans. Company contributions to the plan are based upon employee age and pensionable earnings for employees of the natural gas distribution operations and pensionable earnings for employees of the petroleum transportation operation.

SUPPLEMENTAL PLANS

Certain employees are eligible to receive supplemental benefits under both the defined benefit and defined contribution plans. The supplemental plans provide pension benefits in excess of statutory limits. The supplemental plans are unfunded and are secured by letters of credit.

OTHER POST-EMPLOYMENT BENEFITS

The Company provides retired employees with other post-employment benefits that include, depending on circumstances, supplemental health, dental and life insurance coverage. Post-employment benefits are unfunded and annual expense is recorded on an accrual basis based on independent actuarial determinations, considering among other factors, health care cost escalation. The most recent actuarial valuations were completed as at December 31, 2005 and the date of the next required valuation is December 31, 2008. The expected weighted average remaining service life of employees covered by these benefit plans is 9.9 years (2005 — 9.9 years).

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 each year. The financial positions of the employee defined benefit pension plans and other benefit plans are presented in aggregate in the tables below:

	Pension benefit plans		Other benefit plans	
	2006	**2005**	**2006**	**2005**
Plan assets				
Fair value, beginning of year	**$ 298.5**	$ 274.5	**$ —**	$ —
Company contributions	**7.9**	6.9	**1.9**	1.6
Contributions by members	**3.4**	3.3	**—**	—
Actual return on plan assets	**41.9**	28.6	**—**	—
Benefits paid	**(17.8)**	(14.3)	**(1.8)**	(1.5)
Other	**0.8**	(0.5)	**(0.1)**	(0.1)
Fair value, end of year	**334.7**	298.5	**—**	—
Accrued benefit obligation				
Balance, beginning of year	**344.4**	298.0	**81.9**	67.3
Service cost	**9.0**	8.5	**1.8**	1.4
Interest cost	**17.2**	17.9	**4.1**	4.1
Benefit payments	**(17.8)**	(14.3)	**(1.7)**	(1.5)
Contributions by members	**3.4**	3.3	**—**	—
Plan amendments and curtailments	**—**	0.9	**—**	—
Past service cost	**—**	0.3	**—**	0.4
Special termination benefits	**0.4**	—	**—**	—
Actuarial loss	**13.4**	2.8	**3.6**	—
Change in discount rate	**—**	27.0	**—**	10.2
Balance, end of year	**370.0**	344.4	**89.7**	81.9
Plan deficiency	**(35.3)**	(45.9)	**(89.7)**	(81.9)
Unamortized transitional (benefit) obligation	**(20.4)**	(23.8)	**3.1**	4.7
Unamortized actuarial loss	**50.3**	62.7	**40.0**	39.7
Unamortized past service costs	**6.6**	7.4	**(2.3)**	(2.6)
Accrued benefit asset (liability)	**$ 1.2**	0.4	**$ (48.9)**	$ (40.1)
Represented by				
Pension assets	**$ 17.5**	$ 13.8	**$ —**	$ —
Accrued benefit liability	**(16.3)**	(13.4)	**(48.9)**	(40.1)
	$ 1.2	0.4	**$ (48.9)**	$ (40.1)

The net accrued benefit liability is included in other long-term liabilities and deferred credits (Note 9) and the pension asset is included in other assets (Note 7).

Included in the accrued benefit obligation and fair value of the plan assets at year-end are the following amounts in respect of plans with accrued benefit obligations in excess of fair value of assets:

	Pension benefit plans		Other benefit plans	
	2006	**2005**	**2006**	**2005**
Accrued benefit obligations:				
Unfunded plans	**$ 39.4**	$ 35.9	**$ 89.7**	$ 81.9
Funded plans	**275.8**	258.0	**—**	—
	315.2	293.9	**89.7**	81.9
Fair value of plan assets	**278.9**	246.2	**—**	—
Funded status deficit	**$ (36.3)**	$ (47.7)	**$ (89.7)**	$ (81.9)

The accrued benefit obligations for unfunded pension benefit plans are secured by letters of credit.

The net benefit plan expense is as follows:

	Pension benefit plans		Other benefit plans	
	2006	**2005**	**2006**	**2005**
Current service cost	**$ 9.2**	$ 8.7	**$ 1.9**	$ 1.6
Interest cost on projected benefit obligations	**17.2**	17.9	**4.1**	4.1
Actual return on plan assets	**(41.9)**	(28.6)	**—**	—
Net actuarial gains	**13.4**	29.8	**3.6**	9.0
Past service costs	**—**	0.3	**—**	—
Impact of curtailment/settlement	**—**	0.9	**—**	—
Net benefit plan (income) expense before adjustments	**(2.1)**	29.0	**9.6**	14.7
Adjustments to recognize the long-term nature of employee future benefit costs:				
Difference between actual and expected return on plan assets	**18.3**	9.2	**—**	—
Difference between actual and recognized actuarial losses in year	**(5.9)**	(26.8)	**(0.4)**	(6.4)
Difference between actual and recognized past service costs in year	**0.7**	0.4	**(0.2)**	(0.3)
Special termination benefits (obligations)	**0.4**	(0.7)	**—**	—
Amortization of transitional (benefit) obligation	**(3.4)**	(3.4)	**1.6**	1.6
Other	**—**	—	**—**	—
Net benefit plan expense	**$ 8.0**	$ 7.7	**$ 10.6**	$ 9.6
Defined contribution plan expense	**$ 2.1**	$ 1.6		
	$ 10.1	$ 9.3		

BENEFIT PLAN ASSETS

The weighted-average asset allocation by asset category of the Company's funded defined benefit pension plans is as follows:

	Pension benefit plans	
	2006	**2005**
Equity securities	**58%**	57%
Fixed income securities	**36%**	38%
Other assets	**6%**	5%
Total assets	**100%**	100%

The investment policy for benefit plan assets is to optimize the risk-return using a portfolio of various asset classes. The Company's primary investment objectives are to secure registered pension plans, and maximize investment returns in a cost-effective manner while not compromising the security of the respective plans. The pension plans utilize external investment managers to manage the investment policy. Assets in the plan are held in trust by independent third parties.

The pension plans do not directly hold any shares of the Company.

SIGNIFICANT ASSUMPTIONS

The discount rate assumption used in determining pension and post-retirement benefit obligations and net benefit expense reflects the market yields, as of the measurement date, on high-quality debt instruments. The expected rate of return on plan assets assumption is reviewed annually by management, in conjunction with actuaries. The assumption is based on the expected returns for the various asset classes, weighted by the portfolio allocation.

The weighted average significant actuarial assumptions used to determine the accrued benefit obligation and the benefit plan expense are as follows:

	Pension benefit plans		Other benefit plans	
	2006	**2005**	**2006**	**2005**
Accrued benefit obligation				
Discount rate at December 31, based on AA Corporate bonds	**5.00%**	5.00%	**5.00%**	5.00%
Rate of compensation increase for five years and 3.41% thereafter	**3.84%**	3.50%	**—**	—
Net benefit plan expense				
Discount rate at January 1, based on AA Corporate bonds	**5.00%**	6.00%	**5.00%**	6.00%
Expected rate of return on plan assets	**7.25%**	7.50%	**—**	—

The assumed health-care cost trend rates for other post-employment benefit plans are as follows:

	2006	**2005**
Extended health benefits		
Initial health care cost trend rate	**10%**	9.0%
Annual rate of decline in trend rate	**1.0%**	1.0%
Ultimate health care cost trend rate	**5.0%**	5.0%
Year that the rate reaches the ultimate trend rate	**2011**	2008
Medical Services Plan Benefits Premium trend rate	**4.0%**	4.0%

A one percentage-point change in assumed health-care cost trend rates would have the following effects:

2006	**One percentage-point increase**	**One percentage-point decrease**
Effect on the total of the service cost and interest cost components of the benefit plan expense	**$ 0.8**	**$ (0.7)**
Effect on accrued benefit obligation	**10.4**	**(9.3)**

CASH FLOWS

Total cash contributions for employee benefit plans consist of:

	Employee benefit plans	
	2006	**2005**
Funded plans	**$ 5.6**	$ 5.3
Beneficiaries of unfunded plans	**4.2**	3.2
Defined contribution plans	**2.0**	1.6
Total	**$ 11.8**	$ 10.1

The contributions for 2007 are anticipated to be approximately the same as 2006 for both the defined pension benefit plans and other benefit plans.

IMPACT OF RATE REGULATION

As required by the regulator, Terasen Gas is required under its approved cost of service model to defer the amounts of pension benefit expense that exceed or are less than the amounts approved by the regulator to be recovered in rates each year. During the year ended December 31, 2006, the Company has deferred pension expense of $2.7 million that was in excess of the amount approved by the regulator to be refunded in rates in 2007.

13. FINANCING COSTS

	2006	**2005**
Interest and expense on long-term debt	**$ 172.9**	$ 178.3
Interest on short-term debt	**11.1**	15.0
Interest capitalized	**(4.5)**	(1.9)
	$ 179.5	$ 191.4

Included in interest expense on long-term debt for the year ended December 31, 2006, is $Nil (2005 — $10.9 million) of redemption premium paid on the redemption of Trans Mountain Debentures during the year.

As allowed by the regulators, during the year ended December 31, 2006, the Company capitalized interest for borrowing requirements for construction of assets that have not been included in rate base of $4.5 million (2005 — $1.9 million).

14. INCOME TAXES

PROVISION FOR INCOME TAXES

	2006	2005
Current income taxes	**$ 67.3**	$ 48.7
Future income taxes	**1.1**	2.9
	$ 68.4	$ 51.6

VARIATION IN EFFECTIVE INCOME TAX RATE

Consolidated income taxes vary from the amount that would be computed by applying the Canadian and United States Federal, British Columbia and Alberta combined statutory income tax rate of 33.66% (2005 — 33.77%) to earnings before income taxes as shown in the following table:

	2006	2005
Earnings before income taxes	**$ 215.6**	$ 157.7
Combined statutory income tax rate	**33.66%**	33.77%
Combined income taxes at statutory rate	**$ 72.6**	$ 53.3
(Decrease) increase in income taxes resulting from:		
Capital cost allowance and other deductions claimed for income tax purposes over amounts recorded for accounting purposes	**(17.5)**	(10.0)
Large Corporations Tax in excess of (surtax credit) surtax	**(1.2)**	6.1
Non-deductible expenses and non-taxable income	**2.4**	9.6
Equity income not subject to tax	**(6.3)**	(4.7)
Provincial income tax applicable to prior years	**15.2**	—
Other, net	**3.2**	(2.7)
Actual consolidated income taxes	**$ 68.4**	$ 51.6
Effective income tax rate	**31.73%**	32.72%

FUTURE INCOME TAXES

The net future income tax liability of the Company of $76.5 million (2005 — $88.7 million) relates primarily to the tax effect of temporary differences on non-regulated property, plant and equipment balances and tax benefits repayable to shippers in future periods.

As a result of the Company accounting for income taxes following the taxes payable method for its natural gas distribution and petroleum transportation regulated operations, the Company has not recognized net future income tax liabilities amounting to $291.2 million at December 31, 2006 (2005 — $301.8 million) and has not recognized a future income tax recovery of $10.6 million for the year ended December 31, 2006 (2005 — expense of $23.1 million), all of which were calculated using the asset and liability method.

15. FINANCIAL INSTRUMENTS

FAIR VALUE ESTIMATES

The carrying values of cash and short-term investments, accounts receivable, short-term notes and accounts payable and accrued liabilities approximate their fair values due to the relatively short period to maturity of the instruments.

The fair value of the Company's investment in the Express System is estimated to be $500 million.

The fair value of the Company's long-term debt, calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues at December 31, 2006, or by using available quoted market prices, is estimated at $2,622.3 million (2005 — $2,673.4 million). The majority of the Company's long-term debt relates to regulated operations which enables the Company to recover the existing financing charges through rates or tolls.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment.

DERIVATIVE INSTRUMENTS

The Company uses derivative instruments to hedge its exposures to fluctuations in natural gas prices and interest rates.

			December 31			
			2006		2005	
Asset (Liability)	**Number of swaps and options**	**Term to maturity (years)**	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
			(in millions)			
Interest Rate Swaps						
Terasen Inc	**2**	**2-8**	**$—**	**$1.3**	$—	$ 3.6
TGI	**3**	**1**	**—**	**(0.9)**	—	(1.6)
TGVI	**2**	**2**	**—**	**(0.3)**	—	(0.6)
Corridor	**2**	**3-9**	**—**	**(1.0)**	—	0.3
Natural Gas Commodity Swaps and Options						
TGI and TGVI	**250**	**Up to 3**	**(139.0)**	**(139.5)**	21.2	105.6

The natural gas derivatives fair value reflects only the value of the natural gas derivatives and not the offsetting change in value of the underlying future purchases of natural gas. These fair values reflect the estimated amounts the Company would receive or pay to terminate the contracts at the stated dates.

Included in the carrying value of the natural gas derivatives is $139.7 million of unrealized fair value losses associated with derivative instruments which were deemed to be ineffective at December 31, 2006, and $0.7 million of derivative instruments which did not qualify for hedge accounting that are in a liability position.

Clean Energy, an entity in which the Company held an interest, had historically purchased gas forward contract positions to offset future commodity supply contracts. Since these contracts were not specifically designated as hedges, these positions were marked-to-market at each balance sheet date and gains or losses were reported in the statement of earnings as cost of revenues from other activities. During the year ended December 31, 2005, the Company included in earnings an amount of $10.9 million net of tax and estimated selling expenses pertaining to the Company's proportionate share of Clean Energy's gas forward contracts.

The derivatives entered into by Terasen Gas and TGVI relate to regulated operations and any resulting gains or losses are recorded in rate stabilization accounts, subject to regulatory approval, and passed through to customers in future rates.

The Company is exposed to credit risk in the event of non-performance by counterparties to derivative instruments. Because it deals with high credit quality institutions in accordance with established credit approval practices, the Company does not expect any counterparties to fail to meet their obligations.

16. RELATED PARTY TRANSACTIONS

The Company estimates that its parent company, Kinder Morgan Inc., provided corporate management services totaling approximately $10.4 million (2005 — nil) for the year ended December 31, 2006.

17. COMMITMENTS & CONTINGENCIES

The Company's subsidiaries and proportionately consolidated entities have entered into operating leases for certain building space and natural gas distribution assets. In addition, Terasen Gas and TGVI have entered into gas purchase contracts which represent future purchase obligations.

The following table sets forth the Company's operating lease and gas purchase obligations due in the years indicated:

	Operating leases	Purchase obligations	Total
2007	$ 21.0	$ 511.2	$ 532.2
2008	21.1	22.9	44.0
2009	19.5	27.7	47.2
2010	18.3	—	18.3
2011	18.6	—	18.6
2012 and later	116.9	—	116.9
	$ 215.4	$ 561.8	$ 777.2

Gas purchase contract commitments are based on market prices that vary with gas commodity indices. The amounts disclosed reflect index prices that were in effect at December 31, 2006.

In prior years, TGVI received non-interest bearing, repayable loans from the Federal and Provincial governments of $50 million and $25 million respectively, in connection with the construction and operation of the Vancouver Island natural gas pipeline. As approved by the BCUC, these loans have been recorded as a government grant and have reduced the amounts reported for property, plant and equipment. The government loans are repayable in any fiscal year after 2002 and prior to 2012 under certain circumstances and subject to the ability of TGVI to obtain non-government subordinated debt financing on reasonable commercial terms. In 2006, all of the repayment criteria were met when TGVI obtained additional financing through a new credit agreement (Note 8(e)) which resulted in a repayment on the government loans of $6.2 million. In addition, since the conditions continue to be met (an annual test) TGVI is expected to make a repayment on the loans in 2007 of approximately $3.7 million. As the loans are repaid and replaced with non-governmental loans, property, plant and equipment and long-term debt will increase in accordance with the approved capital structure, as will the rate base used in determining rates. The amounts are not included in the obligations in the table above as the amounts and timing of repayments is dependent upon the approved RDDA recovery each year and the ability to replace the loans with non-government subordinated debt financing on reasonable commercial terms.

Terasen Gas received a Notice of Assessment dated July 31, 2006 from the British Columbia Social Service Tax authority for $37.1 million of additional provincial sales tax and interest on the Southern Crossing Pipeline, which was completed in 2000. This has not been provided for as Terasen Gas will appeal this assessment since management believes that this assessment is without merit and will not have a material adverse impact on our business, financial position, results of operations or cash flows. In October 2006, Terasen Gas made a payment of $10 million pending resolution of the appeal as a good faith payment in order to forestall an order from the Province to provide full payment or security. The payment has been recorded as a long term receivable and a request for regulatory deferral account treatment has been made. This payment does not reflect Management's belief as to the ultimate sustainability of the assessment. Subsequent to year end a decision was issued with respect to the appeal filed by Terasen Gas see note 19.

A number of claims and lawsuits seeking damages and other relief are pending against the Company. Management is of the opinion, based upon information presently available, that it is unlikely that any liability, to the extent not provided for through insurance or otherwise, would be material in relation to the Company's consolidated financial statements.

18. GUARANTEES

The Company has, for a fee, arranged for the issuance of a letter of credit in the amount of US$15.3 million on behalf of co-investors in the Express System to fund the Debt Service Reserve Account required under the Express System's trust indenture. The letter of credit is subject to annual renewal. If the letter of credit is drawn upon, the Company will have recourse to the co-investors, major Canadian pension funds.

The Company has letters of credit outstanding at December 31, 2006 totaling $117.9 million to support its operations and capital projects, including $61.5 million for its unfunded supplemental pension benefit plans and $17.8 million for the letter of credit referred to above on behalf of co-investors in the Express System.

19. SUBSEQUENT EVENT

On January 23, 2007, Corridor increased its credit facility from $225 million to $375 million and extended this facility and the associated $20 million demand facility, as permitted under these facilities, for an additional 364 days.

On February 16 2007, the Company completed a reorganization, where it was amalgamated with its direct parent (0731297 BC Ltd.). The Company continues to be the parent company of the entities specified in the notes to the accounts.

On February 26, 2007, KMI, the Company's parent announced that it entered into a definitive agreement with Fortis, Inc. to sell Terasen Inc. and its principal natural gas distribution assets, including its subsidiaries Terasen Gas and TGVI as well as other activities including Terasen Energy Services. The sale does not include the petroleum transportation subsidiaries nor investments under the Kinder Morgan Canada name. The purchase price of approximately $3.7 billion includes the assumption of approximately $2.4 billion of debt. The transaction is expected to close in mid-2007 subject to the fulfillment of customary closing conditions and required regulatory approvals.

On March 5, 2007, KMI, the Company's parent company announced that it entered into an agreement to sell the shares of the Corridor Pipeline System to Inter Pipeline Fund for approximately $760 million including debt. The transaction is subject to certain closing conditions and regulatory approvals, as well as a right of first refusal and is expected to close in mid-2007.

On March 26, 2007, the Minister of Small Business and Revenue and Minister Responsible for Regulatory Reform issued a decision in respect of the Company's appeal of an assessment of British Columbia Social Service Tax in the amount of $37.1 million. The Minister has reduced the assessment to $7.0 million including interest. The Social Service Tax Act provides for a further appeal to the courts that must be commenced within 90 days of the Minister's decision. The Company is reviewing its options with respect to the appeal process.

