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Our File No.: 5497-148

April 2, 2007

VIA E-MAIL AND COURIER

British Columbia Utilities Commission
6th Floor, 900 Howe Street
Vancouver, B.C.
V6Z 2N3

Attention: Mr. R.J. Pellatt
Commission Secretary

Dear Sirs/Mesdames:

Re: Application by Fortis Inc. ("Fortis") for Approval of the Acquisition of the Issued and Outstanding Shares of Terasen Inc. - Project No. 3698454

Further to Fortis' Response to British Columbia Utilities Commission ("BCUC" or the "Commission") Information Request ("IR") No. 1, Question 11.1, please find attached the audited financial statements of Terasen Inc. and the Terasen Utilities (including Terasen Gas Inc., Terasen Gas (Vancouver Island) Inc., and Terasen Gas (Squamish) Inc.) for the year ended December 31, 2006.

As the Commission is aware, the financial statements of Terasen Gas (Whistler) Inc. ("TGW") and Terasen Energy Services Inc. are not audited but are included in the audited Terasen Inc. consolidated results. The unaudited financial statements of TGW will be filed in due course with the annual report.

Yours truly,

FARRIS, VAUGHAN, WILLS & MURPHY LLP

Per:

George K. Macintosh, Q.C.

/fc
Enclosures
cc: Registered Intervenors

CONSOLIDATED FINANCIAL STATEMENTS OF

TERASEN INC.

YEARS ENDED DECEMBER 31, 2006 AND 2005

MANAGEMENT'S REPORT

Financial Reporting

Management is responsible for the accompanying consolidated financial statements. These financial statements have been prepared in conformity with Canadian generally accepted accounting principles and, where appropriate, include amounts that are based on management's best estimates and judgments.

The Board of Directors, through its Audit Committee, oversees Management's responsibilities for financial reporting and internal control. The Audit Committee meets with the internal auditors, the independent auditors and management to discuss auditing and financial matters and to review the consolidated financial statements and the independent auditors' report. The Audit Committee reports its findings to the Board for consideration in approving the consolidated financial statements for issuance to the shareholders.

Internal Control over Financial Reporting

Management is also responsible for establishing and maintaining adequate internal control over the Company's financial reporting. The internal control system was designed to provide reasonable assurance to the Company's Management regarding the preparation and presentation of the consolidated financial statements.

Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of the Company's internal control over financial reporting as at December 31, 2006. In making its assessment, Management has used the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework in Internal Control – Integrated Framework to evaluate the effectiveness of the Company's internal control over financial reporting. Based on our evaluation, Management has concluded that the Company's internal control over financial reporting was effective as at December 31, 2006.

The Company's independent auditors, PricewaterhouseCoopers LLP, conduct an audit in accordance with Canadian generally accepted auditing standards. Their report outlines the scope of their audit and gives their opinion on the consolidated financial statements.

Signed: *"C. Park Shaper"*

President

Signed: *"Kimberley A. Dang"*

Chief Financial Officer

Vancouver, Canada
March 29, 2007

PricewaterhouseCoopers LLP
Chartered Accountants
PricewaterhouseCoopers Place
250 Howe Street, Suite 700
Vancouver, British Columbia
Canada V6C 3S7
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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

In millions of Canadian dollars *Years ended December 31*	**2006**	2005
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

In millions of Canadian dollars *Years ended December 31*	**2006**	2005
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

In millions of Canadian dollars *As at December 31*	**2006**	2005
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. ("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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(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

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

2. SEGMENT DISCLOSURES (CONTINUED)

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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

3. DISCONTINUED OPERATIONS AND DISPOSITIONS (CONTINUED)

(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	**-**	-

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

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

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

6. RATE STABILIZATION ACCOUNTS (CONTINUED)

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

7. OTHER ASSETS (CONTINUED)

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.

7. OTHER ASSETS (CONTINUED)

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 million 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).

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

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

8. LONG-TERM DEBT (CONTINUED)

(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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

8. LONG-TERM DEBT (CONTINUED)

(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

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

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.

9. OTHER LONG-TERM LIABILITIES AND DEFERRED CREDITS (CONTINUED)

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 resulted 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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

10. SHARE CAPITAL (CONTINUED)

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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

11. SHARE OPTION PLAN AND STOCK-BASED COMPENSATION (CONTINUED)

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	-	$ -

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

11. SHARE OPTION PLAN AND STOCK-BASED COMPENSATION (CONTINUED)

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).

12. EMPLOYEE BENEFIT PLANS (CONTINUED)

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).

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

12. EMPLOYEE BENEFIT PLANS (CONTINUED)

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).

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

12. EMPLOYEE BENEFIT PLANS (CONTINUED)

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		

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

12. EMPLOYEE BENEFIT PLANS (CONTINUED)

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%	**-**	-

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

12. EMPLOYEE BENEFIT PLANS (CONTINUED)

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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

12. EMPLOYEE BENEFIT PLANS (CONTINUED)

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).

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

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.

Asset (Liability)		**2006**			2005	
December 31 *(in millions)*	Number of swaps and options	Term to maturity (years)	Carrying Value	Fair Value	Carrying Value	Fair Value
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.

15. FINANCIAL INSTRUMENTS (CONTINUED)

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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

17. COMMITMENTS & CONTINGENCIES (CONTINUED)

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

17. COMMITMENTS & CONTINGENCIES (CONTINUED)

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.

CONSOLIDATED FINANCIAL STATEMENTS OF

TERASEN GAS INC.

YEARS ENDED DECEMBER 31, 2006 AND 2005

MANAGEMENT'S REPORT

Financial Reporting

Management is responsible for the accompanying consolidated financial statements. These financial statements have been prepared in conformity with Canadian generally accepted accounting principles and, where appropriate, include amounts that are based on management's best estimates and judgments.

The Board of Directors, through its Audit Committee, oversees Management's responsibilities for financial reporting and internal control. The Audit Committee meets with the internal auditors, the independent auditors and management to discuss auditing and financial matters and to review the consolidated financial statements and the independent auditors' report. The Audit Committee reports its findings to the Board for consideration in approving the consolidated financial statements for issuance to the shareholders.

Internal Control over Financial Reporting

Management is also responsible for establishing and maintaining adequate internal control over the Company's financial reporting. The internal control system was designed to provide reasonable assurance to the Company's Management regarding the preparation and presentation of the consolidated financial statements.

Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of the Company's internal control over financial reporting as at December 31, 2006. In making its assessment, Management has used the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework in Internal Control – Integrated Framework to evaluate the effectiveness of the Company's internal control over financial reporting. Based on our evaluation, Management has concluded that the Company's internal control over financial reporting was effective as at December 31, 2006.

The Company's independent auditors, PricewaterhouseCoopers LLP, conduct an audit in accordance with Canadian generally accepted auditing standards. Their report outlines the scope of their audit and gives their opinion on the consolidated financial statements.

Signed: *"R.L. (Randy) Jespersen*

President

Signed: *"Scott A. Thomson"*

Vice President, Finance and Regulatory Affairs and Chief Financial Officer

Vancouver, Canada
March 29, 2007

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated statements of financial position of Terasen Gas 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 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 notes 7 and 15 (a), which are as of March 2, 2006 and note 15 (b) which is as of March 31, 2006.

(Signed) PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, British Columbia
March 29, 2007

TERASEN GAS INC.

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

YEARS ENDED DECEMBER 31, 2006 AND 2005

CONSOLIDATED STATEMENTS OF EARNINGS

Years ended December 31	**2006**	2005
Revenues		
Natural gas distribution	**$ 1,525.3**	$ 1,465.9
Expenses		
Cost of natural gas	**1,008.7**	961.1
Operation and maintenance	**173.9**	169.8
Depreciation and amortization	**83.9**	79.2
Property and other taxes	**41.6**	39.8
	1,308.1	1,249.9
Operating income	**217.2**	216.0
Financing costs (note 10)	**105.2**	111.1
Earnings before income taxes	**112.0**	104.9
Current income taxes (note 11)	**43.6**	39.6
Net earnings	**$ 68.4**	$ 65.3

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Years ended December 31	**2006**	2005
Retained earnings, beginning of year	**$ 43.9**	$ 38.6
Net earnings	**68.4**	65.3
	112.3	103.9
Dividends on common shares	**40.0**	60.0
Retained earnings, end of year	**$ 72.3**	$ 43.9