SCHEDULE C

Terasen Inc.

Unaudited Interim Consolidated Financial Statements
Three Months Ended March 31, 2007

(see attached)

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE EARNINGS

(Unaudited)

	Three months ended March 31 2007	2006 (Restated Note 1)
	In millions of Canadian dollars	
Revenues		
Natural gas distribution	**$ 630.2**	$ 682.0
Petroleum transportation	**39.8**	38.2
Other activities	**8.9**	12.1
	678.9	732.3
Expenses		
Cost of natural gas	**435.3**	482.2
Cost of revenues from other activities	**6.8**	7.2
Operation and maintenance	**65.6**	63.0
Depreciation and amortization	**31.6**	32.6
Property and other taxes	**19.3**	18.1
	558.6	603.1
Operating income	**120.3**	129.2
Financing costs	**73.7**	75.7
Earnings before share of equity investments, goodwill impairment, discontinued operations and income taxes	**46.6**	53.5
Share of earnings from Express System	**5.5**	5.2
Impairment in carrying value of goodwill (note 4)	**(441.9)**	—
(Loss) earnings before income taxes and discontinued operations	**(389.8)**	58.7
Income taxes	**9.9**	16.0
(Loss) earnings before discontinued operations	**(399.7)**	42.7
Gain from discontinued operations, net of income taxes	**3.3**	3.4
Net (loss) earnings and comprehensive (loss) earnings	**$ (396.4)**	$ 46.1

CONSOLIDATED STATEMENTS OF (DEFICIT) RETAINED EARNINGS
(Unaudited)

	Three months ended March 31	
	2007	**2006 (Restated Note 1)**
	In millions of Canadian dollars	
(Deficit) retained earnings, beginning of period	**$ (669.0)**	$ 10.5
Adjustment to deficit (note 2)	**35.5**	—
	$ (633.5)	$ 10.5
Net (loss) earnings	**(396.4)**	46.1
(Deficit) retained earnings, end of period	**$ (1,029.9)**	$ 56.6

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Unaudited)

	In millions of Canadian dollars As at	
	March 31, 2007	**December 31, 2006 (Restated Note 1)**
Assets		
Current assets		
Cash and short-term investments	**$ 26.4**	$ 11.2
Accounts receivable	**394.4**	336.5
Inventories of gas in storage and supplies	**79.7**	189.5
Prepaid expenses	**8.6**	12.6
Current portion of rate stabilization accounts	**35.2**	134.5
Current assets held for sale	**2.1**	—
	546.4	684.3
Property, plant and equipment	**3,623.6**	4,377.2
Long-term investment	**524.5**	480.5
Goodwill	**1,072.1**	1,589.7
Rate stabilization accounts	**32.2**	48.3
Other assets	**87.6**	102.2
Long-lived assets held for sale	**1,012.1**	—
	$ 6,898.5	$ 7,282.2
Liabilities and shareholder's equity		
Current liabilities		
Short-term notes	**$ 213.0**	$ 556.0
Accounts payable and accrued liabilities	**395.6**	618.3
Income and other taxes payable	**60.4**	16.4
Current portion of rate stabilization accounts	**1.8**	—
Current portion of long-term debt	**287.6**	285.9
Due to parent company	**12.6**	8.9
Current liabilities held for sale	**415.1**	—
	1,386.1	1,485.5
Long-term debt	**1,819.0**	2,121.5
Subordinated debt	**2,491.3**	2,491.3
Other long-term liabilities and deferred credits	**214.3**	207.4
Future income taxes	**197.3**	223.6
Long-term liabilities held for sale	**325.9**	—
	6,433.9	6,529.3
Shareholder's equity		
Common shares	**1,475.3**	1,402.7
Preferred shares	**51.0**	—
Contributed surplus	**19.2**	19.2
Deficit	**(1,029.9)**	(669.0)
	515.6	752.9
Less cost of preferred shares held by Trans Mountains Holdings Ltd.	**(51.0)**	—
	464.6	752.9
	$ 6,898.5	$ 7,282.2

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended March 31 2007	2006 (Restated Note 1)
	In millions of Canadian dollars	
Cash flows provided by (used for)		
Operating activities		
Net (loss) earnings	**$ (396.4)**	$ 46.1
Adjustments for non-cash items		
Depreciation and amortization	**31.6**	37.0
Share of earnings from long term investments, in excess of cash distributions	**(5.5)**	(5.2)
Future income taxes	**(0.9)**	(1.7)
Impairment in carrying value of goodwill	**441.9**	—
Other	**5.1**	0.4
	75.8	76.6
Decrease in rate stabilization accounts	**11.4**	38.1
Changes in non-cash working capital	**95.4**	74.7
	182.6	189.4
Investing activities		
Property, plant and equipment	**(99.2)**	(33.0)
Disposal of discontinued operations	**30.6**	(7.5)
Other assets	**15.4**	0.3
	(53.2)	(40.2)
Financing activities		
Decrease in short-term notes	**(118.0)**	(241.0)
Increase in current portion of long-term debt	**0.3**	317.0
Reduction of long-term debt	**(0.2)**	(210.0)
Advances to KMI	**3.7**	0.9
	(114.2)	(133.1)
Net increase in cash	**15.2**	16.1
Cash at beginning of period	**11.2**	79.4
Cash at end of period	**$ 26.4**	$ 95.5
Supplemental cash flow information		
Interest paid in the period	**$ 44.8**	$ 45.4
Income taxes paid in the period	**2.2**	19.2
Non-cash transactions		
Mark to market on certain gas derivatives deferred in rate stabilization on accounts	**$ (105.8)**	$ 54.0
Accounts payable and accrued liabilities settled by issuance of shares	**72.6**	—
Property, plant and equipment purchases included in accounts payable and accrued liabilities	**(6.3)**	—
Reclassification of current portion of repayable government loans from capital assets to current portion of a long term debt	**—**	4.5

Cash is defined as cash or bank indebtedness.

In millions of Canadian dollars

1. AMALGAMATION AND RESTATEMENT OF PRIOR PERIODS

On February 16, 2007, Terasen Inc. was amalgamated with Terasen Pipelines (Trans Mountain) Inc. and 0731297 BC Ltd. under the name "Terasen Inc." which is the Company represented in these statements. 0731297 BC Ltd was the direct parent of Terasen Inc prior to the amalgamation and acquired the shares of Terasen as part of the Kinder Morgan Inc. ("KMI") acquisition of Terasen on November 30, 2005. The effect of this amalgamation is that the consolidated statements of earnings and comprehensive earnings, statements of (deficit) retained earnings, statements of financial position, and statements of cash flows have been restated to show the effects of the push down of the purchase accounting as if 0731297 BC Ltd had been the reporting company since November 30, 2005.

The Terasen acquisition has been accounted for as a purchase business combination with 0731297 BC Ltd as the accounting acquirer. The purchase of Terasen at November 30, 2005 was funded by a combination of the issuance of common shares and the issuance of debt.

Purchase Cost

Shares of KMI issued	1,338.7
Debt issued	2,491.3
Transaction costs	18.5
	$ 3,848.5

In accordance with the purchase method of accounting, the purchase cost was allocated to the underlying assets acquired and liabilities assumed based primarily upon their estimated fair values at the date of acquisition. The estimated fair values were based on a combination of independent appraisals and internal estimates. The excess of purchase cost over the net identifiable tangible and intangible assets acquired represents goodwill. The goodwill is not deductible for tax purposes. The purchase cost and purchase price allocation are summarized in the following table:

Purchase Price Allocation

Current assets	788.5
Property plant and equipment	4,244.1
Investment in Express	455.5
Rate stabilization — long term	51.5
Other assets	93.2
Goodwill	2,271.6
Current liabilities	(1,581.7)
Long term debt and debentures	(2,060.6)
Long term liabilities	(163.1)
Future income taxes	(250.5)
	$ 3,848.5

The following table presents the December 31, 2006 balance sheet previously presented and adjusts for the push down of purchase accounting and other items on the purchase of Terasen to present an adjusted balance sheet after the amalgamation discussed above.

	As presented	Note	Adjustments due to Amalgamation	As adjusted
Cash and short term investments	$ 11.2		—	$ 11.2
Accounts receivable	336.5		—	336.5
Inventories of gas in storage and supplies	189.5		—	189.5
Prepaid expenses	12.6		—	12.6
Current portion of rate stabilization accounts	134.5		—	134.5
	$ 684.3			$ 684.3
Property plant and equipment	$ 4,194.7	[a]	182.5	$ 4,377.2
Long term investments	260.9	[b]	219.6	480.5
Goodwill	76.4	[c]	1,513.3	1,589.7
Rate stabilization accounts	48.3		—	48.3
Other assets	103.4		(1.2)	102.2
	$ 5,368.0		1,914.2	$ 7,282.2
Short term notes	$ 556.0		—	$ 556.0
Accounts payable and accrued liabilities	523.8	[d]	94.5	618.3
Income and other taxes payable	29.3	[e]	(12.9)	16.4
Current portion of long term debt	285.9		—	285.9
Due to parent company	8.9		—	8.9
	$ 1,403.9		81.6	$ 1,485.5
Long term notes	$ 2,107.8		13.7	$ 2,121.5
Subordinated debt	—	[f]	2,491.3	2,491.3
Other long term liabilities and deferred credits	198.4	[g]	9.0	207.4
Future income taxes	76.5	[h]	147.1	223.6
	$ 3,786.6		2,742.7	$ 6,529.3
Common shares	$ 904.9	[i]	497.8	$ 1,402.7
Contributed surplus	172.7	[i]	(153.5)	19.2
Retained earnings	554.7	[i]	(1,223.7)	(669.0)
Cumulative currency transaction adjustment	0.1		(0.1)	—
Less cost of common shares held by Trans Mountain Holdings Ltd	(51.0)	[i]	51.0	—
	1,581.4		828.5	752.9
	$ 5,368.0		1,914.2	$ 7,282.2

(a) Represents the net unamortized incremental fair value assigned to the property plant and equipment.

(b) Represents the increase in fair value assigned to the Investment in Express.

(c) Represents any excess between considerations paid and fair values assigned to the various assets and liabilities. Goodwill has been reduced by an impairment charge of $762.3 million taken during the fourth quarter of 2006.

(d) Represents interest payable on the subordinated debt assumed as part of the acquisition and acquisition costs payable.

(e) Represents the tax benefit of certain deductions related to the push down accounting and the income tax effect of certain deductions from income.

(f) Represents the subordinated debt assumed as part of the transaction.

(g) Represents the fair value adjustment related to the non-regulated pension and other post employment benefit liabilities.

(h) Represents future income tax liabilities arising on the purchase accounting.

(i) All of the amalgamation adjustments in equity represent the re-setting of the equity accounts as if the equity of Terasen Inc on November 30, 2005 was eliminated as part of the acquisition. The adjustments were made as if 0731297 BC Ltd was the parent Company since November 30, 2005.

	March, 31, 2006 continuing operations		Adjustments due to amalgamation	As adjusted
	In millions of Canadian dollars			
Revenues		Note		
Natural gas distribution	$ 682.0		—	$ 682.0
Petroleum transportation	38.2		—	38.2
Other activities	12.1		—	12.1
	732.3		—	732.3
Expenses				
Cost of natural gas	482.2		—	482.2
Cost of revenues from other activities	7.2		—	7.2
Operation and maintenance	63.7	[a]	(0.7)	63.0
Depreciation and amortization	31.9	[b]	0.7	32.6
Property and other taxes	18.1		—	18.1
	603.1		—	603.1
	129.2			
Operating income			—	129.2
Financing costs	40.8	[c]	34.9	75.7
Earnings before share of equity investments, goodwill impairment, discontinued operations and income taxes	88.4		(34.9)	53.5
Share of earnings from Express System	5.2		—	5.2
Earnings (loss) before income taxes and discontinued operations	93.6		(34.9)	58.7
Income taxes	27.5	[d]	(11.5)	16.0
Earnings (loss) before discontinued operations	66.1		(23.4)	42.7
Gain (loss) from discontinued operations, net of income taxes	(1.8)	[e]	5.2	3.4
Net earnings (loss)	64.3		$ (18.2)	$ 46.1

(a) Represents the reversal of a write-off which is eliminated when KMI acquired Terasen.

(b) Represents the amortization of the fair value increments assigned to the property, plant and equipment.

(c) Represents the amortization of the fair value assigned to long term debt and the interest expense on the subordinated debt.

(d) Represents mainly the tax benefit associated with the interest expense recorded on the subordinated debt.

(e) Represents the reversal of the loss on disposal of the Terasen Water and Utility Services segment which for purchase accounting is eliminated when KMI acquired Terasen.

2. BASIS OF PRESENTATION

The accounting policies and methods of application used in the preparation of these interim consolidated financial statements are consistent with the accounting policies used in the Company's year-end audited consolidated financial statements of December 31, 2006 except for those described below under "new accounting policies" and as described in Note 1. These consolidated financial statements do not include all disclosures required for annual financial statements, and therefore these statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2006.

Certain comparative figures have been restated to conform with the current period presentation, as stated above in Note 1.

The interim statements and notes presented for this interim period have been prepared by Management.

On February 26, 2007, KMI, the Company's parent announced that it entered into a definitive agreement with Fortis Inc. to sell Terasen Inc. and its principal natural gas distribution assets, including its subsidiaries Terasen Gas and Terasen Gas (Vancouver Island) Inc. as well as other activities including Terasen Energy Services. The sale does not include the petroleum transportation subsidiaries nor investments under the Kinder Morgan Canada name. The purchase price of approximately $3.7 billion includes the assumption of approximately $2.4 billion of debt. The transaction closed on May 17, 2007.

On March 5, 2007, KMI, the Company's parent company announced that it entered into an agreement to sell the shares of the Corridor Pipeline System to Inter Pipeline Fund for approximately $760 million including debt. The transaction is subject to certain closing conditions and regulatory approvals, as well as a right of first refusal and is expected to close in mid-2007. Certain comparative figures have been restated to reflect the income from Corridor as discontinued.

New Accounting Policies

Effective January 1, 2007, the Company adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA").

a) Section 3855, *Financial Instruments — Recognition and Measurement,* prescribes the criteria for recognition and presentation of financial instruments on the balance sheet and the measurement of financial instruments according to prescribed classifications. These sections also address how financial instruments are measured subsequent to initial recognition and how the gains and losses are recognized.

The Company is required to designate its financial instruments into one of the following five categories: held for trading; available for sale; held to maturity; loans and receivables; and other financial liabilities. All financial instruments are to be initially measured at fair value. Financial instruments classified as held for trading or available for sale are subsequently measured at fair value with any change in fair value recorded in net earnings and other comprehensive income, respectively. All other financial instruments are subsequently measured at amortized cost.

All derivative financial instruments are recorded on the balance sheet at fair value. Mark-to-market adjustments on these instruments are included in net earnings, unless the instruments are designated as part of a cash flow hedge relationship then the effective portion of changes in fair value are recorded in other comprehensive income. Any change in fair value relating to the ineffective portion is recorded immediately in net earnings. In accordance with the standard's transitional provisions, the Company recognizes as separate assets and liabilities only embedded derivatives acquired or substantively modified on or after January 1, 2003.

The Company has designated its financial instruments as follows:

- Accounts receivable and long-term investment are classified as "Loans and Receivables". These financial assets are recorded at values that approximate their amortized cost using the effective interest method.

- Short-term notes, accounts payable and accrued liabilities, long-term debt, subordinated debt and related issue costs are classified as "Other Financial Liabilities ". These financial liabilities are recorded at values that approximate their amortized cost using the effective interest method.

As a result of adopting Section 3855, deferred financing costs of $9.4 million as at March 31, 2007 (2006 — $9.8 million), relating to long-term debt, have been reclassified from other assets to long- term debt on the balance sheet. These costs will be taken into earnings using the effective interest method over the life of the related debt. Prior to January 1, 2007, deferred financing costs were amortized using the straight-line method of amortization. As allowed by the standard a one-time adjustment of $1.7 million has been made to retained earnings to reflect the difference between the straight-line method and the effective interest method of amortization prior to January 1, 2007.

b) Section 1530, *Comprehensive Income*, requires the presentation of a statement of comprehensive income and provides guidance for the reporting and display of other comprehensive income. Comprehensive income represents the change in equity of an enterprise during a period from transactions and other events arising from non-owner sources including gains and losses arising on translation of self-sustaining foreign operations, gains and losses from changes in fair value of available for sale financial assets and changes in fair value of the effective portion of cash flow hedging instruments. The Company has not recognized any adjustments through other comprehensive income for the three months ended March 31, 2007.

c) Section 3865, *Hedges* specifies the criteria under which hedge accounting may be applied, how hedge accounting should be performed under permitted hedging strategies and the required disclosures. The majority of the Company's cash flow hedges are for the purchase of natural gas. Given that the Company is subject to rate regulation, the ineffective portion of changes in the fair value of these hedges are deferred as an asset or liability until they are settled, offset by an asset or liability on behalf of ratepayers. Upon settlement, the recognized gain or loss is recorded as a regulatory asset or liability and is collected from or refunded to ratepayers in subsequent periods. The company recognized an additional liability of $1.1 million to counterparties for unrealized losses related to gas purchase hedges at January 1, 2007 and an amount recoverable from ratepayers of $1.1 million. Amounts recoverable from ratepayers are recorded in rate stabilization accounts.

The Company utilized fair value hedges to hedge the value of debt instruments. Fair value hedges for rate regulated businesses are recorded in Other assets with the offset to Other long- term liabilities and deferred credits while the non-regulated fair value hedges are recorded in Other assets and Long term debt. The adoption of this new standard on January 1, 2007 increased Other assets by $0.9, increased Long term debt by $0.1 and increased Other long-term liabilities and deferred credits by $0.8.

Under the Canadian standard prior to January 1, 2007, certain equity investees of the Company have designated future U.S. dollar revenues as a hedge of the foreign currency risk associated with U.S. dollar debt. The investees defer the exchange gains and losses on the U.S. dollar long-term-debt and recognize an adjustment to the related revenues at the time the revenue is earned. These arrangements do not qualify for hedge accounting under the new Canadian standard. Accordingly, the Company has recorded a one time adjustment of $38.6 million to the value of its investment offset by an increase of $4.8 million of future income taxes for a net adjustment to retained earnings of $33.8 million.

3. SEGMENT DISCLOSURES

Three months ended March 31

2007	Natural gas distribution	Petroleum transportation	Other activities	Total
	(in millions of dollars)			
Revenues	**$ 630.2**	**$ 39.8**	**$ 8.9**	**$ 678.9**
Earnings (loss) before discontinued operations	**54.8**	**(427.2)**	**(27.3)**	**(399.7)**
Net earnings (loss)	**54.8**	**(423.9)**	**(27.3)**	**(396.4)**
Total assets	**4,133.9**	**2,686.9**	**77.7**	**6,898.5**
Goodwill	**751.2**	**320.9**	**—**	**1,072.1**

2006 (restated)	Natural gas distribution	Petroleum transportation	Other activities	Total
	(in millions of dollars)			
Revenues	$ 682.0	$ 38.2	$ 12.1	$ 732.3
Earnings (loss) before discontinued operations	55.3	15.2	(27.8)	42.7
Net earnings (loss)	55.3	18.6	(27.8)	46.1
Total assets	4,950.9	2,655.0	280.7	7,886.6
Goodwill	1,482.2	762.8	—	2,245.0

4. IMPAIRMENT IN CARRYING VALUE OF GOODWILL

On April 18, 2007, it was announced Kinder Morgan Energy Partners would acquire the Trans Mountain pipeline system from Terasen. Subsequently, on April 30, 2007 the assets were transferred to Kinder Morgan Energy Partners. This transaction caused the Company to consider the fair value of the Trans Mountain pipeline system, which is currently in the Petroleum Segment, in determining whether goodwill related to these assets was impaired. Accordingly, based on the Company's consideration of the transaction value and supporting third-party information obtained regarding the fair values of the Trans Mountain pipeline system assets, a goodwill impairment charge of $441.9 million was recorded in the current quarter.