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

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	2006	2005
Assets		
Current assets		
Cash and short-term investments	**$ 6.5**	$ 15.6
Accounts receivable	**290.3**	401.4
Inventories of gas in storage and supplies	**168.3**	177.9
Prepaid expenses	**5.2**	4.4
Current portion of rate stabilization accounts (note 3)	**118.1**	13.0
	588.4	612.3
Property, plant and equipment (note 2)	**2,352.9**	2,329.2
Rate stabilization accounts (note 3)	**24.7**	25.9
Other assets (note 4)	**62.2**	50.3
	$ 3,028.2	$ 3,017.7
Liabilities and shareholders' equity		
Current liabilities		
Short-term notes	**$ 217.0**	$ 313.0
Accounts payable and accrued liabilities	**407.7**	319.4
Income and other taxes payable	**30.6**	29.6
Current portion of rate stabilization account (note 3)	**-**	47.9
Current portion of long-term debt (note 5)	**251.4**	121.7
	906.7	831.6
Long-term debt (note 5)	**1,098.6**	1,229.9
Other long-term liabilities and deferred credits (note 6)	**121.0**	110.0
Future income taxes	**0.5**	0.5
	2,126.8	2,172.0
Shareholders' equity		
Share capital (note 7)	**594.0**	594.0
Contributed surplus (note 7)	**235.1**	207.8
Retained earnings	**72.3**	43.9
	901.4	845.7
	$ 3,028.2	$ 3,017.7

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

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

CONSOLIDATED STATEMENTS OF CASH FLOWS

	2006	2005
Cash flows provided by (used for)		
Operating activities		
Net earnings	**$ 68.4**	$ 65.3
Adjustments for non-cash items		
Depreciation and amortization	**83.9**	79.2
Other	**7.9**	8.0
	160.2	152.5
Change in rate stabilization accounts	**4.0**	1.9
Changes in working capital	**80.6**	(46.4)
	244.8	108.0
Investing activities		
Property, plant and equipment	**(108.7)**	(152.7)
Proceeds on sale of natural gas distribution assets (note 6)	**-**	7.2
Other assets and deferred credits	**(7.7)**	2.4
	(116.4)	(143.1)
Financing activities		
(Decrease) increase in short-term notes	**(96.0)**	206.0
Increase in long-term debt	**120.0**	301.5
Reduction of long-term debt	**(121.5)**	(398.5)
Dividends on common shares	**(40.0)**	(60.0)
	(137.5)	49.0
(Decrease) increase in cash	**(9.1)**	13.9
Cash at beginning of year	**15.6**	1.7
Cash at end of year	**$ 6.5**	$ 15.6
Supplemental cash flow information		
Interest paid in the year	**$ 106.0**	$ 113.4
Income taxes paid in the year	**14.7**	9.5
Non-cash transactions		
Mark to market on certain gas derivatives deferred in rate-stabilization accounts	**$ 155.9**	21.2

Cash is defined as cash or bank indebtedness.

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

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 and its subsidiaries, including Terasen Gas (Squamish) Inc. (“Squamish”).

Certain comparative figures have been reclassified to conform with the current year’s presentation.

(b) REGULATION

The Company and Squamish are subject to the regulation of the British Columbia Utilities Commission (“the BCUC”), an independent regulatory authority. The Company has a multi-year agreement that will expire at the end of 2007. This multi-year agreement is a cost-of-service based agreement 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 the Company’s deemed equity components from 33% to 35%, 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 the Company. For 2007, the allowed ROE was set at 8.37%.

The allowed rate of return is based on a notional debt-equity ratio of 65% debt and 35% equity. The Company has an annual review process for rate approvals and allowed rates of return are reset annually, unless directed differently by the BCUC.

The BCUC exercises statutory authority over such matters as rates of return, construction and operation of facilities, accounting practices, rates, 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 the Significant Accounting Policies, and in Note 2 “Property, Plant and Equipment”, Note 3 “Rate Stabilization Accounts”, Note 4 “Other Assets”, Note 6 “Other Long-Term Liabilities and Deferred Credits”, Note 8 “Employee Benefit Plans”, Note 10 “Financing Costs”, and Note 11 “Income Taxes”.

(c) 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.

(d) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated 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 BCUC, 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.

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.

(e) 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) 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 systems are not currently determinable, the Company has not recognized an asset retirement obligation at December 31, 2006 and 2005. For regulated operations there is a reasonable expectation that asset retirement costs would be recoverable through future rates.

(g) RATE STABILIZATION ACCOUNTS

The Company is authorized by the BCUC to maintain rate stabilization accounts to 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 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).

All rate stabilization account balances are recovered through rates as approved by the BCUC.

(h) DEFERRED CHARGES

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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

(i) DERIVATIVE FINANCIAL INSTRUMENTS

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

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 included in rates and passed on to customers.

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 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(j) REVENUE RECOGNITION

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

Revenues from natural gas sales are recorded 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.

(k) 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 BCUC requires costs to be expensed as paid. The Company uses the projected benefit method based on years of service and 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 BCUC 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 and reported as the market-related value of plan assets.

Adjustments, in excess of 10% of the greater of the accrued benefit obligation and plan asset 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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(l) INCOME TAXES

The Company and Squamish account for and recover income tax expense in rates as prescribed by the BCUC for ratemaking purposes. 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, as approved by the BCUC. Therefore, future income taxes related to temporary differences are not recorded. The taxes payable method is followed as there is reasonable expectation that all future income taxes will be recovered in rates when they become payable.

(m) 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 has concluded that there are no entities that are required to be consolidated or variable interests that are required to be disclosed under the requirements of the Guideline.

2. PROPERTY, PLANT AND EQUIPMENT

2006	Weighted average depreciation rate	Cost	Accumulated depreciation	Net book Value
Natural gas distribution systems	**2.33%**	**$ 2,687.9**	**$ 576.5**	**$ 2,111.4**
Plant, buildings and equipment	**8.25%**	**304.5**	**145.3**	**159.2**
Land and land rights	**0.00%**	**83.6**	**1.3**	**82.3**
		$ 3,076.0	**$ 723.1**	**$ 2,352.9**

2005	Weighted average depreciation rate	Cost	Accumulated depreciation	Net book Value
Natural gas distribution systems	2.34%	$ 2,623.8	$ 546.8	$ 2,077.0
Plant, buildings and equipment	9.81%	277.5	106.7	170.8
Land and land rights	0.00%	82.8	1.4	81.4
		$ 2,984.1	$ 654.9	$ 2,329.2

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 $0.7 million (2005 - $0.6 million) and approved capitalized overhead of $27.2 million (2005 - $26.3 million), with offsetting inclusions in earnings.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

3. RATE STABILIZATION ACCOUNTS

	2006	2005
Current Assets		
RSAM	**$ 11.3**	$ 13.0
CCRA	**81.3**	-
MCRA	**25.5**	-
	118.1	13.0
Long-Term Assets		
RSAM	**24.7**	25.9
	24.7	25.9
Current Liabilities		
CCRA	**-**	(21.3)
MCRA	**-**	(26.6)
	-	(47.9)
Net rate stabilization accounts	**$ 142.8**	$ (9.0)

The current portion of the rate stabilization accounts represents the amounts expected to be recovered or refunded in rates over the next twelve months. Actual recoveries/(refunds) will vary depending on 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.

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 $230.9 million (2005 – increased $34.3 million), increased natural gas distribution revenues of $4.3 million (2005 - $0.1 million) and decreased income taxes expense of $74.8 million (2005 – increased $11.4 million).

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

4. OTHER ASSETS

	2006	2005
Deferred charges		
Subject to rate regulation and approved for recovery in rates		
Income taxes recoverable on post-employment benefits	$ 13.1	$ 10.6
Long-term debt issue costs	7.8	7.7
Commercial commodity unbundling costs	2.5	3.2
Replacement transportation agreement	2.2	3.2
Other items approved for recovery in rates	8.5	8.9
Subject to rate regulation but not yet approved for recovery in rates		
Southern Crossing Pipeline PST Reassessment	10.0	-
Other items subject to rate regulation but not yet approved	-	1.8
	44.1	35.4
Long-term receivables	9.6	10.0
Pension assets (Note 8)	8.5	4.9
	$ 62.2	$ 50.3

Amortization of these deferred charges in rates for the year ended December 31, 2006 totaled $2.3 million (2005 - $7.7 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 a timing difference for income tax purposes. Since the Company 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 5 “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 the Company. 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 the Company 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.

4. OTHER ASSETS (CONTINUED)

The deferral account for the Southern Crossing Pipeline PST reassessment relates to a payment made in regards to a possible assessment of additional provincial sales tax on the Southern Crossing Pipeline. See Note 14.

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.

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 million 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 and deferred credits for rate regulated entities that have been aggregated in the table above and in Note 6 relate to more than 40 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 from the costs related to the pension asset. This would have resulted in increased income taxes of $2.5 million (2005 - $2.2 million), increased financing costs of $0.1 million (2005 – $0.8 million) and increased operation and maintenance costs of $5.7 million (2005 – $2.6 million).

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

5. LONG-TERM DEBT

	2006	2005
(a) 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
(b) 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
Total long-term debt	1,350.0	1,351.6
Less: current portion of long-term debt	251.4	121.7
	$ 1,098.6	$ 1,229.9

(a) 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 the Company's 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.