5. SEASONAL OPERATIONS

Due to the seasonal nature of the Company's natural gas distribution operations quarterly earnings statements are not indicative of earnings on an annual basis.

6. RELATED PARTY TRANSACTIONS

The Company estimates that its parent company, KMI, provided management services totalling approximately $2.5 million (2006 — $2.0 million) for the three months ended March 31, 2007.

7. EMPLOYEE BENEFIT PLANS

The Company and its subsidiaries have defined benefit pension plans and defined contribution pension plans for employees. The Company also provides post-employment benefits other than pensions for retired employees. Additional information about these benefit plans can be found in the Company's 2006 Annual Report. The Company's estimated contributions to defined benefit pension plans for 2007 are anticipated to be $9.9 million (2006 actual $11.8 million).

Costs recognized in the periods are presented in the following table:

	Pension benefit plans		Other benefit plans	
Three months ended March 31	**2007**	**2006**	**2007**	**2006**
	(in millions of dollars)			
Current service cost	**$ 2.9**	$ 2.4	**$ 0.6**	$ 0.5
Interest cost on projected benefit obligations	**4.6**	4.3	**1.1**	1.0
Expected return on plan assets	**(5.8)**	(5.2)	**—**	—
Net actuarial losses	**—**	—	**—**	—
Plan amendments	**—**	(0.1)	**—**	—
Net benefit plan expense before adjustments of employee benefit costs:	**1.7**	1.4	**1.7**	1.5
Difference between actual and expected return on plan assets	**0.1**	0.1	**—**	—
Difference between actual and recognized actuarial gains (losses) in the year	**0.9**	1.1	**0.8**	0.8
Difference between actual and recognized past service	**0.2**	0.2	**(0.1)**	(0.1)
Amortization of transitional obligation (benefit)	**(0.8)**	(0.8)	**0.4**	0.4
Net benefit plan expense	**$ 2.1**	$ 2.0	**$ 2.8**	$ 2.6
Defined contribution plan expense	**$ —**	$ 0.7		
Total pension expense	**$ 2.1**	$ 2.7		

8. COMMITMENTS AND CONTINGENCIES

On March 26, 2007, the Minister of Small Business and Revenue and Minister Responsible for Regulatory Reform issued a decision in respect of the Company's appeal of an assessment of British Columbia Social Service Tax in the amount of $37.1 million. The Minister has reduced the assessment to $7.0 million including interest. The Social Service Tax Act provides for a further appeal to the courts that must be commenced within 90 days of the Minister's decision. The Company is reviewing its options with respect to the appeal process.

SCHEDULE D

PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

FORTIS INC.

(Unaudited)

As at March 31, 2007 and for the three months ended March 31, 2007 and the year ended December 31, 2006

(see attached)

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

The following unaudited *pro forma* consolidated financial statements give effect to the acquisition (the "Acquisition") of Terasen Inc. ("Terasen") under the purchase method of accounting. The unaudited *pro forma* consolidated balance sheet gives effect to the Acquisition as if it had occurred on March 31, 2007. The unaudited *pro forma* consolidated statements of earnings for the three months ended March 31, 2007 and for the year ended December 31, 2006 give effect to the Acquisition as if it was completed on January 1, 2006.

These unaudited *pro forma* consolidated financial statements are presented for illustrative purposes only. The *pro forma* adjustments are based upon available information and certain assumptions that are believed to be reasonable in the circumstances, as described in the notes to the unaudited *pro forma* consolidated financial statements.

Terasen is a holding company headquartered in Vancouver, British Columbia, with subsidiaries carrying on the business of natural gas distribution in British Columbia. As part of a reorganization of its business prior to the closing of the Acquisition, Terasen Inc. was required to divest its petroleum transportation assets. In connection with this divestiture, on February 16, 2007 Terasen Inc. amalgamated with Terasen Pipelines (Trans Mountain) Inc., formerly a wholly owned subsidiary of Terasen Inc., and 0731297 BC Ltd., a holding company that was formerly the direct parent of Terasen Inc., with the amalgamated corporation continuing under the name "Terasen Inc.". It is the amalgamated corporation that is represented in the Terasen Inc. unaudited interim consolidated financial statements as at March 31, 2007 and for the three months ended March 31, 2007 and 2006. Post-amalgamation, Terasen Inc. continues to own the gas distribution business operated by its subsidiaries.

As a result of this amalgamation, the Terasen Inc. consolidated financial statements as at December 31, 2006 and for the years ended December 31, 2006 and 2005 do not reflect the same entity as, and are not directly comparable with, the unaudited interim consolidated financial statements as at March 31, 2007 and for the three months ended March 31, 2007 and 2006 that relate to the amalgamated corporation. The effect of the amalgamation is described in greater detail in note 1 of the Terasen Inc. unaudited interim consolidated financial statements on page C-6 of Schedule C to the BAR, and in note 2[o] to these *pro forma* financial statements.

These unaudited *pro forma* consolidated financial statements are based on Terasen's financial statements as at and for the three months ended March 31, 2007 and for the year ended December 31, 2006. The financial position and results of the petroleum transportation operations have been excluded from the unaudited *pro forma* consolidated balance sheet and statements of earnings, respectively, by way of *pro forma* adjustments. Refer to Notes 2[b] and 2[d].

The *pro forma* information presented, including allocation of purchase price, is based on preliminary estimates of fair values of assets acquired and liabilities assumed, available information and assumptions and may be revised as additional information becomes available. The actual adjustments to the consolidated financial statements upon the closing of the Acquisition will depend on a number of factors, including additional information available and the net assets on the closing date of the Acquisition. Therefore, the actual adjustments will differ from the *pro forma* adjustments, and the differences may be material. For example, the final purchase price allocation is dependent on, among other things, the finalization of asset and liability valuations. A final determination of these fair values will reflect consideration of a final valuation prepared by independent third-party appraisers. This final valuation will be based on the actual net tangible and intangible assets and liabilities that exist as of the closing date of the Acquisition. Any final adjustment may change the allocation of purchase price, which could affect the fair value assigned to the assets and liabilities and could result in a change to the unaudited *pro forma* consolidated financial statements, including a change to goodwill.

Fortis Inc.

PRO FORMA CONSOLIDATED BALANCE SHEET
As at March 31, 2007
(Unaudited)
($ millions)

	Fortis Inc.	Terasen Inc.	Note	Pro forma adjustments	Pro forma consolidated balance sheet
ASSETS					
Current assets					
Cash and cash equivalents	43.2	26.4	2[n]	193.2	**71.2**
			2[n]	(191.6)	
Accounts receivable	268.6	394.4	2[b]	(16.1)	**646.9**
Income taxes receivable	11.0	—		—	**11.0**
Prepaid expenses	16.7	8.6	2[b]	(1.5)	**23.8**
Regulatory assets	41.1	35.2		—	**76.3**
Gas inventories, materials and supplies	32.1	79.7	2[b]	(3.4)	**108.4**
Current assets held for sale	—	2.1	2[b]	(2.1)	—
	412.7	546.4		(21.5)	**937.6**
Corporate income tax deposit	5.9	—		—	**5.9**
Deferred charges and other assets	171.6	87.6	2[b]	(20.6)	**235.6**
			2[e]	(3.0)	
Regulatory assets	132.2	32.2		—	**164.4**
Future income taxes	9.3	—	2[f]	8.4	**36.8**
			2[g]	16.7	
			2[n]	2.4	
Utility capital assets	3,629.6	3,623.6	2[b]	(858.9)	**6,394.3**
Income producing properties	468.5	—		—	**468.5**
Investments	2.5	524.5	2[b]	(524.5)	**2.5**
Intangibles, net of amortization	8.8	—		—	**8.8**
Goodwill	658.3	1,072.1	2[b]	(189.7)	**1,540.7**
Long-lived assets held for sale	—	1,012.1	2[b]	(1,012.1)	—
	5,499.4	6,898.5		(2,602.8)	**9,795.1**
LIABILITIES					
Current liabilities					
Short-term borrowings	54.2	213.0		—	**267.2**
Accounts payable and accrued charges	336.2	408.2	2[b]	(24.9)	**729.5**
			2[l]	10.0	
Dividends payable	24.9	—		—	**24.9**
Income taxes payable	—	60.4	2[b]	(13.3)	**49.1**
			2[e]	2.0	
Regulatory liabilities	13.1	1.8		—	**14.9**
Current instalments of long-term debt and capital lease obligations	76.1	287.6		—	**363.7**
Subscription Receipt issue	1,151.2	—	2[g]	(1,151.2)	—
Restricted cash — Subscription Receipt issue	(1,151.2)	—	2[g]	1,151.2	—
Future income taxes	9.5	—		—	**9.5**
Current liabilities held for sale	—	415.1	2[b]	(415.1)	—
	514.0	1,386.1		(441.3)	**1,458.8**
Deferred credits and other liabilities	79.7	214.3	2[b]	(7.6)	**286.4**
Regulatory liabilities	336.3	—		—	**336.3**
Future income taxes	49.5	197.3	2[b]	(211.8)	**35.0**
Long-term debt and capital lease obligations	2,517.2	1,819.0	2[f]	24.0	**4,360.2**
Subordinated debt	—	2,491.3	2[b]	(2,491.3)	—
Long-term liabilities held for sale	—	325.9	2[b]	(325.9)	—
Non-controlling interest	127.8	—		—	**127.8**
Preference shares	319.5	—		—	**319.5**
	3,944.0	6,433.9		(3,453.9)	**6,924.0**
SHAREHOLDERS' EQUITY					
Common shares	980.1	1,475.3	2[g]	1,151.2	**2,100.2**
			2[g]	(31.1)	
			2[k]	(1,475.3)	
Preference shares(1)	122.5	—	2[n]	200.0	**318.1**
			2[n]	(4.4)	
Contributed surplus	5.2	19.2	2[k]	(19.2)	**5.2**
Equity portion of convertible debentures	7.0	—		—	**7.0**
Accumulated other comprehensive loss	(63.3)	—		—	**(63.3)**
Retained earnings	503.9	(1,029.9)	2[k]	1,029.9	**503.9**
	1,555.4	464.6		851.1	**2,871.1**
	5,499.4	6,898.5		(2,602.8)	**9,795.1**

(1) Terasen Inc. preference shares are net of $51.0 million of shares held by its wholly owned subsidiary Trans Mountains Holdings Ltd.

See accompanying notes

Fortis Inc.

PRO FORMA CONSOLIDATED STATEMENT OF EARNINGS
For the year ended December 31, 2006
(Unaudited)
($ millions, except for per share amounts)

	Fortis Inc.	Terasen Inc.	Note	Pro forma adjustments	Pro forma consolidated statement of earnings
Operating revenues	1,462.0	2,027.7	2[d]	(242.4)	**3,245.4**
			2[o]	(1.9)	
Equity income	9.7	24.5	2[d]	(24.5)	**9.7**
	1,471.7	2,052.2		(268.8)	**3,255.1**
Expenses					
Energy supply costs	540.5	1,117.9		—	**1,658.4**
Operating	398.6	394.0	2[d]	(108.9)	**675.7**
			2[o]	(8.0)	
Amortization	177.5	145.2	2[d]	(37.7)	**282.9**
			2[o]	(2.1)	
	1,116.6	1,657.1		(156.7)	**2,617.0**
Operating income	355.1	395.1		(112.1)	**638.1**
Finance charges	168.3	179.5	2[d]	(26.8)	**456.0**
			2[m]	(5.3)	
			2[o]	140.3	
Impairment in carrying value of goodwill	—	—	2[o]	762.3	**762.3**
Gain on sale of income producing property	(2.1)	—		—	**(2.1)**
	166.2	179.5		870.5	**1,216.2**
Earnings (loss) before corporate taxes	188.9	215.6		(982.6)	**(578.1)**
Corporate taxes	32.5	68.4	2[d]	(17.3)	**26.3**
			2[i]	1.9	
			2[o]	(59.2)	
Earnings (loss) before non-controlling interest	156.4	147.2		(908.0)	**(604.4)**
Non-controlling interest	7.6	—		—	**7.6**
Earnings (loss) before discontinued operations	148.8	147.2		(908.0)	**(612.0)**
Loss from discontinued operations, net of corporate taxes	—	17.5	2[o]	(17.5)	**—**
Net earnings (loss)	148.8	129.7		(890.5)	**(612.0)**
Preference share dividends	1.6	—	2[n]	9.8	**11.4**
Net earnings (loss) applicable to common shares	147.2	129.7		(900.3)	**(623.4)**
Weighted average common shares outstanding (number, in millions)	103.6		2[g]	44.3	**147.9**
Earnings (loss) per common share					
Basic	$ 1.42				**$ (4.21)**
Diluted	$ 1.37				**$ (4.21)**

See accompanying notes

Fortis Inc.

PRO FORMA CONSOLIDATED STATEMENT OF EARNINGS
For the three months ended March 31, 2007
(Unaudited)
($ millions, except for per share amounts)

	Fortis Inc.	Terasen Inc.	Note	Pro forma adjustments	Pro forma consolidated statement of earnings
Operating revenues	483.0	678.9	2[d]	(39.8)	**1,122.1**
Equity income	—	5.5	2[d]	(5.5)	**—**
	483.0	684.4		(45.3)	**1,122.1**
Expenses					
Energy supply costs	214.7	435.3		—	**650.0**
Operating	115.4	91.7	2[d]	(20.5)	**186.6**
Amortization	54.1	31.6	2[d]	(5.7)	**80.0**
	384.2	558.6		(26.2)	**916.6**
Operating income	98.8	125.8		(19.1)	**205.5**
Finance charges	47.6	73.7	2[d]	(0.9)	**119.1**
			2[m]	(1.3)	
Impairment in carrying value of goodwill	—	441.9	2[d]	(441.9)	**—**
	47.6	515.6		(444.1)	**119.1**
Earnings (loss) before corporate taxes	51.2	(389.8)		425.0	**86.4**
Corporate taxes	6.9	9.9	2[d]	(3.6)	**13.7**
			2[i]	0.5	
Earnings (loss) before non-controlling interest	44.3	(399.7)		428.1	**72.7**
Non-controlling interest	1.3	—		—	**1.3**
Earnings (loss) before discontinued operations	43.0	(399.7)		428.1	**71.4**
Gain from discontinued operations, net of corporate taxes	—	(3.3)	2[d]	3.3	**—**
Net earnings (loss)	43.0	(396.4)		424.8	**71.4**
Preference share dividends	1.5	—	2[n]	2.5	**4.0**
Net earnings (loss) applicable to common shares	41.5	(396.4)		422.3	**67.4**
Weighted average common shares outstanding (number, in millions)	109.4		2[g]	44.3	**153.7**
Earnings per common share					
Basic	$ 0.38				**$ 0.44**
Diluted	$ 0.35				**$ 0.43**

See accompanying notes

FORTIS INC.

NOTES TO PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited *pro forma* consolidated financial statements give effect to the acquisition (the "Acquisition") of all of the issued and outstanding shares in Terasen Inc. ("Terasen") as described in the Business Acquisition Report dated June 13 , 2007 (the "BAR"). The accompanying unaudited *pro forma* consolidated financial statements have been prepared by management of Fortis Inc. ("Fortis" or the "Corporation") and are derived from the unaudited and audited consolidated financial statements of Fortis as at and for the three months ended March 31, 2007 and for the year ended December 31, 2006, respectively; and the unaudited and audited financial statements of Terasen as at and for the three months ended March 31, 2007 and for the year ended December 31, 2006, respectively.

As part of a reorganization of its business prior to the closing of the Acquisition, Terasen Inc. was required to divest its petroleum transportation assets. In connection with this divestiture, on February 16, 2007 Terasen Inc. amalgamated with Terasen Pipelines (Trans Mountain) Inc., formerly a wholly owned subsidiary of Terasen Inc., and 0731297 BC Ltd., a holding company that was formerly the direct parent of Terasen Inc., with the amalgamated corporation continuing under the name "Terasen Inc.". It is the amalgamated corporation that is represented in the Terasen Inc. unaudited interim consolidated financial statements as at March 31, 2007 and for the three months ended March 31, 2007 and 2006. Post-amalgamation, Terasen Inc. continues to own the gas distribution business operated by its subsidiaries.

As a result of this amalgamation, the Terasen Inc. consolidated financial statements as at December 31, 2006 and for the years ended December 31, 2006 and 2005 do not reflect the same entity as, and are not directly comparable with, the unaudited interim consolidated financial statements as at March 31, 2007 and for the three months ended March 31, 2007 and 2006 that relate to the amalgamated corporation. The effect of the amalgamation is described in greater detail in note 1 of the Terasen Inc. unaudited interim consolidated financial statements on page C-6 of Schedule C to the BAR, and in note 2[o] to these *pro forma* financial statements.

The accounting policies used in the preparation of these unaudited *pro forma* consolidated financial statements are those disclosed in the Corporation's audited financial statements. Management has determined that no adjustments to Terasen's financial statements are required to comply with the accounting policies used by Fortis in the preparation of its consolidated financial statements. Certain accounting policies followed by Terasen are different from that of Fortis due to rate regulation associated with a gas utility imposed by the British Columbia Utilities Commission ("BCUC").

As is standard with similar transactions in regulated utilities, the purchase price is primarily based upon the regulated assets at the point of closing. Based on the purchase price calculation, as detailed in the acquisition agreement dated February 26, 2007, the estimated net purchase price of Terasen is $1,295.0 million (refer to Note 2[a]).

The unaudited *pro forma* consolidated balance sheet and unaudited *pro forma* consolidated statements of earnings reflect the acquisition effected on March 31, 2007 and January 1, 2006, respectively. The unaudited *pro forma* consolidated financial statements are not necessarily indicative of the results that actually would have been achieved if the transactions reflected therein had been completed on the dates indicated or the results which may be obtained in the future. For instance, the actual purchase price allocation will reflect the fair value, at the purchase date, of the assets acquired and liabilities assumed based upon the acquirer's evaluation of such assets and liabilities following the closing of the transaction and, accordingly, the final purchase price allocation, as it relates principally to intangible assets, may differ significantly from the preliminary allocation reflected herein.

These unaudited *pro forma* consolidated financial statements should be read in conjunction with the description of the transaction described in the BAR; the audited and unaudited financial statements of Terasen, including the notes thereto, included in the BAR; and the audited and unaudited consolidated financial statements of Fortis including the notes thereto.

The underlying assumptions for the *pro forma* adjustments provide a reasonable basis for presenting the significant financial effect directly attributable to the Acquisition. These *pro forma* adjustments are tentative and are based on available financial information and certain estimates and assumptions. The actual adjustments to the consolidated financial statements will depend on a number of factors. Therefore, we believe that the actual adjustments will differ from the *pro forma* adjustments, and the differences may be material.