(b) DEBENTURES AND MEDIUM TERM NOTE DEBENTURES:

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

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

5. LONG-TERM DEBT (CONTINUED)

The Company's Series B Purchase Money Mortgages, Series E Debentures, and Series 11, Series 13, Series 18, Series 19, and Series 21 Medium Term Note 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	$ 251.4
2008	189.4
2009	61.4
2010	1.5
2011	1.5

6. OTHER LONG-TERM LIABILITIES AND DEFERRED CREDITS

	2006	2005
Pension and other post-employment benefit liabilities (Note 8)	**$ 39.2**	$ 31.2
Deferred gains on sale of natural gas distribution assets	**54.8**	59.2
Deferred credits		
Subject to rate regulation and approved for recovery 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 approved for recovery in rates	**7.1**	6.0
Other deferred credits subject to rate regulation	**-**	1.6
	$ 121.0	$ 110.0

The deferred gains on sale of natural gas distribution assets occurred upon the sale 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 14.

Amortization of these deferred credits in rates for the year ended December 31, 2006 totaled $4.1 million (2005 - $4.5 million).

The Earnings Sharing Mechanism is a mechanism agreed to in the Company's multi-year agreement to share, on a 50/50 basis, amounts earned by the Company 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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

6. OTHER LONG-TERM LIABILITIES AND DEFERRED CREDITS (CONTINUED)

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.

The Company 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). The balance of the account is being amortized on a straight-line basis over three years.

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. This would have resulted in decreased operation and maintenance costs of $1.9 million (2005 - $5.7 million), increased financing costs of $2.0 million (2005 – $0.1 million) and decreased property and other taxes of $3.1 million (2005 – nil).

7. SHARE CAPITAL

The Company is authorized to issue 500,000,000 common shares, 100,000,000 first preference shares and 100,000,000 second preference shares, all without par value.

	2006	2005
Common shares, 59,591,732 shares issued	**$ 594.0**	$ 594.0

CONTRIBUTED SURPLUS

Income tax benefits in the amount of $27.3 million (2005 - $30.9 million) relating to transactions with entities under common control were recorded as a credit to contributed surplus in 2006.

7. SHARE CAPITAL (CONTINUED)

DIVIDEND POLICY

As part of its approval of the acquisition of Terasen Inc. by Kinder Morgan, Inc., the BCUC imposed a number of conditions intended to ring-fence the Company from its parent companies. These restrictions included a prohibition on the payment of dividends unless the Company 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 described in Note 1(b), the Company 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. Dividends from the Company will not be allowed by the regulator if the requisite equity is not in place. The Company's dividend policy is intended to ensure that it maintains at least as much common equity as that deemed by the BCUC for rate-making purposes.

8. 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 dates 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 10.2 years (2005 - 9.5 years).

DEFINED CONTRIBUTION PLAN

Effective in 2000, all new non-union employees became members of defined contribution pension plans. Company contributions to the plan are based upon employee age and pensionable earnings.

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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

8. EMPLOYEE BENEFIT PLANS (CONTINUED)

OTHER POST-EMPLOYMENT BENEFITS

The Company provides retired employees with other post-employment benefits that include, depending on circumstances, supplemental health, 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 9.0 years (2005 - 9.0 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 the tables below:

	Defined benefit pension plans		Other benefit plans	
	2006	2005	**2006**	2005
Plan assets				
Fair value, beginning of year	**$ 202.4**	$ 185.2	$ -	$ -
Actual return on plan assets	**28.6**	18.9	**-**	-
Company contributions	**5.3**	4.3	**1.2**	0.9
Contributions by members	**3.0**	2.9	**-**	-
Benefits and settlements paid	**(10.3)**	(8.8)	**(1.1)**	(0.8)
Other	**(0.1)**	(0.1)	**(0.1)**	(0.1)
Fair value, end of year	**228.9**	202.4	**-**	-
Accrued benefit obligation				
Obligation, beginning of year	**213.7**	191.7	**64.3**	52.9
Current service cost	**5.3**	5.1	**1.2**	0.9
Interest cost	**10.7**	11.5	**3.3**	3.2
Contributions by members	**3.0**	2.8	**-**	-
Benefits and settlements paid	**(10.3)**	(8.8)	**(1.1)**	(0.8)
Actuarial losses	**4.9**	0.6	**0.7**	-
Change in discount rate	**-**	10.6	**-**	8.1
Past service cost and other	**-**	0.2	**(0.2)**	-
Balance, end of year	**227.3**	213.7	**68.2**	64.3
Funded status - plan surplus (deficiency)	**1.6**	(11.3)	**(68.2)**	(64.3)
Unamortized transitional (benefit) obligation	**(10.5)**	(12.2)	**3.1**	4.7
Unamortized actuarial loss	**13.3**	24.7	**27.7**	29.5
Unamortized past service costs	**3.2**	3.6	**(0.9)**	(1.0)
Accrued benefit asset (liability)	**$ 7.6**	$ 4.8	**$ (38.3)**	$ (31.1)
Represented by				
Pension assets	**$ 8.5**	$ 4.9	**$ -**	$ -
Accrued benefit liability	**(0.9)**	(0.1)	**(38.3)**	(31.1)
	$ 7.6	$ 4.8	**$ (38.3)**	$ (31.1)