2. PRO FORMA ASSUMPTIONS AND ADJUSTMENTS

[a] These *pro forma* consolidated financial statements give effect to the completion of the Acquisition, as if it had occurred on March 31, 2007 in respect of the *pro forma* consolidated balance sheet, and on January 1, 2006 in respect of the *pro forma* consolidated statements of earnings for the year ended December 31, 2006 and for the three-month period ended March 31, 2007. The Acquisition has been reflected in the *pro forma* consolidated financial statements using the purchase method.

Estimated Net Purchase Price

	($ millions)
Unadjusted purchase price	1,801.0
Estimated acquisition costs (Note 2[h])	20.0
Estimated net purchase price, before assumed debt	1,821.0
Assumed short-term notes of Terasen (Note 2[f])	(76.0)
Assumed long-term debt of Terasen (Note 2[f])	(450.0)
Estimated net purchase price	1,295.0

Estimated Net Funding Requirements

	($ millions)
Estimated net purchase price	1,295.0
Assumed short-term notes of Terasen (Note 2[f])	76.0
Assumed long-term debt of Terasen (Note 2[f])	450.0
Common share issuance costs (Note 2[g])	47.8
Estimated net funding requirements	1,868.8

Assumed Financing Structure

	($ millions)
Assumed short-term notes of Terasen (Note 2[f])	76.0
Assumed long-term debt of Terasen (Note 2[f])	450.0
Common share issuance (Note 2[g])	1,151.2
Incremental long-term capital (Note 2[n])	191.6
	1,868.8

[b] Petroleum Transportation segment net assets and allocation of estimated net purchase price

The estimated net purchase price has been allocated to the fair values of Terasen's net assets and liabilities at March 31, 2007, excluding the net assets and liabilities of the petroleum transportation segment which are not being acquired, in accordance with the purchase method, as follows:

	($ millions)				
	Terasen Inc.	Petroleum Transportation	Fair Value and Other Adjustments Note		Net Total
Assets acquired:					
Cash and cash equivalents	26.4	—		—	26.4
Accounts receivable	394.4	(16.1)		—	378.3
Prepaid expenses	8.6	(1.5)		—	7.1
Regulatory assets	35.2	—		—	35.2
Gas inventories, materials and supplies	79.7	(3.4)		—	76.3
Current assets held for sale	2.1	(2.1)		—	—
Current assets	**546.4**	**(23.1)**		**—**	**523.3**
Deferred charges and other assets	87.6	(20.6)	2[e]	(3.0)	64.0
Regulatory assets	32.2	—		—	32.2
Future income taxes	—	—	2[f]	8.4	8.4
Utility capital assets	3,623.6	(858.9)		—	2,764.7
Investments	524.5	(524.5)		—	—
Long-lived assets held for sale	1,012.1	(1,012.1)		—	—
	5,826.4	**(2,439.2)**		**5.4**	**3,392.6**
Liabilities assumed:					
Short-term borrowings	213.0	—		—	213.0
Accounts payable and accrued charges	408.2	(24.9)	2[l]	10.0	393.3
Income taxes payable	60.4	(13.3)	2[e]	2.0	49.1
Regulatory liabilities	1.8	—		—	1.8
Current instalments of long-term debt and capital lease obligations	287.6	—		—	287.6
Current liabilities held for sale	415.1	(415.1)		—	—
Current liabilities	**1,386.1**	**(453.3)**		**12.0**	**944.8**
Deferred credits and other liabilities	214.3	(7.6)		—	206.7
Future income taxes	197.3	(211.8)		—	(14.5)
Long-term debt and capital lease obligations	1,819.0	—	2[f]	24.0	1,843.0
Subordinated debt (i)	2,491.3	(2,491.3)		—	—
Long-term liabilities held for sale	325.9	(325.9)		—	—
	6,433.9	**(3,489.9)**		**36.0**	**2,980.0**
Net (liabilities) assets at fair value, as at March 31, 2007	**(607.5)**	**1,050.7**		**(30.6)**	**412.6**
Net purchase price					**1,295.0**
Goodwill					**882.4**
Goodwill previously recorded by Terasen					**1,072.1**
Goodwill adjustment					**(189.7)**

(i) Subsequent to March 31, 2007 the subordinated debt balance of $2,491.3 million was partially repaid. The remaining amount was converted to preferred shares which have been subsequently acquired by the Corporation as part of the Acquisition.

Terasen's natural gas distribution business is regulated under traditional cost of service. The determination of revenues and earnings is based on regulated rates of return that are applied to historic values and does not change with a change of ownership. Therefore, for the regulated business, no fair market value adjustments are recorded as part of the purchase price on individual assets and liabilities, including intangibles, to be acquired, because all of the economic benefits and obligations associated with them beyond regulated rates of return accrue to the customers. The book value of the assets and liabilities of the regulated business to be acquired has been assigned as fair value for the purchase price allocation.

[c] Goodwill

The excess of the purchase price, including estimated fees and expenses related to the Acquisition, over the preliminary fair value of net assets acquired from Terasen, is classified as goodwill on the accompanying *pro forma* consolidated balance sheet.

[d] Results of Petroleum Transportation segment

The acquisition of Terasen does not include the petroleum transportation segment and, as such, the results of this segment for the year ended December 31, 2006 and for the three months ended March 31, 2007 have been excluded, as follows:

	($ millions)	
	Year ended December 31, 2006	**Three months ended March 31, 2007**
Operating revenues	242.4	39.8
Equity income	24.5	5.5
	266.9	45.3
Expenses		
Operating	108.9	20.5
Amortization	37.7	5.7
Finance charges	26.8	0.9
Corporate taxes	17.3	3.6
	190.7	30.7
Other Items		
Impairment in carrying value of goodwill	—	441.9
Gain from discontinued operations, net of corporate taxes	—	(3.3)
	—	438.6

[e] Fair value adjustments

An adjustment of $3.0 million to reduce investments in international consulting operations to their estimated fair value has been recorded under the deferred charges and other assets line item. An adjustment of $2.0 million to income taxes payable has also been recorded relating to potential tax exposures.

[f] Assumed debt

Terasen has long-term debt outstanding of $450.0 million, in various series with due dates ranging from 2008 to 2040. The rates range from 5.56% to 8.0%, resulting in the fair market value of the debt exceeding book value by $24.0 million, ($15.6 million, net of future income taxes of $8.4 million), calculated as at March 31, 2007. No adjustments were made to the carrying value of the debt securities of Terasen Gas Inc. and Terasen Gas (Vancouver Island) Inc. This is due to the rate-regulated nature of their businesses in which recovery in rates of the costs related to these debt securities is subject to the regulation of the BCUC.

Terasen also has short-term notes of $76.0 million that are being assumed. The remaining short-term notes balance of $137.0 million relates to the BCUC regulated business.

[g] Common share issuance

To finance a significant portion of the Acquisition, the Corporation will issue one common share for each subscription receipt sold, resulting in approximately 44.3 million common shares being issued for gross proceeds of $1,151.2 million, or net proceeds after common share issuance costs of $1,120.1 million ($47.8 million common share issuance costs less $16.7 million of future income taxes). The Subscription Receipts were sold at a price of $26.00 per share during the three months ended March 31, 2007.

[h] Acquisition costs

It is assumed that Acquisition costs will approximate $20.0 million, and will form part of the investment cost base. These primarily relate to investment banking and legal fees.

[i] Corporate taxes

Corporate taxes applicable to the *pro forma* adjustments are tax effected at Fortis' average tax rates of 35.0% and 35.0% for the year ended December 31, 2006 and the three months ended March 31, 2007, respectively.

[j] Earnings per common share

The calculation of the *pro forma* earnings per common share for the year ended December 31, 2006, and for the three months ended March 31, 2007, considers the issuance of 44.3 million common shares as if the issuance had taken place as at January 1, 2006.

[k] Terasen historical shareholder's equity balances

The historical common shares, contributed surplus and retained earnings balances of Terasen have been eliminated.

[l] Transition costs

Estimated known restructuring costs of $10.0 million are related to an after-tax estimate of expenses associated with a transition plan. The assessment of and actions under this plan will be completed as soon as possible.

[m] Amortization of fair value debt adjustment

The fair value debt adjustment will be amortized over the term of the related debt. Refer to Note 2[f].

[n] Incremental long-term capital

To finance a portion of the Acquisition, the Corporation plans to issue approximately 8.0 million preference shares at a price of $25.00 per share for total gross proceeds of $200.0 million. Preference share issuance costs of $6.8 million are expected to be incurred which will create a future income tax asset of $2.4 million. The dividend yield is estimated at 4.9% per share. The net cash proceeds of $193.2 million will be used to fund the remaining portion of the assumed financing structure, currently estimated at $191.6 million. Prior to finalizing the preference share issue, the Corporation will use its existing credit facilities to fund, on an interim basis, the remaining portion of the purchase consideration.

[o] Terasen Inc.

The Terasen Inc. consolidated statement of earnings for the year ended December 31, 2006 has been adjusted for the effects of the push down of the purchase accounting, due to an amalgamation of certain Terasen entities. Refer to Note 1 "Amalgamation and Restatement of Prior Periods" on page C-6 of the unaudited interim consolidated financial statements of Terasen for the three months ended March 31, 2007 included in Schedule C of the BAR for further details relating to the nature of the amalgamation.

The following table presents the consolidated statement of earnings for the year ended December 31, 2006 as previously presented with the adjustments that resulted from the push down of purchase accounting and other items on the purchase of Terasen Inc. related to the businesses acquired by Fortis to present an adjusted statement of earnings after the amalgamation.

	($ millions) Year Ended December 31,2006			
	As Presented		Adjustments due to Amalgamation	Adjusted
Revenues				
Operating revenues	2,027.7	(i)	(1.9)	2,025.8
Equity income	24.5		—	24.5
	2,052.2		(1.9)	2,050.3
Expenses				
Energy supply costs	1,117.9		—	1,117.9
Operating	394.0	(i)	(8.0)	386.0
Amortization	145.2	(ii)	(2.1)	143.1
	1,657.1		(10.1)	1,647.0
Operating income	395.1		8.2	403.3
Finance charges	179.5	(iii)	140.3	319.8
Impairment in carrying value of goodwill	—	(iv)	762.3	762.3
	179.5		902.6	1,082.1
Earnings (loss) before corporate taxes	215.6		(894.4)	(678.8)
Corporate taxes	68.4	(v)	(59.2)	9.2
Earnings (loss) before discontinued operations	147.2		(835.2)	(688.0)
Loss from discontinued operations, net of corporate taxes	17.5	(vi)	(17.5)	—
Net earnings (loss)	129.7		(817.7)	(688.0)

(i) Represents the reversal of a write-off which occurred when Kinder Morgan, Inc. ("Kinder Morgan") acquired Terasen.

(ii) Represents the amortization of fair value increments assigned to property, plant and equipment.

(iii) Represents the amortization of fair value increments assigned to long-term debt and the interest on the subordinated debt.

(iv) An impairment in carrying value of goodwill of $762.3 million was taken during the fourth quarter of 2006.

(v) Represents mainly the tax benefits associated with the interest expense recorded on the subordinated debt.

(vi) Represents the reversal of the loss on the Terasen Water and Utility Services segment which, for purchase accounting, was eliminated when Kinder Morgan acquired Terasen.

SCHEDULE E

Terasen Inc.

2006 Management's Discussion and Analysis
For the Year Ended December 31, 2006

March 30, 2007

(see attached)

This discussion should be read in conjunction with the consolidated financial statements of the Company and related notes for the years ended December 31, 2006 and 2005. In this MD&A, we, us, our, the Company and Terasen mean Terasen Inc., its subsidiaries, joint ventures and investments in significantly influenced companies. Terasen Gas refers to Terasen Gas Inc., TGVI refers to Terasen Gas (Vancouver Island) Inc., Trans Mountain refers to Terasen Pipelines (Trans Mountain) Inc., Corridor refers to Terasen Pipelines (Corridor) Inc., Terasen Pipelines refers to Terasen Pipelines Inc., Express refers to the Express and Platte Pipeline Systems; and Water and Utility Services refers to Terasen Waterworks (Supply) Inc., Terasen Utility Services Inc. and Terasen's 50% interest in Fairbanks Sewer and Water Inc. KMI refers to Kinder Morgan, Inc.

The financial data included in this discussion has been prepared in accordance with Canadian generally accepted accounting principles (GAAP), and all dollar amounts are in Canadian dollars unless otherwise stated.

About Terasen

On November 30, 2005, all of the shares of the Company were acquired by Kinder Morgan, Inc. ("KMI"), through a subsidiary, pursuant to a Combination Agreement dated as of August 1, 2005. On May 29, 2006, KMI management and some investment partners announced a proposal to take KMI private. This was approved by KMI shareholders on December 19, 2006, and is expected to close in the second quarter of 2007, subject to outstanding approvals from one state regulatory utility commission.

On February 26, 2007, Kinder Morgan, Inc. announced that it entered into a definitive agreement with Fortis, Inc. to sell Terasen Inc. and its principal natural gas distribution assets, including its subsidiaries Terasen Gas and TGVI as well as other activities including Terasen Energy Services. The sale does not include the petroleum transportation subsidiaries nor investments under the Kinder Morgan Canada name. The purchase price of $3.7 billion includes the assumption of approximately $2.4 billion of debt. The transaction is expected to close in mid-2007 subject to the fulfillment of customary closing conditions and required regulatory approvals.

On March 5, 2007, Kinder Morgan, Inc. announced that it entered into an agreement to sell the shares of the Corridor Pipeline System to Inter Pipeline Fund for approximately $760 million including debt. The transaction is subject to certain closing conditions and regulatory approvals, as well as a right of first refusal and is expected to close in mid-2007.

The effects of the above two transactions will have Terasen's holdings be primarily in natural gas distribution assets. All petroleum transportation assets, liabilities, revenues and expenses will be sold after these transactions.

Natural Gas Distribution

Terasen's natural gas distribution operations consist primarily of Terasen Gas and TGVI in addition to several small related utility operations. Terasen Gas is the largest distributor of natural gas in British Columbia, serving more than 815,000 residential, commercial and industrial customers in more than 100 communities. Major areas served by Terasen Gas are Greater Vancouver, the Fraser Valley and the Thompson, Okanagan, Kootenay and North Central Interior regions of the province. TGVI serves approximately 87,000 residential, commercial and industrial customers on Vancouver Island and the Sunshine Coast area and Terasen Gas (Whistler) serves approximately 2,400 residential and commercial customers in the Whistler region. Terasen Gas and TGVI provide transmission and distribution services to their customers, and obtain natural gas supplies on behalf of residential and commercial customers. Gas supplies are sourced primarily from northeastern British Columbia and, through the Company's Southern Crossing Pipeline, from Alberta.

Petroleum Transportation

Terasen's petroleum transportation operations are the Trans Mountain, Corridor, Express and Platte pipelines. These operations are conducted under the Kinder Morgan Canada name. Trans Mountain transports crude oil and refined products from Edmonton, Alberta to Burnaby, British Columbia and also delivers Canadian crude oil to several refineries in Washington State. Trans Mountain also owns the Westridge Marine Terminal, which is located at tidewater in the Port of Vancouver, and a jet fuel pipeline connecting to Vancouver International Airport. Corridor owns a dual pipeline system which transports diluted bitumen and diluent between the Muskeg River mine near Fort McMurray and the Shell upgrader north of Edmonton, Alberta. Corridor commenced commercial operations in May 2003. Terasen also owns a one-third interest in the Express Pipeline and the Platte Pipeline which transports crude oil from Hardisty, Alberta to the Rocky Mountain region of the United States and on to Wood River, Illinois.

Other Activities

In addition to Terasen's core businesses of Natural Gas Distribution and Petroleum Transportation, Terasen owns interests in several smaller businesses including a 30% interest in CustomerWorks LP. CustomerWorks provides billing and customer care services to utilities, municipalities and retail energy companies. CustomerWorks has outsourced the provision of its customer care services to an entity owned and operated by Accenture Inc.

In January 2006, Terasen entered into a Purchase and Sale Agreement to dispose of its interest in its water and utility services operations for proceeds of approximately $132 million. The disposition was completed on May 19, 2006 with the proceeds from the sale being used to reduce debt. The disposition gave rise to a $17.5 million loss which has been fully recorded.

Results of Operations

Net Earnings

	Years ended December 31	
	2006	**2005**
	(in millions of dollars)	
Natural gas distribution		
Terasen Gas	**$ 68.4**	$ 65.3
TGVI	**27.1**	25.5
	95.5	90.8
Petroleum transportation		
Trans Mountain	**36.8**	25.4
Corridor	**13.3**	13.6
Express System	**26.1**	25.5
	76.2	64.5
Discontinued operations	**(17.5)**	(4.9)
Other activities	**(24.5)**	(49.2)
Net earnings	**$ 129.7**	$ 101.2

Net earnings for 2006 increased by $28.5 million compared to 2005. The significant items that impacted net earnings in 2006 compared to the previous year were as follows:

Certain items

	($ millions)
2005 unusual one time items primarily KMI transaction costs	$ 44.0
2005 premium on Trans Mountain debt redemption	7.3
2006 loss on sale of Terasen Water & Utility Services	(17.5)
2006 provision for retroactive tax amending legislation in the Province of Quebec	(15.2)
2006 earnings from Petroleum transportation, primarily increased volumes	4.4
	$ 23.0

In 2005, there were a number of one-time charges including the transaction costs associated with the acquisition of Terasen by KMI of $42.9 million, disallowed costs of $3.6 million incurred in connection with the Inland Pacific Connector project, a $2.5 million gain associated with the sale and hedge gains of the Company's investment in Clean Energy, and a charge to earnings of $7.3 million that was incurred in connection with the premium that was paid to redeem the Trans Mountain Series C debentures.

On May 19, 2006, Terasen completed the sale of its water and utility services business. Total proceeds of $132 million were used to reduce debt. The sale resulted in an accounting loss of $12.9 million and the business incurred an operating loss of $4.1 million prior to the sale.

In 2006, a provision of $15.2 million was set up relating to a reassessment from Revenue Quebec for the 2004 and 2005 taxation years. These reassessments were made pursuant to new, retroactive legislation passed in Quebec in June 2006 for the express purpose of challenging certain inter-provincial Canadian tax structures.

The water and utility services business operations earnings have been reclassified to discontinued operations for 2006, 2005 and 2004.

Selected Annual Information

	Years ended December 31		
	2006	**2005**	**2004**
	(in millions of dollars)		
Total revenues [1]	**$ 2,027.7**	$ 1,952.5	$ 1,798.1
Net income before discontinued operations [1]	**147.2**	106.1	146.5
Net income [2]	**129.7**	101.2	149.8
Common dividends paid	**—**	95.1	86.4
Total assets (restated) [1]	**5,377.8**	5,329.9	4,981.8
Long-term debt [1,3]	**2,117.6**	2,012.9	2,291.6
Current portion of long-term debt	**285.9**	398.2	416.7

1. Total revenues in 2004 and 2005 has been restated to reflect the reclassification of the water and utility services business as discontinued operations. Net income before discontinued operations and long-term debt for 2004 has been restated for the reclassification of the Company's capital securities from equity to long-term debt, and the reclassification of the respective financing costs and income taxes. Total assets for 2005 and 2004 has been restated to reflect the reclassification of amounts between other assets and other long-term liabilities and deferred credits.