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

8. EMPLOYEE BENEFIT PLANS (CONTINUED)

The net accrued benefit liability is included in other long-term liabilities and deferred credits (Note 6) and the pension asset is included in other assets (Note 4).

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	**$ 10.2**	$ 10.2	**$ 68.2**	$ 64.3
Funded plans	**162.2**	153.0	**-**	-
	172.4	163.2	**68.2**	64.3
Fair value of plan assets	**173.0**	150.1	**-**	-
Funded status surplus (deficit)	**$ 0.6**	$ (13.1)	**$ (68.2)**	$ (64.3)

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	**$ 5.3**	$ 5.1	**$ 1.2**	$ 0.9
Interest cost on projected benefit obligations	**10.7**	11.5	**3.3**	3.2
Actual positive return on plan assets	**(28.6)**	(18.9)	**-**	-
Net actuarial losses	**4.9**	11.2	**0.7**	8.1
Past service costs	**-**	0.3	**(0.2)**	0.1
Other	**0.1**	-	**0.1**	-
Net benefit plan (income) expense before adjustments	**(7.6)**	9.2	**5.1**	12.3
Adjustments to recognize the long-term nature of employee future benefit costs:				
Difference between actual and expected return on plan assets	**14.8**	6.1	**-**	-
Difference between actual and recognized actuarial losses in year	**(3.4)**	(9.9)	**1.8**	(6.1)
Difference between actual and recognized past service costs in year	**0.5**	0.3	**-**	(0.1)
Amortization of transitional (benefit) obligation	**(1.8)**	(1.8)	**1.6**	1.6
Other	**-**	-	**-**	-
Net benefit plan expense	**$ 2.5**	$ 3.9	**$ 8.5**	$ 7.7
Defined contribution plan expense	**$ 1.1**	$ 1.0		
	$ 3.6	$ 4.9		

8. EMPLOYEE BENEFIT PLANS (CONTINUED)

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

BENEFIT PLAN ASSETS

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

	Defined Benefit Pension Plans	
	2006	2005
Equity securities	**58%**	58%
Fixed income securities	**34%**	34%
Other assets	**8%**	8%
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's parent.

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 3.36% thereafter	**3.64%**	3.36%	**-**	-
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%	**-**	-

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

8. EMPLOYEE BENEFIT PLANS (CONTINUED)

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	**10.0%**	8.0%
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 costs and interest cost components of the benefit plan expense	**$ 0.6**	**$ (0.5)**
Effect on accrued benefit obligation	**8.2**	**(7.4)**

CASH FLOWS

Total cash contributions for employee benefit plans consist of:

	Employee benefit plans	
	2006	2005
Funded plans	**$ 4.5**	$ 3.8
Beneficiaries of unfunded plans	**2.0**	1.4
Defined contribution plans	**1.1**	1.0
Total	**$ 7.6**	$ 6.2

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

IMPACT OF RATE REGULATION

As required by the regulator, the Company 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 (2005 – $0.3 million) that was in excess of the amount approved by the regulator to be refunded in rates in 2007.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

9. STOCK-BASED COMPENSATION

The Company's parent, Terasen Inc., granted stock options to employees of the Company under its stock option plans until November 30, 2005, when all of the outstanding shares of Terasen Inc. were purchased by Kinder Morgan, Inc. In 2005, 164,500 options to purchase shares in Terasen Inc. were issued to employees of the Company at an average exercise price of $29.45. In 2005, the Company was charged, and recorded as an expense, $0.4 million for the fair value of the stock compensation granted in 2005 by Terasen Inc.