2. Terasen is a wholly-owned subsidiary of KMI and accordingly earnings per share information is not disclosed.

3. Excluding current portion of long-term debt.

Growth in total revenues has been caused mainly by higher natural gas commodity prices, particularly in 2005, which are flowed through in customer rates. Net income, when adjusted for the KMI transaction costs and Trans Mountain Series C redemption costs in 2005, has grown since 2004 mainly as a result of strong and steady earnings growth in petroleum transportation. The Express System expansion in April 2005 and throughput growth on the Trans Mountain system have been the main contributors to earnings growth. The increase in total assets from 2004 to 2005 reflected both capital expenditures and growth in natural gas inventories and accounts receivable as a result of higher natural gas commodity prices. Increase in assets in 2006 was partially offset by the disposition of the water and utility services business segment.

Results by Business Segment

Natural Gas Distribution

	Years ended December 31	
	2006	**2005**
	(in millions of dollars)	
Natural gas distribution revenues	**$ 1,741.1**	$ 1,678.0
Natural gas distribution net earnings	**95.5**	90.8

Revenues from natural gas distribution increased in 2006 compared to 2005 mainly as a result of higher market prices for natural gas, which are flowed through in customer rates. Cost of natural gas increased by a corresponding amount.

Earnings from natural gas distribution increased from $90.8 million in 2005 to $95.5 million in 2006 mainly due to strong operating performance in both Terasen Gas and TGVI and a higher debt to equity component in rate base, offset by a lower allowed return on equity in both Terasen Gas and TGVI and a provision made for retroactive tax legislation as discussed in further detail below.

TERASEN GAS

Earnings from Terasen Gas increased slightly from $65.3 million to $68.4 million. $11.5 million of costs related to a reassessment from Revenue Quebec for the 2004 and 2005 taxation years were expensed in 2006. These reassessments were made pursuant to new, retroactive legislation passed in Quebec in June 2006 for the express purpose of challenging certain inter-provincial Canadian tax structures. This was offset by strong operating performance, including higher transportation revenue and rate base growth and lower debt financing costs due to a higher equity thickness allowed by the British Columbia Utilities Commission ("BCUC").

Terasen Gas net customer additions during 2006 were 10,289, down from 12,613 customer additions in 2005. Though 2006 was another strong year for housing starts in British Columbia, adverse winter conditions slowed construction activities in the latter part of the year. In addition, the growth in multi-family housing also impacted net additions as natural gas use is less prevalent in this type of dwelling. Terasen Gas industrial sales and transportation volumes decreased by 501 terajoules and 1,662 terajoules, respectively, from the previous year. The decrease in the industrial sales volumes is due to customers switching to commercial and transport sales. The 1,662 terajoules decrease in transportation volumes is due to the permanent shutdown of the Domtar Pulp facility half way through 2006 (500 TJ), an employee strike in 2006 at a greenhouse in the Fraser Valley (150 TJ), the closure of a sawmill in the interior (150TJ) and the remaining decrease is attributed to a general decrease in usage from the forestry industry in response to the housing slowdown in the US and fuel switching to wood in the greenhouse sector. Terasen Gas earns approximately the same margin regardless of whether a customer contracts for sales or transportation service.

Regulation

Terasen Gas' rates are based on estimates of several items, such as natural gas sales volumes, cost of natural gas, and interest rates. In order to manage the risks associated with some of these estimates, a number of regulatory deferral accounts are in place.

Two mechanisms to ameliorate unanticipated changes in sales volumes, such as changes caused by weather, have been implemented specifically for Terasen Gas. The first, originally called the Gas Cost Reconciliation Account (GCRA), relates to the recovery of all gas costs through a deferral account which captures all variances (overages and shortfalls) from forecasts. Balances are either refunded to or recovered from customers via an application with the BCUC. Creation of the GCRA was approved by the BCUC in October 1993. Effective April 2004, the GCRA was split into two new deferral accounts called the Commodity Cost Reconciliation Account (CCRA) and the Midstream Cost Reconciliation Account (MCRA). The CCRA and MCRA were created to support commodity unbundling and the refund /recovery mechanism works the same as that used for the GCRA. The second mechanism seeks to stabilize revenues from residential and commercial customers through a deferral account that captures variances in the forecast versus actual customer use throughout the year. This mechanism is called the Revenue Stabilization Adjustment Mechanism (RSAM).

The RSAM and CCRA/MCRA accounts reduce Terasen Gas' earnings exposure to related risks by deferring any variances between projected and actual gas consumption and gas costs, and refunding or recovering those variances in rates in subsequent periods. Variances in usage by large volume, industrial transportation and sales customers are not covered by these deferral accounts as their usage is more predictable and less likely to be significantly affected by weather.

In 2006, the net balances of the RSAM and CCRA/MCRA accounts increased to a receivable of $142.8 million from a payable of $9.0 million in 2005. In order to ensure that the balances in the CCRA/MCRA account are recovered on a timely basis, Terasen Gas prepares and files quarterly calculations with the BCUC to determine whether customer rate adjustments are needed to reflect prevailing market prices for natural gas costs. In addition, ineffective hedges, which are out of the money at December 31, 2006, accounts for $156.0 million of the change. Customer rate adjustments ignore the temporal effect of derivative valuation adjustments on the balance sheet and instead reflect the forward forecast of gas costs over the recovery period.

Short-term and long-term interest rate deferral accounts are also in place to absorb interest rate fluctuations. The interest rate deferral accounts which were in place during 2006 effectively fixed the interest expense on short-term funds attributable to Terasen Gas' regulated assets at 4.00% during both 2005 and 2006. The effective fixed short-term interest rate for 2007 has been set at 4.75%. Any variations from this rate throughout the year are recorded in deferral accounts.

Allowed Return on Equity (ROE) and Capital Structure

Terasen Gas' allowed ROE is determined annually based on a formula that applies a risk premium to a forecast of long-term Government of Canada bond yields. For 2006, the application of the ROE formula set Terasen Gas' allowed ROE at 8.80%, down from 9.03% in 2005. Terasen Gas and TGVI applied to the BCUC in June 2005 to increase their deemed equity components from 33% to 38% and from 35% to 40%, respectively. The same application also requested an increase in the allowed ROE from the levels that would have resulted from the historic formula, which would have been 8.29% for Terasen Gas and 8.79% for TGVI in 2006.

The BCUC rendered its decision on the application on March 2, 2006, to be effective as of January 1, 2006. The generic ROE formula for a benchmark utility in British Columbia was changed such that it will be reset annually off a forecast of 30 Year Canada Bonds plus a 3.90% risk premium when the forecast yield on 30 Year Canada Bond is 5.25%. The risk premium is adjusted annually by 75% of the difference between 5.25% and the forecast yield on 30 Year Canada Bonds. The changes increased the allowed ROE from 8.29% to 8.80% for Terasen Gas and from 8.79% to 9.50% for TGVI in 2006. The decision also resulted in increases in the deemed equity components of Terasen Gas and TGVI to 35% and 40%, respectively. For 2007, the allowed ROE was set at 8.37% for Terasen Gas.

2004-2007 Performance Based Rate Plan (PBR)

In July 2003, Terasen Gas received BCUC approval of a negotiated settlement for a 2004-2007 PBR. The PBR Settlement establishes a process for determining Terasen Gas' delivery charges and incentive mechanisms for improved operating efficiencies. The four-year agreement includes incentives for Terasen Gas to operate more efficiently through the sharing of the benefits between Terasen Gas and its customers. The PBR Settlement includes ten service quality measures designed to ensure Terasen Gas maintains service levels. It also sets out the requirements for an annual review process which will provide a forum for discussion between Terasen Gas and interested parties regarding its current performance and future activities.

Operation and maintenance costs and base capital expenditures are subject to an incentive formula reflecting increasing costs due to customer growth and inflation, less an adjustment factor based on 50 percent of inflation during the first two years of the PBR and 66 percent of inflation during the last two years. Base capital expenditure amounts are a function of customer numbers and projected customer additions. The PBR Settlement provides for a 50/50 sharing mechanism of earnings above or below the allowed return on equity beginning in 2004.

In January 2007, Terasen Gas Inc. applied for an extension of the 2004-2007 PBR settlement agreement. After an extensive stakeholder consultation process, Terasen Gas Inc. filed an application for approval of a two-year extension to the current 2004-2007 Multi-Year Performance Based Rate Plan. The application requested approval to extend the existing settlement term for 2008-2009. On March 23, 2007, the BCUC approved the application as filed.

Amalgamation of Terasen Gas (Squamish) Inc.

On November 2, 2006, the government of British Columbia approved the amalgamation of Terasen Gas (Squamish) Inc. ("TGS") with Terasen Gas Inc. Effective January 1, 2007, natural gas rates charged to TGS customers were aligned with the Terasen Gas Inc. rates. Integration of TGS into Terasen Gas Inc. resulted in changes to regulatory oversight. The BCUC will now have sole authority over the amalgamated company, whereas TGS was regulated through contractual agreements with the province and the BCUC.

Unbundling

Over the past several years, Terasen Gas Inc., the BCUC and a number of interested parties have laid the groundwork for the introduction of natural gas commodity unbundling. On November 1, 2004, commercial customers of Terasen Gas Inc. became eligible to sign up to buy their natural gas commodity supply directly from third-party suppliers. Terasen Gas Inc. continues to provide delivery of the natural gas. Approximately 79,000 commercial customers are eligible to participate in commodity unbundling. By December 31, 2006, 18,700 customers elected to participate in this program.

During 2006, the BCUC approved offering commodity supply choice to residential customers. The BCUC agreed to open a portion of the province's residential natural gas market to competition, allowing homeowners to sign long-term fixed price contracts for natural gas with companies other than Terasen Gas Inc. starting in May 2007. Consumers can choose to remain with Terasen Gas Inc. or sign with a marketer, in which case they will begin receiving gas at the marketer's rate starting in November 2007. Terasen Gas Inc. will continue to provide delivery service to unbundled customers and delivery margins are not expected to be impacted by migration of residential customers to alternative commodity suppliers.

Municipal Leasing Transactions

The Company has a leasing arrangement that allows Terasen Gas to continue to operate the gas distribution assets by effectively selling the assets to the municipality and leasing them back for a 17 year period. After 17 years, Terasen Gas has an option to repurchase the assets at depreciated value. At December 31, 2006, Terasen Gas had entered into transactions involving a total value of $153 million. In addition the municipalities participating in the leasing transactions have the right each year to acquire any new asset additions within their boundaries at cost, subject to the same repurchase option at the end of the initial 17 year lease term.

TGVI

Earnings from TGVI remained steady, increasing slightly from \$25.5 million in 2005 to \$27.1 million in 2006. The increase was primarily due to an increase in equity thickness allowed by the BCUC in 2006.

TGVI net customer additions during 2006 were 4,080, down slightly from 4,354, customer additions in 2005. Customer additions decreased slightly in 2006 due to increased service costs that TGVI began charging in 2006 as per the BCUC.

Regulation

TGVI is also regulated by the BCUC. In 1995, an agreement was entered into between TGVI, the Province of British Columbia (the Province) and the Government of Canada, which included a Special Direction that was issued to the BCUC. The agreement, which expires no sooner than December, 2011, includes the following terms:

- TGVI receives, for the benefit of its customers, an annual payment until 2011 from the Province based on the wellhead price of natural gas in B.C. This payment amounted to \$36.3 million in 2006, down from \$46.7 million in 2005.

- The accumulated revenue deficiency resulting from overall revenues being below the cost of service prior to 2003 had been recorded in a Revenue Deficiency Deferral Account (RDDA). When Terasen acquired TGVI, the amount of the RDDA was \$85 million, for which Terasen paid a price of \$61 million. The accumulated RDDA recorded on Terasen's consolidated financial statements totaled \$30.9 million as at December 31, 2006, corresponding to a balance for TGVI regulatory purposes of \$41.4 million. The balance on Terasen's consolidated financial statements is down \$4.3 million from December 31, 2005. Terasen is committed to fund these revenue deficiencies by purchasing preferred shares or subordinated debt issued by TGVI. The BCUC was directed to set rates beginning in 2003 that amortize the RDDA balance over the shortest period reasonably possible, having regard for TGVI's competitive position relative to alternative energy sources and the desirability of reasonable rates. The earnings impact of the RDDA discount is discussed under Results — Natural Gas Distribution.

- Any variances in the achieved ROE in a particular year from the allowed ROE (other than variances resulting from operation and maintenance costs) are deferred and recorded in the RDDA. The RDDA accumulated by TGVI is funded by the Company. Recovery of the deficiency through rates charged to customers is dependent upon regulatory approval and must be balanced against maintaining the competitiveness of TGVI's service relative to alternative energy sources. As a result, most risks associated with TGVI's annual financial results (other than operating costs) are, subject to BCUC approval, transferred to customers through the RDDA. The Company began recovery of the deficiency in 2003.

TGVI renewed its regulatory settlement in late 2005 for a two-year period effective January 1, 2006. It provides for a continuation of the operation and maintenance cost incentive arrangements previously in place. The allowed ROE for TGVI was 9.50% for 2006, compared to 9.53% in 2005. Due to a decline in the forecast benchmark 30-year Canada Bond, TGVI's ROE for 2007 has been set at 9.07% and TGVI's deemed equity component of its capital structure for 2007 is 40%.

To ensure prompt recovery of the RDDA, the BCUC has approved a rate-setting mechanism for TGVI whereby customer rates are set at levels in excess of TGVI's cost of service, but effectively capped by the price of competitive alternative fuels (electricity or heating oil). This has resulted in significant RDDA amortization in both 2005 and 2006. However, RDDA recovery is sensitive to the relative pricing of natural gas and electricity in TGVI's service area, as well as to margin generated under TGVI's firm transportation agreements discussed below. There is no certainty that TGVI will be able to charge rates that will be sufficient to fully recover the RDDA prior to the expiry of the Provincial royalty payments at the end of 2011.

TGVI has applied for an extension of its settlement agreement which expires at the end of 2007. After an extensive stakeholder consultation process, TGVI filed an application for approval of a two-year extension to the current 2006-2007 Negotiated Settlement Agreement. The BCUC has determined that the application will be reviewed through a written public process throughout February/March, with a decision expected in April 2007.

Contractual Arrangements

During 2005, TGVI's firm transportation agreements with the Vancouver Island Gas Joint Venture were renewed. The new agreements extend until 2012, and the committed volume under the contracts were set at 12.5 TJ per day for 2006 to April 1, 2007 and 9.1 TJ from April 2007 to 2012, inclusive, down from 20 TJ per day in 2005.

TGVI has also entered into a firm transportation agreement with BC Hydro to serve BC Hydro's gas supply needs to a gas-fired cogeneration plant at Elk Falls, B.C. The agreement, for 45 TJ per day, expires on December 31, 2007. BC Hydro has an option to extend the agreement for one year. BC Hydro has indicated that it is considering changing the Elk Falls facility from a baseload facility to a dispatchable facility. Accordingly, there is no certainty that the firm transportation agreement with BC Hydro will be extended beyond 2007.

On February 16, 2005, the BCUC approved TGVI's proposed liquefied natural gas (LNG) storage facility, subject to several conditions including the execution of a long-term Transportation Service Agreement (TSA) with BC Hydro backed by the capacity demand requirements of the Duke Point Power project. On June 17, 2005, BC Hydro announced its intention to abandon the Duke Point Power project on Vancouver Island as a result of a continuing appeal process. As a result, the expected construction timeline for TGVI's proposed storage facility has been delayed and, pending re-evaluation, will require BCUC approval prior to proceeding.

Petroleum Transportation

	Years ended December 31	
	2006	**2005**
	(in millions of dollars)	
Petroleum transportation revenues	**$ 242.4**	$ 227.8
Petroleum transportation net earnings	**76.2**	64.5

Revenues from petroleum transportation increased by $14.6 million in 2006 compared to 2005 as a result of higher revenues on both the Corridor system and the Trans Mountain System. Corridor revenues were higher in 2006 due to an increase in the Annual Revenue Requirement while the Trans Mountain revenues increased as a result of an increase in throughput on both the Canadian and US mainlines.

Earnings from petroleum transportation increased from $64.5 million in 2005 to $76.2 million in 2006 mainly as a result of higher revenue on the Trans Mountain system higher earnings from the Express System due to a full year impact on earnings of the Express Expansion project, partially offset by a lower return on equity on Corridor. Earnings in 2005 were also impacted by a $7.3 million after-tax charge to earnings associated with the redemption of the Trans Mountain Series C Debentures.

TRANSPORTATION VOLUMES

	Years ended December 31	
	2006	**2005**
	(barrels per day)	
Trans Mountain Canadian mainline	**229,300**	220,900
Trans Mountain U.S. mainline	**93,000**	74,600
Express System	**231,200**	213,000

Actual throughput on the Corridor Pipeline does not impact earnings as all of Corridor's capacity is contracted through ship-or-pay arrangements.

Throughput in the first quarter of 2005 on the Trans Mountain system was impacted by the decline in production from the Alberta oilsands resulting from temporary production outages, as well as turnarounds at refineries connected to the Trans Mountain pipeline. These issues affected throughput on both the Canadian and U.S. mainlines. Volumes returned to more normal levels for the remainder of 2005.

Throughput on the Express System increased in 2006 as a result of the completion of the Express expansion project in April 2005.

TRANS MOUNTAIN

Earnings from Trans Mountain were up from $25.4 million in 2005 to $36.8 million in 2006 mainly as a result of the costs of the Trans Mountain Series C Debenture redemption in 2005 and reduced throughput on the Trans Mountain system in the first quarter of 2005.

Regulation

The National Energy Board (NEB) regulates the Canadian portion of Trans Mountain's crude oil and refined products pipeline system. The NEB authorizes pipeline construction and establishes tolls and conditions of service.

In November 2000, Trans Mountain and shipper representatives reached a negotiated agreement to determine Trans Mountain's tolls for the period 2001-2005. This Incentive Toll Settlement (ITS) was approved by the NEB on March 22, 2001 to take effect as of January 1, 2001.

The 2001-2005 ITS establishes base tolls, within a band of approximately 179,000 to 201,000 bpd, on Trans Mountain's Canadian mainline for the term of the settlement. Base tolls are set using a throughput level of approximately 189,000 bpd. Any revenue shortfalls arising from annual throughput levels below 179,000 bpd are recovered from the shippers. Incremental revenues arising from annual throughput above 201,000 bpd are shared equally between Trans Mountain and the shippers. The base tolls do not escalate with inflation unless Canadian inflation rates increase above 3.5%. Trans Mountain keeps all of the benefits achieved through productivity initiatives and operating efficiencies.

In November 2004, Trans Mountain entered into negotiations with the Canadian Association of Petroleum Producers ("CAPP") and principal shippers for a new Incentive Toll Settlement to be effective for the period starting January 1, 2006 and ending December 31, 2010 (the "2006 ITS"). In January 2006, Trans Mountain reached agreement in principle reduced to a memorandum of understanding for the 2006 ITS. A final agreement was reached with CAPP in October 2006 and NEB approval was received in November 2006. The 2006 ITS provides the commercial support for the much needed first phase of expansion of the Trans Mountain pipeline system, which will increase capacity to 300,000 barrels per day ("bpd"). The project includes the Trans Mountain pump station expansion that will increase pipeline capacity from the current 225,000 bpd to 260,000 bpd by April 2007, and the Anchor Loop expansion, which will add an additional 40,000 bpd of new capacity to the west coast of British Columbia and Washington state by late 2008. These projects represent approximately C$638 million in capital investments and reflect a commitment by Kinder Morgan Canada to progressively expand pipeline capacity from Alberta to serve markets in Canada, the United States and offshore.