10. FINANCING COSTS

	2006	2005
Interest and expense on long-term debt	**$ 98.8**	$ 102.4
Interest on short-term debt	**7.1**	9.3
Interest capitalized (note 2)	**(0.7)**	(0.6)
	$ 105.2	$ 111.1

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 $0.7 million (2005 - $0.6 million).

11. INCOME TAXES

VARIATION IN EFFECTIVE INCOME TAX RATE

Consolidated income taxes vary from the amount that would be computed by applying the federal and provincial combined statutory income tax rate of 34.12% (2005 – 33.97%) to earnings before income taxes as shown in the following table:

	2006	2005
Earnings before income taxes	**$ 112.0**	$ 104.9
Combined statutory income tax rate	**34.12%**	33.97%
Combined income taxes at statutory rate	**$ 38.2**	$ 35.7
Decrease in income taxes resulting from capital cost allowance and other deductions claimed for income tax purposes over amounts recorded for accounting purposes	**(7.5)**	(1.5)
Large Corporations Tax in excess of (surtax credit) surtax	**(1.1)**	3.7
Deferred Large Corporations Tax	**3.1**	-
Non-deductible expenses and non-taxable income	**2.5**	3.6
Provincial income tax applicable to prior years	**11.6**	-
Other	**(3.2)**	(1.9)
Actual consolidated income taxes	**$ 43.6**	$ 39.6
Effective Income Tax Rate	**38.93%**	37.75%

11. INCOME TAXES (CONTINUED)

FUTURE INCOME TAXES

As a result of the Company accounting for income taxes following the taxes payable method for its regulated operations, the Company has not recognized net future income tax liabilities amounting to $217.5 million at December 31, 2006 (2005 – $230.9 million) and has not recognized a future income tax recovery of $13.4 million for the year ended December 31, 2006 (2005 – expense of $15.1 million), all of which were calculated using the asset and liability method.

12. 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 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 $1,547.2 million (2005 - $1,580.7 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, interest rates and foreign currency exchange rates.

Asset (Liability)			**2006**		2005	
December 31 (in millions)	Number of swaps and options	Term to maturity (years)	Carrying Value	Fair Value	Carrying Value	Fair Value
Natural Gas						
Commodity Swaps and Options	225	Up to 3	**$ (133.0)**	**$ (133.6)**	$ 21.2	$ 97.9
Interest Swaps	3	Up to 1	**-**	**(0.9)**	-	(1.6)

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.

(Tabular amounts in millions of Canadian dollars, except where stated otherwise)

12. FINANCIAL INSTRUMENTS (CONTINUED)

Included in the carrying value of the natural gas derivatives is $133.7 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.

The derivatives entered into by the Company 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.

13. RELATED PARTY TRANSACTIONS

(a) The Company received $4.1 million in 2006 (2005 – $4.1 million) from Terasen Gas (Vancouver Island) Inc. ("TGVI"), a subsidiary company of Terasen Inc., for transporting gas through the Company's pipeline system.

(b) The Company paid approximately $44.6 million during the year ended December 31, 2006 (2005 – $43.6 million) for customer care and billing services to a limited partnership. Terasen Inc. holds a 30% interest in the limited partnership and jointly controls it. The Company is committed to pay approximately $42.6 million as base contract fees for 2007.

(c) The Company paid $8.5 million in 2006 (2005 – $8.7 million) to Terasen Inc. for management services.

(d) The Company charged affiliated companies $6.6 million in 2006 (2005 – $5.6 million) for management services.

14. COMMITMENTS AND CONTINGENCIES

The Company has entered into operating leases for certain building space and natural gas distribution assets. In addition, the Company enters into gas purchase contracts. 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	$ 15.5	$ 474.1	$ 489.6
2008	15.6	22.9	38.5
2009	15.2	27.7	42.9
2010	14.8	-	14.8
2011	14.5	-	14.5
2012 and later	107.6	-	107.6
	$ 183.2	$ 524.7	$ 707.9

14. COMMITMENTS AND CONTINGENCIES (CONTINUED)

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.

The Company 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 the Company 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, 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 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 15.

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.

15. SUBSEQUENT EVENTS

On January 1, 2007, the Company and its subsidiary, Squamish, were amalgamated.

On February 26, 2007, Kinder Morgan Inc., 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 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.

FINANCIAL STATEMENTS OF

TERASEN GAS (VANCOUVER ISLAND) INC.