The toll charged for the U.S. portion of Trans Mountain's pipeline in Washington State falls under the jurisdiction of the Federal Energy Regulatory Commission (FERC). Regulation by FERC is on a complaint basis. There were no complaints in 2006.

Trans Mountain Pump Station Expansion Project

On Nov. 10, 2005, Kinder Morgan Canada received approval from the National Energy Board (NEB) to increase the capacity of the Trans Mountain pipeline system from 225,000 bpd to 260,000 bpd. The $195 million expansion is designed to add 35,000 bpd of heavy crude oil capacity by building new and upgrading existing pump stations along the pipeline system between Edmonton, Alberta, and Burnaby, British Columbia. Construction began in the summer of 2006 and the expansion is expected to be in service in April 2007.

Trans Mountain Anchor Loop Project

Kinder Morgan Canada filed a comprehensive environmental report with the Canadian Environmental Assessment Agency on Nov. 15, 2005, and filed a complete NEB application for the Anchor Loop project on February 17, 2006. The $443 million project involves looping a 158-kilometre section of the existing Trans Mountain pipeline system between Hinton, Alberta, and Jackman, British Columbia, and the addition of three new pump stations. With construction of the Anchor Loop, the Trans Mountain system's capacity will increase from 260,000 bpd to 300,000 bpd by the end of 2008. The public hearing of the application was held the week of August 8, 2006. On October 26, 2006, the NEB released its favorable decision on the application and construction is expected to begin in mid-2007.

Based on management's expectations for petroleum transportation demand to the West Coast of British Columbia and shipper feedback, Kinder Morgan Canada has decided not to seek long-term contracts with shippers for the Pump Station Expansion Project or the Anchor Loop Project. As a result, there is no certainty that shipments on the Trans Mountain system will be sufficient to adequately recover the entire capital costs of the Pump Station and Anchor Loop expansions. However, the provisions of the 2006-2010 ITS will mitigate Trans Mountain's financial exposure to throughput shortfalls during that timeframe.

On May 2, 2006, Kinder Morgan Canada announced the start of a binding open season for the second major stage of its West Coast expansion of the Trans Mountain pipeline system. Known as TMX-2, this proposed project would add 100,000 bpd of incremental capacity to the Trans Mountain pipeline system, bringing the pipeline's total capacity to approximately 400,000 bpd. The TMX-2 open season began on May 2, 2006, and closed on July 17, 2006 without full subscription for the expanded pipeline. Discussions with shippers are ongoing and we remain confident that shippers will ultimately support the expansion. TMX-2 is part of a multi-staged expansion designed to link growing western Canadian oil production with West Coast and offshore markets. The project consists of two pipeline loops: (i) 252 kilometers of 36-inch diameter pipe in Alberta between Edmonton and Edson, and (ii) 243 kilometers of 30- and 36-inch diameter pipe in British Columbia between Rearguard and Darfield, north of Kamloops. The proposed loops will generally follow the existing 24-inch diameter Trans Mountain pipeline. New pump stations and storage tank facilities will also be required for the TMX-2 project.

CORRIDOR

Earnings from the Corridor system were $13.3 million in 2006, down from $13.6 million in 2005 as a result of a lower allowed return on equity caused by lower long Canada bond yields in 2006 compared to 2005. The Firm Service Agreement (FSA) between Corridor and its shippers sets pipeline tolls based on conventional cost of service mechanisms. The FSA is a 25-year agreement, with return on equity linked to prevailing long Canada bond yields. Shell Canada Limited, Chevron Canada Limited and Western Oil Sands L.P. have entered into a long-term ship-or-pay contract with Corridor for 60%, 20% and 20%, respectively, of the available capacity on the Corridor Pipeline.

Corridor Pipeline Expansion

We have initiated engineering, environmental, consultation and procurement activities on the proposed Corridor pipeline expansion project, as authorized and supported by shipper resolutions and the underlying firm service agreement. The proposed $1.8 billion expansion includes building a new 42-inch diameter diluent/bitumen (“dilbit”) pipeline, a new 20-inch diameter products pipeline, tankage and upgrading existing pump stations along the existing pipeline system from the Muskeg River Mine north of Fort McMurray to the Edmonton region. The Corridor pipeline expansion would add an initial 180,000 bpd of dilbit capacity to accommodate the new bitumen production from the Muskeg River Mine. An expansion of the Corridor pipeline system has been completed in 2006 increasing the dilbit capacity to 278,000 bpd by upgrading existing pump station facilities. By 2009, the dilbit capacity of the Corridor system is expected to be approximately 460,000 bpd. An application for the Corridor pipeline expansion project was filed with the Alberta Energy Utilities Board and Alberta Environment on December 22, 2005, and approval was received in August 2006. Construction of the Corridor pipeline expansion began in November 2006 as the shippers have received definitive approval of their Muskeg River Mine expansion.

As described on page 2, Kinder Morgan, Inc. entered into an agreement to sell the shares of the Corridor Pipeline System to Inter Pipeline Fund for approximately $760 million including debt on March 5, 2007. The transaction is subject to certain closing conditions and regulatory approvals, as well as a right of first refusal and is expected to close in mid-2007.

EXPRESS SYSTEM

Earnings from the Express System were $26.1 million in 2006, up from $25.5 million in 2005. The Express System had a capacity expansion in April 2005 which resulted in additional throughput on the Express System in 2005.

Express has 84% of its 280,000 bpd post-expansion total capacity contracted. These contracts expire in 2007, 2012, 2014 and 2015 in amounts of 1%, 40%, 11% and 32% of total capacity, respectively. These contracts provide for committed tolls for transportation on the Express System, which can be increased each year by up to 2%. The remaining capacity is made available to shippers as uncommitted capacity.

Other Activities

	Years ended December 31	
	2006	**2005**
	(in millions of dollars)	
Other activities revenues	**$ 44.2**	$ 46.7
Other activities net (loss)	**(24.5)**	(49.2)

Revenues from other activities declined from $46.7 million in 2005 to $44.2 million in 2006 as a result of lower revenues in our international operations as contracts are winding down and lower revenues from CustomerWorks due to lower negotiated fees in service contracts.

The loss from other activities decreased from $49.2 million in 2005 down to $24.5 million in 2006 primarily as a result of $34.4 million of costs incurred in connection with the acquisition of the Company by KMI in 2005, offset by a gain of $2.6 million on the sale of Clean Energy in 2005 and a $3.6 million provision made for retroactive tax legislation from a reassessment from Revenue Quebec.

Discontinued Operations

The disposition of the water and utility services operations was completed on May 19, 2006 and resulted in a total loss of $17.5 million in 2006, compared to a loss of $4.9 million in 2005. The 2005 loss was mainly due to the expiry of tax loss carryforwards associated with the KMI acquisition and the recognition of a currency translation loss resulting from the pending sale of the business, somewhat offset by strong operating performance in the business.

Summary of Quarterly Results

	For the three months ended				
	Mar-31	Jun-30	Sep-30	Dec-31	Total
			($ millions)		
2006					
Revenues (restated) [1]	$ 750.5	$ 367.3	$ 288.3	$ 621.6	$ 2,027.7
Net income before discontinued operations	69.5	6.1	6.6	65.0	147.2
Net income	64.3	(1.6)	2.5	64.5	129.7
2005					
Revenues (restated) [1]	$ 627.5	$ 354.3	$ 282.6	$ 688.1	$ 1,952.5
Net income before discontinued operations	66.9	27.1	0.9	11.2	106.1
Net income	66.3	29.5	4.0	1.4	101.2

1 Revenues for 2005 and 2006 have been restated to reflect the reclassification of the water and utility services business as a discontinued operation, and to reclassify certain revenues from Clean Energy to equity accounting.

Because of natural gas consumption patterns, the natural gas distribution operations of Terasen Gas normally generate higher net earnings in the first and fourth quarters, which are offset by net losses in the second and third quarters. The Company's water and utility services business, which has been reclassified as a discontinued operations, typically experiences stronger second and third quarter results, offset by weaker first and fourth quarter results, based on the level of construction and general economic activity. Earnings from Terasen's petroleum pipeline operations are not subject to material fluctuations due to seasonality. As a result of the fluctuations in Terasen Gas, interim earnings statements are not indicative of earnings on an annual basis.

Revenues in 2006 were generally higher than in 2005 on a quarterly and annual basis as a result of higher natural gas commodity prices in 2006, except for the fourth quarter of 2006 when prices were lower than the fourth quarter of 2005.

March 2006/2005 — Earnings decreased by $2.0 million due to the loss of $5.0 million on the sale of the water and utility operation, offset by higher petroleum transportation throughput on Trans Mountain and Express. Trans Mountain was negatively impacted in the first quarter of 2005 by the decline in production from the Alberta oilsands and maintenance turnarounds at refineries connected to the Trans Mountain pipeline. The Express system also contributed higher earnings as the expansion Project was completed in April 2005.

June 2006/2005 — Earnings decreased by $31.1 million due to a provision of $14.5 million made for retroactive tax amending legislation that was introduced in a provincial legislature, an incremental loss of $7.7 million recorded on the sale of water and utility services operations during the quarter, the loss of earnings from Clean Energy operations which was disposed on October 2005, higher operating expenses due to higher management fees, and lower revenues in petroleum transportation from a combination of lower tolls and lower throughput due to refinery turnarounds.

September 2006/2005 — Earnings declined by $1.5 million over the prior year's third quarter due to an incremental loss of $4.1 million recorded on disposal of the water and utility services business partially offset by lower costs in 2006 due to 2005 one time transaction costs of $4.1 million on the sale of Clean Energy and $4.0 million of transaction costs associated with the Kinder Morgan acquisition incurred in 2005.

December 2006/2005 — Earnings increased by $63.1 million mainly due to higher earnings from operating companies due to a higher equity component in the gas distribution utilities, the impact of the new Incentive Toll settlement between Trans Mountain and its shippers approved in November 2006, as well as a result of one-time costs incurred in 2005 including transactions costs incurred in the acquisition of the Company by KMI of $38.9 million, and a charge to earnings associated with the redemption of the Trans Mountain Series C Debentures of $7.3 million.

Liquidity and Capital Resources

Consolidated Cash Flow

	Years ended December 31	
	2006	**2005**
	(in millions of dollars)	
Cash flow provided by (used for):		
Operating activities	**$ 335.6**	$ 190.2
Investing activities	**(276.0)**	(206.6)
Financing activities	**(127.8)**	76.5
Net (decrease) increase in cash	**$ (68.2)**	$ 59.4

CASH FLOW FROM OPERATING ACTIVITIES

Cash flow from operating activities increased from $190.2 million in 2005 to $335.6 million in 2006 due to a number of factors. Net earnings from continuing operations were $41.1 million higher in 2006 as a result of items outlined on page 3. The net recovery of rate stabilization accounts in 2006 was $7.9 million compared with $10.1 million in 2005, mainly due to higher rate stabilization account receivable balances at the beginning of 2005. In addition, changes in working capital were a source of $61.8 million in 2006 compared to a use of $68.3 million in 2005, mainly as a result of the impact of lower year end gas prices on the value of natural gas inventory and accounts receivable. Higher tax payments in 2006 were a use of cash of $25.6 million.

INVESTING ACTIVITIES

Capital expenditures totaled $377.1 million in 2006 compared with $214.7 million in 2005. The increase in the capital expenditures is also due to the construction of the first phase of the expansion of the Trans Mountain system West Coast pipeline expansion (“TMX”) and the expansion of the Corridor pipeline started in the fourth quarter of 2006. The capital additions are offset by the proceeds from the sale of the water and utility services business.

FINANCING ACTIVITIES

On January 13, 2006, TGVI entered into a five-year $350 million unsecured committed revolving credit facility with a syndicate of banks. TGVI issued bankers’ acceptances under this facility to completely refinance TGVI’s former term facility and intercompany advances from Terasen. The bankers’ acceptances have terms not to exceed 180 days at the end of which time they are replaced by new bankers’ acceptances. The facility can also be utilized to finance working capital requirements and for general corporate purposes. The terms and conditions are similar to those of the previous facility and common for such term credit facilities.

Concurrently with executing this facility, TGVI entered into a $20 million seven-year unsecured committed non-revolving credit facility with one bank. This facility will be utilized for purposes of refinancing any annual prepayments that TGVI may be required to make on non-interest bearing government contributions. The terms and conditions are primarily the same as the aforementioned TGVI facility except this facility ranks junior to repayment of TGVI’s Class B subordinated debt, which is held by its parent company, Terasen. At December 31, 2006, TGVI had outstanding bankers’ acceptances under the $350 million credit facility with an average term of less than three months. While the bankers’ acceptances are short term, the underlying credit facility on which the bankers’ acceptances are committed is open through January 2011. Accordingly, under the $350 million credit facility, borrowings outstanding at December 31, 2006 of $269.0 million have been classified as long-term debt and an estimated $27.0 million as current maturities in our accompanying Consolidated Balance Sheet at a weighted-average interest rate of 4.41%. Borrowings outstanding against the $20 million credit facility at December 31, 2006 were $3.7 million at a weighted-average interest rate of 4.32%.

On January 31, 2006, Terasen Pipelines (Corridor) Inc.'s $225 million senior unsecured revolving credit facility and the associated $20 million non-revolving demand facility were extended under the same terms for an additional 364 days as permitted under the terms of the facilities.

On May 8, 2006, Terasen Inc.'s $100 million of 4.85%, Series 2 Medium Term Notes matured and Terasen Inc. paid the holders of the notes, utilizing a combination of incremental short-term borrowing and proceeds from the sale of the water and utility services business as previously discussed under "Discontinued Operations."

On May 9, 2006, Terasen Inc. entered into a $450 million three-year revolving credit facility. This facility replaces three bi-lateral facilities aggregating $450 million and includes terms and conditions similar to the facilities it replaced.

On June 21, 2006, Terasen Gas Inc. entered into a $500 million three-year revolving credit facility, extendible annually for an additional 364 days at the option of the lenders. This facility replaces five bilateral facilities aggregating $500 million and includes terms and conditions similar to the facilities it replaced.

On June 30, 2006, TGVI made a $6.2 million payment on its government loans, of which approximately $3.7 million was refinanced through borrowings under its $20 million non-revolving credit facility and the remaining amount funded with cash on hand.

On July 31, 2006, Terasen Gas Inc.'s $100 million 6.15% medium term note debentures matured, and the note holders were paid utilizing a combination of cash on hand and incremental short-term borrowing.

On September 25, 2006, Terasen Gas Inc. issued $120 million of 5.55% medium term note debentures, due September 25, 2036. Of the $119.4 million net proceeds from this issuance after underwriting discounts and commissions, $100 million was used to repay short-term commercial paper debt that was primarily incurred to pay Terasen Gas Inc.'s $100 million 6.15% medium term note debentures that matured on July 31, 2006. The remaining proceeds were used to repay Terasen Gas Inc.'s $20 million 9.75% notes, which matured on December 17, 2006.

On January 23, 2007, Terasen Pipelines (Corridor) Inc. increased its credit facility from $225 million to $375 million and extended this facility and the associated $20 million demand facility, as permitted under these facilities, for an additional 364 days.

As at December 31, 2006, the Company and its subsidiaries had lines of credit in place totaling $1,175 million to finance cash requirements. These lines enable the respective companies to borrow directly from their bankers, issue bankers' acceptances and support commercial paper issuance. Bank lines of $501 million were unutilized at the end of 2006. Virtually all short-term cash needs are funded through commercial paper and bankers' acceptances in the Canadian market at rates generally below bank prime. Terasen does not have, nor does it expect to have, any defaults or arrears.

No dividends on common shares were declared during 2006 compared to $95.1 million in 2005.

Financial Position

The following table outlines the significant changes in the consolidated balance sheets as at December 31, 2006 compared to December 31, 2005, other than changes arising from the reclassification of the water and utility services business as a discontinued operation.

Balance Sheet Item	Increase (Decrease) ($ millions)	Explanation
Cash and short-term investments	$ (68.2)	Decrease is a result of significant cash flow in late 2005 that was used to repay short-term notes in 2006.
Accounts receivable	(131.6)	Decrease mainly a result of the impact of lower gas prices on accounts receivable for Terasen Gas and TGVI. Additionally, the decline is caused by some ineffective hedges in 2005 which were in the money at the end of 2005 but not in the money at the end of 2006.
Short-term notes	(125.0)	The decrease in short term notes is due to a number of factors. First, the short term borrowings were reduced due to the paying down of short term debt with the proceeds from the sale of the water and

		utility services business and cash from 2005 as discussed above. This is offset with an increase in the borrowings related to the Corridor and TMX expansions in 2006.
Accounts payable and accrued liabilities ...	90.0	Increased mainly as a result of the impact of gas commodity contracts in Terasen Gas and TGVI which were ineffective hedges at year end. The contracts were substantially 'out of the money' at year end due to lower gas commodity prices. These amounts will be recoverable from customers in future periods. Additionally, there was an increase in accounts payable in the Pipelines businesses due to the capital expansions on TMX and Corridor.

Working Capital

Terasen's working capital requirements fluctuate seasonally based on natural gas consumption. Given the regulated nature of its business, Terasen is able to maintain negative working capital balances. Terasen maintains adequate committed credit facilities to meet its working capital requirements. On an annual basis, Terasen generates sufficient cash flow to meet its working capital requirements.

Dividend Restrictions

As part of its approval of the acquisition of Terasen by KMI, the BCUC imposed a number of conditions intended to ring-fence Terasen Gas and TGVI from Terasen. These restrictions included a prohibition on the payment of dividends unless Terasen Gas or TGVI has in place at least as much common equity as that deemed by the BCUC for rate-making purposes. As a result of this and the decision issued by the BCUC on March 2, 2006 Terasen Gas and TGVI must maintain a percentage of common equity to total capital that is at least as much as that determined by the BCUC from time to time for ratemaking purposes.

Corridor's credit agreement restricts its ability to issue dividends subject to certain debt-to-total capital requirements. Cash distributions from Express are subject to limitations in the Express financing agreements and decisions made by the Express Board of Directors, which Terasen does not control.

In 2006, none of these restrictions constrained the distribution of subsidiary earnings not otherwise needed for reinvestment.

Credit Ratings

Securities issued by Terasen, Terasen Gas and Corridor are rated by DBRS Inc. (DBRS) and Moody's Investors Service Inc. (Moody's). The ratings assigned to securities issued by the Terasen group of companies are reviewed by these agencies on an ongoing basis.

The table below summarizes the ratings assigned to the Company's various securities. The DBRS rating for Terasen is as of February 26, 2007, for Terasen Gas it is as of March 16, 2007 and for Corridor it is as of March 5, 2007. The Moody's ratings for Terasen and Terasen Gas are as of March 8, 2007 and for Corridor it is as of November 14, 2006.

CREDIT RATINGS	DBRS	MOODY'S
Terasen Inc.		
Commercial paper	R-2 (High)	
Unsecured long-term debt	BBB (High)	Baa2
Capital securities	BBBy	Baa3
Terasen Gas Inc.		
Commercial paper	R-1 (Low)	
Secured long-term debt	A	A2
Unsecured long-term debt	A	A3
Terasen Pipelines (Corridor) Inc.		
Commercial paper	R-1 (Low)	
Unsecured long-term debt	A	A2

Trans Mountain's ratings were withdrawn by DBRS in late 2005 following the redemption of Trans Mountain's Series C Debentures. Trans Mountain no longer has indebtedness to third parties.

In conjunction with the announced sale of Terasen, DBRS changed Terasen's rating from under review with negative implication to under review with developing implications on February 26, 2007, and Moody's changed it's review of Terasen from under review for possible downgrade to under review for possible upgrade on March 8, 2007.

A number of ratings actions were taken on Terasen in December 2005 following the acquisition of Terasen by KMI to make the ratings consistent with those of KMI. Moody's downgraded the ratings on Terasen's unsecured long-term debt and capital securities by two gradations each (from A3 to Baa2 in the case of unsecured long-term debt). DBRS downgraded Terasen's ratings on unsecured long-term debt and capital securities by one gradation each (from A (Low) to BBB (High) in the case of unsecured long-term debt). DBRS also downgraded Terasen's commercial paper rating from R-1 (Low) to R-2 (High). As a result, it is no longer economic for Terasen to issue commercial paper in the Canadian market, and Terasen is issuing Bankers' Acceptances under its committed credit facilities to fund its short-term borrowing requirements.

Also in December 2005, Moody's downgraded Terasen Gas' long-term debt ratings by one gradation. However, Moody's noted that this downgrade was unrelated to the KMI acquisition, and was a result of Terasen Gas' weak financial profile compared to its peers.

After reassessing its relationship with Standard & Poor's Ratings Services, a division of the McGraw-Hill Companies (Canada) Corporation (S&P), Terasen decided early in 2004 to discontinue the engagement of S&P to provide credit ratings on the debt of Terasen and Terasen Gas. Terasen believes the credit ratings issued by Moody's and DBRS will be sufficient to service the requirements of creditors and maintain the Company's access to capital. S&P continues to provide an unsolicited rating on Terasen's outstanding debt based on publicly available information. As of January 5, 2007, Terasen's unsecured long-term debt was rated BB– by S&P.

There is a provision in Terasen's $450 million credit facilities that a downgrade of Terasen's unsecured long-term debt rating below BBB (low) or Baa3 by DBRS or Moody's, respectively, would shorten the remaining term of Terasen's credit facility to ten months. In addition, a downgrade of Terasen Gas below investment grade by any of the major credit rating agencies could trigger margin calls and other cash requirements under Terasen Gas' gas purchase and commodity derivative contracts.

Projected Capital Expenditures

Terasen has estimated total 2007 consolidated capital expenditures of $1,232.4 million. Major capital expenditures in 2007 include construction on the Corridor Pipeline Expansion ($676.3 million), construction on the Trans Mountain Anchor Loop Project ($182.4 million) and construction on the Trans Mountain Pump Station Expansion project ($94.2 million). The estimated capital additions include expenditures for companies where there are plans subsequent to year end to dispose of the subsidiaries.

The Company expects to finance capital expenditures in 2007 with a combination of proceeds from shareholder advances, short-term borrowings and internally generated funds. The Company does not expect to pay common dividends to its shareholder in 2007, instead retaining its earnings for reinvestment in growth opportunities.

Off-Balance Sheet Arrangements

In 2000, Terasen Gas entered into a leasing arrangement with a syndicate of Canadian banks and the BCG Coastal Facilities Trust, a special-purpose entity, to finance new building facilities in the Greater Vancouver area. The Coastal Facilities synthetic lease agreement had been accounted for as an off-balance sheet item. As at December 31, 2004, the value of the Coastal Facilities leasing agreement was approximately $49.4 million. Lease payments of approximately $4.5 million were made by Terasen Gas in 2004.

In 2004, Terasen Gas applied to the BCUC for and received approval to unwind the synthetic lease and include the Coastal Facilities assets in rate base. On January 4, 2005, Terasen Gas paid approximately $49.4 million to BCG Coastal Facilities Trust to unwind the synthetic lease. The Coastal Facilities assets have been included in the Terasen Gas rate base commencing January 2005.

Other than the Coastal Facilities lease, which has been refinanced, there are no other material off-balance sheet agreements.

Transactions with Related Parties

The Company estimates that its parent company, Kinder Morgan Inc., provided corporate management services totaling approximately $1.9 million for the three-months ended December 31, 2006. Year to date corporate management service fees were $10.4 million.

Changes in Accounting Policies

Variable Interest Entities

In January 2005, the Company adopted the CICA Handbook Accounting Guideline 15 "Consolidation of Variable Interest Entities". The Company has performed a review of the entities with whom it conducts business and determined that under the definitions in the Guideline the Company's investment in Express US Holdings LP, part of the Express System (the "Express System"), is deemed to be a variable interest entity. As the Company has not been identified as the primary beneficiary of Express US Holdings LP, the Company continues to account for its investment in the Express System on an equity basis. The Company's future exposure to loss regarding its investment is represented by the carrying value of the investment.

Rate Regulated Entities

The Canadian Institute of Chartered Accountants ("CICA") undertook a project to review and change how rate regulated enterprises recognize and measure regulated assets and liabilities. The results of this project could have introduced significant volatility into the earnings of such businesses, which may have included the elimination of regulatory deferral accounts. The project could also have required rate regulated enterprises to include future income taxes payable on their balance sheets. The CICA withdrew this project in 2006 in favour of the adoption of International Accounting Standards ("IAS"). Currently, there is no standard for rate regulated enterprises under IAS.

Financial Instruments, Hedges and Comprehensive Income

In 2005, the Canadian Institute of Chartered Accountants issued three new accounting standards: Comprehensive Income, Financial Instruments — Recognition and Measurement and Hedges. These standards were intended to harmonize Canadian GAAP with US GAAP and with International Financial Reporting Standards. These accounting standards will be effective for Terasen on January 1, 2007.

Comprehensive Income

The new comprehensive income standard provides guidance for the reporting and presentation of other comprehensive income. Comprehensive income represents the change in equity of an enterprise during a period from transactions and other events arising from non-owner sources. Examples of some items that would be included in other comprehensive income are changes in the fair value of available for sale assets and the effective portion of the change in fair value cash flow hedging instruments. As of January 1, 2007, the Company does not expect any material adjustments through comprehensive income for 2007.

Financial Instruments

The new financial instruments standards require that all financial assets and liabilities be classified into categories based on their attributes. The categories determined for each of the financial assets and liabilities will determine their measurement, either at fair value or amortized cost, and how gains or losses are recognized. The standards also require all derivatives, and derivatives that are embedded in non-derivative contracts, to be recognized in the financial statements and measured at fair value.

Based on the Company's preliminary review, Terasen expects to classify its financial assets and liabilities into categories that will result in measurements that are based on amortized cost, which we do not expect to be materially different than carrying values of these items. Under the new standards, deferred financing costs are no longer recognized as deferred assets and the Company is expected to recognize unamortized deferred financing costs as an offset to its debt balances. These costs are required to be amortized using the effective interest method versus the straight line method used prior to 2007. The change in amortization methodology is not expected to have a material impact on the Company's earnings. The Company is in the process of finalizing its assessment of contracts for embedded derivatives to determine if any exist.

Hedges

The Company has a number of different types of hedging arrangements. The Company had applied hedge accounting to substantially all of its derivatives under Canadian GAAP at December 31, 2006. The existing Canadian standard does not require the recognition of derivative instruments on the consolidated statement of financial position at fair value unless the derivative instrument does not qualify for hedge accounting. Non-qualifying derivatives are adjusted to fair value through earnings each period unless rate regulated accounting is applied in which case the amounts are deferred as allowed.

Certain gas purchase contracts of the Company are considered derivatives under the new Canadian standard but are not considered derivatives under the current Canadian standard and, accordingly, are not recorded in the Company's financial statements at December 31, 2006.

Under the new Canadian standard, all derivative instruments are recognized on the consolidated statements of financial position at their fair value at each period end. Changes in the fair value of derivatives are recorded to earnings in the period of change, except where such derivatives are entered into on behalf of regulated customers, in which case the change in fair value is recorded in a regulatory deferral account. The company expected to book an one time adjustment for these items that will be limited to the balance sheet.

Under the existing Canadian standard, certain equity investees of the Company have designated future U.S. dollar revenues as a hedge of the foreign currency risk associated with U.S. dollar debt. The investees defer the exchange gains and losses on the U.S. dollar long-term debt and recognize an adjustment to the related revenues at the time the revenue is earned. These arrangements do not qualify for hedge accounting under the new Canadian standard. Accordingly, the Company will record an one time adjustment to its equity earnings in the investees to reflect the amounts as if the investees had translated the long-term debt at the period end exchange rates and recognized the resulting foreign exchange gains or losses in the period incurred.

Disclosure Controls and Internal Controls over Financial Reporting

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board and Audit Committee. The Company's chief executive officer ("CEO") and chief financial officer ("CFO") have evaluated and are satisfied with the design and operating effectiveness of these disclosure controls and procedures for the period ending December 31, 2006.

The CEO and CFO acknowledge responsibility for the design of internal controls over financial reporting ("ICFR"), and confirm that there were no changes in these controls that occurred during the year ended December 31, 2006 which materially affected, or are reasonably likely to materially affect, the Company's ICFR.

Financial Instruments

Fair Value Estimates

The fair value of the Company's long-term debt, calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues at December 31, 2006, or by using available quoted market prices, is estimated at $2,622.3 million. The majority of the Company's long-term debt relates to regulated operations which enables the Company to recover the existing financing charges through rates or tolls.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment.

Derivative Instruments

The Company uses derivative instruments to hedge its exposures to fluctuations in natural gas prices and interest rates. As approved by the regulator, derivatives are used to manage natural gas price risk in the natural gas distribution operations. The majority of the natural gas supply contracts have floating, rather than fixed prices. The Company uses natural gas price swap contracts to fix the effective purchase price. Any differences between the effective cost of natural gas purchased and the price of natural gas included in rates are recorded in a deferral account (MCRA and CCRA), and subject to regulatory approval, are passed through in future rates to customers.

The Company's short-term borrowings and variable rate long-term debt are exposed to interest rate risk. The Company manages interest rate risk through the use of interest rate derivatives. Foreign currency risk in natural gas distribution operations relates mainly to purchases and sales of natural gas denominated in U.S. dollars, and is thereby managed through regulatory deferral accounts.

The Company's earnings from the U.S. portion of Trans Mountain's crude oil pipeline system and the Company's investment in the Express System are subject to foreign currency risk. The Company's earnings are also subject to translation risk associated with certain Express System assets and liabilities.

			December 31, 2006		December 31, 2005	
Asset (Liability)	**Number of swaps and options**	**Term to maturity (years)**	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
			(in millions)			
Interest Rate Swaps [1]						
Terasen Inc.	**2**	**2-8**	**$—**	**$ 1.3**	$ —	$ 3.6
TGI	**3**	**1**	**—**	**(0.9)**	—	(1.6)
TGVI	**2**	**2**	**—**	**(0.3)**	—	(0.6)
Corridor	**2**	**3-9**	**—**	**(1.0)**	—	0.3
Natural Gas Commodity Swaps and Options						
Terasen Gas and TGVI [2]	**250**	**Up to 3**	**(139.0)**	**(139.5)**	21.2	105.6

1 The interest rate derivatives entered into by Terasen Inc. resulted in lower interest expense of $1.4 million in 2006, compared with a $4.8 million interest expense reduction in 2005. The derivatives entered into by TGI and TGVI relate to regulated operations and any resulting gains or losses are recorded in deferral accounts, subject to regulatory approval, and passed through to customers in future rates. The gains and losses associated with derivatives entered into by Corridor are similarly passed through to shippers in future rates.

2 The natural gas derivatives fair value reflects only the value of the natural gas derivatives and not the offsetting change in value of the underlying future purchases of natural gas. These fair values reflect the estimated amounts the Company would receive or pay to terminate the contracts at the stated dates. Included in the carrying value of the natural gas derivatives is $139.7 million of unrealized fair value losses associated with derivative instruments which were deemed to be ineffective at December 31, 2006. The gains and losses associated with natural gas derivatives are recorded in deferral accounts, subject to regulatory approval, and passed through to customers in future rates.

Outstanding Share Data

February 28, 2007

Common shares issued and outstanding	115,643,162
Less: Common shares held by Terasen Pipelines (Trans Mountain) Inc.	9,184,188
	106,458,974
8.0% capital securities issued and outstanding	$ 125,000,000

Terasen is an indirect wholly-owned subsidiary of Kinder Morgan, Inc. At December 31, 2006 all of the common shares of the Company are owned by Kinder Morgan, Inc.

The 8.0% capital securities are exchangeable on or after April 19, 2010 for common shares of the Company at 90% of the market price, subject to the right of the Company to redeem the securities for cash. A maximum of 125,000,000 common shares could be issued if this right was exercised.

Forward Looking Statement

Certain information in this Management's Discussion and Analysis constitutes forward-looking statements. Whenever possible, words such as "anticipate", "expect", "project", "believe", "estimate", "forecast" and similar expressions have been used to identify these forward looking statements. Examples of such forward-looking statements, include, but are not limited to, statements relating to pending and proposed projects or possible acquisitions, the proposed disposition by KMI of Terasen Inc. and its principal natural gas distribution assets and the proposed disposition of the Corridor Pipeline System. Such statements are subject to certain risks, uncertainties and assumptions pertaining to operating performance, regulatory parameters, economic conditions and, in the case of pending and proposed projects, risks relating to design and construction, regulatory processes, obtaining financing and performance of other parties, including partners, contractors and suppliers and in the case of possible acquisitions, obtaining financing, acquiring assets or companies at an appropriate price and the ability to effect synergies in a timely and cost-effective manner and in the case of proposed dispositions, the obtaining of all required approvals including regulatory approvals and the fulfilment of other conditions precedent to closing. Although the Company believes that these statements are based on reasonable assumptions, a number of factors could cause actual results, performance or achievements to differ materially from the results discussed or implied in these forward-looking statements and these forward-looking statements are expressly qualified in their entirety by this cautionary statement. The Company disclaims any obligations to update or revise any forward-looking statements to reflect new events or circumstances.

Additional Information

Additional information relating to Terasen Inc. is available on SEDAR at www.sedar.com.

SCHEDULE F

Terasen Inc.

Interim Management's Discussion and Analysis
For the Three Months Ended March 31, 2007

May 30, 2007

(see attached)

The following discussion of the financial condition and the results of operations of Terasen Inc. (Terasen or the Company) should be read in conjunction with the Company's December 31, 2006 annual audited consolidated financial statements and related notes together with Management's Discussion and Analysis and the unaudited interim consolidated financial statements and related notes for the periods ended March 31, 2007.

In this MD&A, we, us, our, the Company and Terasen mean Terasen Inc., its subsidiaries, joint ventures and investments in significantly influenced companies. Terasen Gas refers to Terasen Gas Inc., TGVI refers to Terasen Gas (Vancouver Island) Inc., Trans Mountain refers to Terasen Pipelines (Trans Mountain) Inc., Corridor refers to Terasen Pipelines (Corridor) Inc., Terasen Pipelines refers to Terasen Pipelines Inc., Express refers to the Express and Platte Pipeline Systems; and Water and Utility Services refers to Terasen Waterworks (Supply) Inc., Terasen Utility Services Inc. and Terasen's 50% interest in Fairbanks Sewer and Water Inc. KMI or the parent refers to Kinder Morgan, Inc.

The financial data included in the discussion provided in this report has been prepared in accordance with Canadian generally accepted accounting principles, and all dollar amounts are in Canadian dollars.

FIRST QUARTER 2007 FINANCIAL RESULTS

Amounts have been restated to reflect the application of pushdown accounting applied to Terasen in the first quarter of 2007. See Note 1 of the 2007 first quarter financial statements.

Result of Operations

NET EARNINGS	Three months ended March 31 2007	2006
	(in millions of dollars)	
Natural gas distribution	**$ 54.8**	$ 55.3
Petroleum transportation	**(427.2)**	15.2
Discontinued operations [1]	**3.3**	3.4
Other activities	**(27.3)**	(27.8)
Net earnings	**$ (396.4)**	$ 46.1

[1] On March 5, 2007, a definitive agreement was made with InterPipeline Fund to acquire the Terasen Pipelines Corridor system. The sale is subject to certain conditions and third party consents and is expected to close in the second quarter of 2007. The Corridor Pipeline has been classified as assets and liabilities held for sale and as discontinued operations.

In the first quarter of 2007, Terasen reported a loss of $396.4 million, compared with net earnings of $46.1 million in the corresponding period of 2006. The loss is mainly due to a one time charge of $441.9 related to the impairment of goodwill within the petroleum transportation business.

Results by Business Segment

Natural Gas Distribution

	Three months ended March 31 2007	2006
	(in millions of dollars)	
Natural gas distribution revenues	**$ 630.2**	$ 682.0
Natural gas distribution net earnings	**54.8**	**55.3**

In the first quarter of 2007, revenues from natural gas distribution decreased by $51.8 million to $630.2 million, compared with $682.0 million in the same quarter of 2006. Cost of natural gas also decreased on a year-over-year basis, down $46.9 million over the corresponding quarter of 2006. Lower revenues and cost of natural gas reflected mainly the lower commodity cost of gas charged to customers due to decreases in market prices. Decreased revenues also reflect the lower allowed return on equity described below and a higher revenue deficiency for TGVI, partially offset by customer growth in Terasen Gas and TGVI. Changes in consumption levels and changes in the commodity cost of natural gas do not materially impact earnings as a result of regulatory deferral accounts.

As noted in the Company's annual 2006 Management's Discussion and Analysis, the allowed Return on Equity ("ROE") for 2007 for Terasen Gas has been set at 8.37% (8.80% in 2006) and at 9.07% for TGVI (9.50% in 2006). The deemed equity components for Terasen Gas and TGVI are set at 35% and 40% respectively, unchanged from 2006.

For the three months ended March 31, 2007, Terasen Gas and TGVI net customer additions were 2,235 and 922 respectively, bringing the total number of utility customers to 907,934 at March 31, 2007. The net increase of 3,157 customers is higher than the 2,843 net new customers reported in the same quarter of 2006. Favorable economic conditions and housing activity in British Columbia continue to drive customer growth in the region.

Although the customer impacts above result in higher earnings for both Terasen Gas and TGVI, overall earnings for the gas distribution segment have decreased to $54.8 million compared to $55.3 million in the first quarter of 2006 mainly due a lower rate base in Terasen Gas and lower allowed ROE in both Terasen Gas and TGVI.

Petroleum Transportation

	Three months ended March 31	
	2007	**2006**
	(in millions of dollars)	
Petroleum transportation revenues	**$ 39.8**	$ 38.2
Petroleum transportation net (loss) earnings	**(427.2)**	15.2

	Three months ended March 31	
Transportation volumes	**2007**	**2006**
	(barrels per day)	
Trans Mountain Canadian mainline	**220,150**	246,500
Trans Mountain U.S. mainline	**92,270**	92,700
Express System	**213,520**	215,700

Actual throughput on the Corridor Pipeline does not impact earnings as all of Corridor's capacity is contracted through ship-or-pay arrangements.

In the first quarter of 2007, revenues from petroleum transportation increased to $39.8 million from $38.2 million in the same quarter of 2006. The increase in the quarter is due to an increase in the allowance for funds used during construction which was somewhat offset by a decrease in the Trans Mountain Canadian mainline volumes.

Earnings from petroleum transportation decreased by $442.4 million in the first quarter of 2007 from $15.2 million in the corresponding period of 2006. The decrease in net earnings is due to a goodwill impairment charge of $441.9 million taken in the current quarter. In addition, there was a slight increase in revenues during the quarter that was offset by higher operating and administrative costs and an increase in income taxes.

Other activities

	Three months ended March 31	
	2007	**2006**
	(in millions of dollars)	
Other activities revenues	**$ 8.9**	$ 12.1
Other activities net loss	**27.3**	27.8

During the first quarter of 2007, revenues from other activities decreased by $3.2 million on a year-over-year basis as a result of the loss of a couple of major customer contracts in CustomerWorks LP. The loss from other activities decreased from $27.8 million in the first quarter of 2006 to $27.3 million in the first quarter of 2007 primarily due to a decrease in the loss in our corporate activities due to lower administrative expenses, lower interest expense, and lower taxes. This was offset by lower earnings from CustomerWorks LP due to renegotiations with its outsourcer as a result of losing a couple of major customer contracts.

Discontinued Operations

Discontinued operations for the first quarter of 2007 and the first quarter of 2006 of $3.3 million and $3.4 million, respectively, comprise of the earnings from the Corridor Pipeline system which has been sold to Inter Pipeline Fund. This transaction is expected to close mid-2007.

QUARTERLY FINANCIAL INFORMATION

	2007	2006				2005		
	Mar. [1]	Dec. [1]	Sept. [1]	June [1]	Mar. [1]	Dec. [2]	Sept. [2]	June [2]
Revenues	$ 678.9	$ 599.0	$ 268.2	$ 350.6	$ 732.3	$ 666.6	$ 265.3	$ 337.1
Net (loss) earnings before discontinued operations	(399.7)	(721.7)	(18.8)	(2.8)	42.7	8.1	(2.5)	23.6
Net (loss) earnings	(396.4)	(718.4)	(15.6)	0.6	46.1	1.4	4.0	29.5

[1] Amounts have been restated to reflect the application of pushdown accounting applied to Terasen in the first quarter of 2007 following the amalgamation. See Note 1 of the 2007 Q1 financial statements for further details.

[2] These amounts reflect the historical earnings of Terasen prior to the acquisition of Terasen by KMI.

June 2006/2005 — Earnings are lower in 2006 compared to 2005 due the interest on the subordinated debt included in the 2006 results. The subordinated debt was not outstanding during 2005. Pushdown accounting was applied in the first quarter of 2007 with restatement of periods up to November 30, 2005. For more information, see note 1 to the consolidated financial statements.

September 2006/2005 — Earnings are lower in 2006 compared to 2005 due the interest on the subordinated debt included in the 2006 results. The subordinated debt was not outstanding during 2005. Pushdown accounting was applied in the first quarter of 2007 with restatement of periods up to November 30, 2005. For more information, see note 1 to the consolidated financial statements.

December 2006/2005 — Earnings in 2006 are lower than 2005 due to the goodwill impairment charge of $762.3 million taking during the fourth quarter of 2006. Additionally, earnings in 2006 are lower than 2005 due to interest on the subordinated debt which was outstanding in 2006 for the full year in 2006 compared to one month in 2005. Pushdown accounting was applied in the first quarter of 2007 with restatement of periods up to November 30, 2005. For more information, see note 1 to the consolidated financial statements.

March 2007/2006 — Earnings decreased by $442.5 million due to a goodwill impairment charge of $441.9 million in the first quarter of 2007. In addition, earnings declined due to slightly higher operating and administrative costs.

SEASONALITY

Because of natural gas consumption patterns, the natural gas distribution operations of Terasen Gas normally generate higher net earnings in the first and fourth quarters, which are offset by net losses in the second and third quarters. Earnings from Terasen's petroleum pipeline operations are not subject to material fluctuations due to seasonality. As a result of the gas distribution segment, interim earnings statements are not indicative of earnings on an annual basis.

LIQUIDITY AND CAPITAL RESOURCES

Terasen expects to generate sufficient cash from operations to meet its working capital needs and to maintain its financial capacity and flexibility. The Company's liquidity and capacity to access capital markets to maintain operations and fund growth remain substantially unchanged since December 31, 2006.

CONSOLIDATED CASH FLOW

	Three months ended March 31	
	2007	**2006**
	(in millions of dollars)	
Cash flow provided by (used for):		
Operating activities	**$ 182.6**	$ 189.4
Investing activities	**(53.2)**	(40.2)
Financing activities	**(114.2)**	(133.1)
Net increase in cash	**$ 15.2**	$ 16.1

CASH FLOW FROM OPERATING ACTIVITIES

Cash from operations refers to cash generated before the impact of working capital and rate-stabilization deferral account changes. Cash from operations for the three months ended March 31, 2007 was $75.8 million, compared to $76.6 million in the corresponding period of 2006. Cash flow from operating activities, which includes the impact of changes in working capital and deferral accounts, was $182.6 million in the first quarter of 2007 as compared with $189.4 million in the corresponding quarter of 2006.

Between December 31, 2006 and March 31, 2007, accounts payable and accrued liabilities and inventories of gas in storage and supplies have declined as a result of the typical seasonal increase in natural gas consumption and the use of inventories in storage during the period. Due to these decreases in non-cash working capital accounts and rate stabilization accounts, cash flow generated from operating activities has increased compared to 2006.

INVESTING ACTIVITIES

Capital expenditures totaled $99.2 million in the three months ended March 31, 2007 compared with $33.0 million in the corresponding period in 2006. The increase in capital expenditures was primarily attributable to the Trans Mountain Pump Station Expansion Project which was completed and put into service on April 1, 2007.

There have been no material changes to Terasen's planned capital expenditures from those reported in the Company's Annual 2006 Management's Discussion and Analysis.

FINANCING ACTIVITIES

On January 23, 2007, Terasen Pipelines (Corridor) Inc. increased its credit facility from $225 million to $375 million and extended this facility and the associated $20 million demand facility, as permitted under these facilities, for an additional 364 days. At March 31, 2007, $16.9 million was outstanding under the $20 million demand facility at a weighted-average rate of 6.00%.

No dividends were declared in the first three months of 2007 and 2006.

FINANCIAL POSITION

The following table outlines the significant changes in the consolidated balance sheets as at March 31, 2007 compared to December 31, 2006, other than assets and liabilities held for sale.

Balance Sheet Item	Increase (Decrease) ($ millions)	Explanation
Short-term notes	(343.0)	Decrease is due to the classification of short term debt for Corridor being classified as current liabilities held for resale. In addition, borrowings on the Terasen Gas facility are lower due to seasonality requirements.
Long-term debt (including current portion)	(300.8)	The decrease is mainly due to long term debt associated with Corridor being classified as long term liabilities held for sale.
Accounts payable and accrued liabilities	(222.7)	Decrease is mainly due to both lower gas purchases and the classification of Corridor accounts payable and accrued liabilities in current liabilities held for sale.

Rate stabilization accounts (including current and long term)	(115.4)	The decrease in the net asset position of rate stabilization accounts is mainly due to the fair value mark to market for the gas derivatives being lower than at December 31, 2006.
Inventories of gas in storage and supplies	(109.8)	Decrease is mainly due to drawdown of gas in storage during the winter months.
Income and other taxes payable	44.0	Increase is mainly due to the quarterly provision for income taxes.

WORKING CAPITAL

Terasen's working capital requirements fluctuate seasonally based on natural gas consumption. Given the regulated nature of its business, Terasen is able to maintain negative working capital balances. Terasen maintains adequate committed credit facilities to meet its working capital requirements. On an annual basis, Terasen generates sufficient cash flow to meet its working capital requirements.

LETTERS OF CREDIT

$118.3 million of letters of credit were outstanding at March 31, 2007 primarily related to unfunded pension plans and guarantees to third parties for power purchases and on half of co-investors in the Express System to fund the Debt Service Account.

CREDIT RATINGS

There have been no changes to the Company's credit ratings from those reported in the annual 2006 Management's Discussion and Analysis.

SUBSEQUENT EVENTS

On April 30, 2007, the assets of Trans Mountain were sold to Kinder Morgan Energy Partners Inc for cash proceeds of $549 US million.

On February 26, 2007, KMI, the Company's parent announced that it entered into a definitive agreement with Fortis Inc. to sell Terasen Inc. and its principal natural gas distribution assets, including its subsidiaries Terasen Gas and TGVI as well as other activities including Terasen Energy Services. The sale does not include the petroleum transportation subsidiaries nor investments under the Kinder Morgan Canada name. The purchase price of approximately $3.7 billion includes the assumption of approximately $2.4 billion of debt. The transaction closed on May 17, 2007.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended March 31, 2007, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect such controls.

CHANGES IN ACCOUNTING POLICY

New Accounting Policies

Effective January 1, 2007, the Company adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA").

a) Section 3855, *Financial Instruments — Recognition and Measurement*, prescribes the criteria for recognition and presentation of financial instruments on the balance sheet and the measurement of financial instruments according to prescribed classifications. These sections also address how financial instruments are measured subsequent to initial recognition and how the gains and losses are recognized.

The Company is required to designate its financial instruments into one of the following five categories: held for trading; available for sale; held to maturity; loans and receivables; and other financial liabilities. All financial instruments are to be initially measured at fair value. Financial instruments classified as held for trading or available for sale are subsequently measured at fair value with any change in fair value recorded in net earnings and other comprehensive income, respectively. All other financial instruments are subsequently measured at amortized cost.

All derivative financial instruments are recorded on the balance sheet at fair value. Mark-to-market adjustments on these instruments are included in net earnings, unless the instruments are designated as part of a cash flow hedge relationship then the effective portion of changes in fair value are recorded in other comprehensive income. Any change in fair value relating to the ineffective portion is recorded immediately in net earnings. In accordance with the standard's transitional provisions, the Company recognizes as separate assets and liabilities only embedded derivatives acquired or substantively modified on or after January 1, 2003.

The Company has designated its financial instruments as follows:

- Accounts receivable and long-term investment are classified as "*Loans and Receivables*". These financial assets are recorded at values that approximate their amortized cost using the effective interest method.

- Short-term notes, accounts payable and accrued liabilities, long-term debt, subordinated debt and related issue costs are classified as "*Other Financial Liabilities* ". These financial liabilities are recorded at values that approximate their amortized cost using the effective interest method.

As a result of adopting Section 3855, deferred financing costs of $9.4 million as at March 31, 2007 (2006 — $9.8 million), relating to long-term debt, have been reclassified from other assets to long-term debt on the balance sheet. These costs will be taken into earnings using the effective interest method over the life of the related debt. Prior to January 1, 2007, deferred financing costs were amortized using the straight-line method of amortization. As allowed by the standard a one-time adjustment of $1.7 million has been made to retained earnings to reflect the difference between the straight-line method and the effective interest method of amortization prior to January 1, 2007.

b) Section 1530, *Comprehensive Income*, requires the presentation of a statement of comprehensive income and provides guidance for the reporting and display of other comprehensive income. Comprehensive income represents the change in equity of an enterprise during a period from transactions and other events arising from non-owner sources including gains and losses arising on translation of self-sustaining foreign operations, gains and losses from changes in fair value of available for sale financial assets and changes in fair value of the effective portion of cash flow hedging instruments. The Company has not recognized any adjustments through other comprehensive income for the three months ended March 31, 2007.

c) Section 3865, *Hedges*, specifies the criteria under which hedge accounting may be applied, how hedge accounting should be performed under permitted hedging strategies and the required disclosures. The majority of the Company's cash flow hedges are for the purchase of natural gas. Given that the Company is subject to rate regulation, the ineffective portion of changes in the fair value of these hedges are deferred as an asset or liability until they are settled, offset by an asset or liability on behalf of ratepayers. Upon settlement, the recognized gain or loss is recorded as a regulatory asset or liability and is collected from or refunded to ratepayers in subsequent periods. The company recognized an additional liability of $1.1 million to counterparties for unrealized losses related to gas purchase hedges at January 1, 2007 and an amount recoverable from ratepayers of $1.1 million. Amounts recoverable from ratepayers are recorded in rate stabilization accounts.

The Company utilized fair value hedges to hedge the value of debt instruments. Fair value hedges for rate regulated businesses are recorded in Other assets with the offset to Other long-term liabilities and deferred credits while the non-regulated fair value hedges are recorded as in Other assets and Long term debt. The adoption of this new standard on January 1, 2007 increased Other assets by $0.9, increased Long term debt by $0.1 and increased Other long-term liabilities and deferred credits by $0.8.

Under the Canadian standard prior to January 1, 2007, certain equity investees of the Company have designated future U.S. dollar revenues as a hedge of the foreign currency risk associated with U.S. dollar debt. The investees defer the exchange gains and losses on the U.S. dollar long-term-debt and recognize an adjustment to the related revenues at the time the revenue is earned. These arrangements do not qualify for hedge accounting under the new Canadian standard. Accordingly, the Company has recorded a one time adjustment of $38.6 million to the value of its investment offset by an increase of $4.8 million of future income taxes for a net adjustment to retained earnings of $33.8 million.

TRANSACTIONS WITH RELATED PARTIES

The Company estimates that its parent company, Kinder Morgan Inc., provided corporate management services it receives totaling approximately $2.5 million for the three-months ended March 31, 2007.

FINANCIAL AND OTHER INSTRUMENTS

The Company hedges its exposure to fluctuations in natural gas prices and interest rates through the use of derivative instruments. The table below indicates the valuation of the derivative instruments as at March 31, 2007. For more information on Terasen's derivative please refer to Terasen's 2006 Annual Management's Discussion and Analysis.

Asset (Liability)	Number of swaps	Term to maturity (years)	March 31, 2007 Carrying Value	March 31, 2007 Fair Value	December 31, 2006 Carrying Value	December 31, 2006 Fair Value
			(in millions)			
Interest Rate Swaps						
Terasen Inc	**2**	**2 - 8**	**$**	**$ (0.1)**	$ —	$ 1.3
Terasen Gas [1]	**3**	**1**	**—**	**(0.7)**	—	(0.9)
TGVI [1]	**2**	**2**	**—**	**(0.2)**	—	(0.3)
Corridor [1]	**2**	**3 - 8**		**(1.6)**	—	(1.0)
Natural Gas Commodity Swaps						
Terasen Gas and TGVI [1,2]	**274**	**Up to 3**	**(33.9)**	**(33.9)**	(139.0)	(139.5)

1 The derivatives entered into by Terasen Gas and TGVI relate to regulated operations and any resulting gains or losses are, subject to regulatory approval, passed through to customers in future rates. The derivatives entered into by Corridor are done so on behalf of its shippers and any gains are losses are passed through directly to its shippers.

2 The natural gas derivatives fair value reflects only the value of the natural gas derivatives and not the offsetting change in value of the underlying future purchases of natural gas. These fair values reflect the estimated amounts the Company would receive or pay to terminate the contracts at the stated dates.

REGULATION

EXTENSION OF TGI AND TGVI SETTLEMENT AGREEMENTS

In January 2007, Terasen Gas Inc. applied for an extension of the 2004-2007 PBR settlement agreement. After an extensive stakeholder consultation process, Terasen Gas Inc. filed an application for approval of a two-year extension to the current 2004-2007 Multi-Year Performance Based Rate Plan. The application requested approval to extend the existing settlement term for 2008-2009. On March 22, 2007, the BCUC approved the application as filed.

TGVI had also applied for an extension of its settlement agreement which expires at the end of 2007. After an extensive stakeholder consultation process, TGVI filed an application for approval of a two-year extension to the current 2006-2007 Negotiated Settlement Agreement. On March 22, 2007, the BCUC approved the application as filed.

BUSINESS DEVELOPMENT

The following is an update on Terasen's business development activities during the first quarter of 2007. More information on the Company's business development activities is provided in Terasen's 2006 annual Management's Discussion and Analysis.

TERASEN GAS (WHISTLER) ("TGW")

TGW is converting its piped propane system to natural gas. The project will require TGVI to extend its transmission system to Whistler by the construction of a 50 kilometer pipeline lateral from Squamish to Whistler. TGVI and TGW have received approval from the BCUC for construction of the pipeline lateral and conversion of the propane system. Construction will commence in 2007 and natural gas service is expected to be in place by late 2008 or early 2009.

CORRIDOR EXPANSION

Kinder Morgan Canada has been working with Shell and their partners in the Athabasca Oil Sands Project toward expanding the Corridor Pipeline from 155,000 bpd to 300,000 bpd for 2009 with 90,000 bpd increments every two years thereafter.

The project is currently under construction and involves the building of a new larger pipeline and will expand the system initially by 110,000 bpd. The cost of this expansion is approximately $1.8 billion and is expected be available for service by late 2009.

TMX

In the first quarter of 2007, Trans Mountain completed the construction and commissioning of the Pump Station Expansion that added 35,000 bpd of capacity. The added capacity was brought on-line April 1, 2007.

The next phase of the Trans Mountain expansion will be the construction of the Anchor Loop between Hinton, Alberta and Rearguard, British Columbia adding 40,000 bpd of capacity in 2009. The Anchor Loop project has all necessary regulatory approvals and work will commence during the second quarter of 2007.

Commercial work continues on the development of TMX-2, the next stage of expansion of the existing Trans Mountain system between Edmonton, Alberta and Burnaby, British Columbia.

RISK ASSESSMENT

The risk profile of Terasen remains substantially unchanged from the profile outlined in Terasen’s 2006 Annual Management’s Discussion and Analysis.

FORWARD LOOKING STATEMENT

Certain information in this Management’s Discussion and Analysis constitutes forward-looking statements. Whenever possible, words such as “anticipate”, “expect”, “project”, “believe”, “estimate”, “forecast” and similar expressions have been used to identify these forward looking statements. Examples of such forward-looking statements, include, but are not limited to, statements relating to pending and proposed projects or possible acquisitions, the proposed disposition by KMI of Terasen Inc. and its principal natural gas distribution assets and the proposed disposition of the Corridor Pipeline System. Such statements are subject to certain risks, uncertainties and assumptions pertaining to operating performance, regulatory parameters, economic conditions and, in the case of pending and proposed projects, risks relating to design and construction, regulatory processes, obtaining financing and performance of other parties, including partners, contractors and suppliers and in the case of possible acquisitions, obtaining financing, acquiring assets or companies at an appropriate price and the ability to effect synergies in a timely and cost-effective manner and in the case of proposed dispositions, the obtaining of all required approvals including regulatory approvals and the fulfilment of other conditions precedent to closing. Although the Company believes that these statements are based on reasonable assumptions, a number of factors could cause actual results, performance or achievements to differ materially from the results discussed or implied in these forward-looking statements and these forward-looking statements are expressly qualified in their entirety by this cautionary statement. The Company disclaims any obligations to update or revise any forward-looking statements to reflect new events or circumstances.

ADDITIONAL INFORMATION

Additional information relating to Terasen is available on SEDAR at www.sedar.com.