YEARS ENDED DECEMBER 31, 2006 AND 2005

PRICEWATERHOUSECOOPERS

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AUDITORS' REPORT

To the Shareholder of Terasen Gas (Vancouver Island) Inc.

We have audited the statement of financial position of Terasen Gas (Vancouver Island) Inc. (the "Company") as at December 31, 2006 and the statement 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 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 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 13(b) which are as of March 2, 2006.

PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, British Columbia
March 30, 3007

TERASEN GAS (VANCOUVER ISLAND) INC.

STATEMENTS OF EARNINGS

In thousands of Canadian dollars *Years ended December 31*	2006	2005
Revenues		
Natural gas distribution	$ 153,296	$ 140,283
Transportation revenue	20,384	24,227
Royalty income	36,326	46,722
	210,006	211,232
Expenses		
Cost of natural gas	102,156	95,087
Operation and maintenance	22,727	25,309
Depreciation and amortization	18,021	16,857
Property and other taxes	7,537	7,375
Wheeling	4,090	4,253
	154,531	148,881
Operating Income	55,475	62,351
Financing costs (note 7)	17,490	17,573
Earnings before income taxes and revenue surplus	37,985	44,778
Current income taxes (note 8)	11,580	14,396
Earnings before revenue surplus	26,405	30,382
Revenue surplus	(6,699)	(12,369)
NET EARNINGS	$ 19,706	$ 18,013

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

TERASEN GAS (VANCOUVER ISLAND) INC.

STATEMENTS OF RETAINED EARNINGS

In thousands of Canadian dollars *Years ended December 31*	**2006**	2005
Retained earnings, beginning of year	**$ 56,914**	$ 53,606
Net earnings	**19,706**	18,013
	76,620	71,619
Dividends on common shares	**6,600**	14,705
Retained earnings, end of year	**$ 70,020**	$ 56,914

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

TERASEN GAS (VANCOUVER ISLAND) INC.

STATEMENTS OF FINANCIAL POSITION

In thousands of Canadian dollars *As at December 31*	**2006**	2005
Assets		
Current assets		
Cash and cash equivalents	**$ 5,458**	$ -
Accounts receivable	**28,862**	31,975
Due from related parties (note 10)	**7,585**	-
Inventories of gas in storage and supplies	**16,674**	22,616
Prepaid expenses	**2,153**	675
Current portion of finance contracts	**3**	55
Deferred charges (note 3)	**9,531**	3,072
	70,266	58,393
Finance contracts	**-**	3
Employee benefit plan asset (note 6)	**2,046**	1,745
Property, plant and equipment (note 2)	**462,938**	439,161
Accumulated revenue deficiency (note 3)	**42,029**	48,728
Deferred charges and goodwill (note 3)	**14,171**	15,100
	$ 591,450	$ 563,130
Liabilities and shareholder's equity		
Current liabilities		
Accounts payable and accrued liabilities	**$ 28,636**	$ 20,296
Due to related parties (note 10)	**1,143**	92,893
Income and other taxes payable	**757**	2,206
Security deposits	**1,638**	935
Current portion of long-term debt (note 4)	**38,874**	187,541
	71,048	303,871
Employee benefit plan liabilities (note 6)	**4,286**	3,025
Customer deposits	**996**	1,158
Deferred credits (note 3)	**1,177**	1,014
Long-term debt (note 4)	**311,029**	81,475
	388,536	390,543
Shareholder's equity		
Share capital (note 5)	**91,977**	77,477
Contributed surplus (note 5)	**40,917**	38,196
Retained earnings	**70,020**	56,914
	202,914	172,587
	$ 591,450	$ 563,130

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

TERASEN GAS (VANCOUVER ISLAND) INC.

STATEMENTS OF CASH FLOWS

In thousands of Canadian dollars *Years ended December 31*	2006	2005
Cash flows provided by (used for)		
Operating activities		
Net earnings	$ 19,706	$ 18,013
Adjustments for non-cash items		
Depreciation and amortization	18,021	16,857
Revenue surplus	6,699	12,369
	44,426	47,239
Changes in working capital	11,320	(11,640)
	55,746	35,599
Investing activities		
Property, plant and equipment	(31,424)	(24,214)
Deferred charges and credits	(1,505)	(2,897)
Other	853	200
	(32,076)	(26,911)
Financing activities		
(Repayment to) advance from parent company and related parties	(99,335)	25,817
Proceeds of bank loan	299,734	-
Repayment of bank loan	(207,919)	(19,801)
Share issue	14,500	-
Repayment of subordinate debt	(12,369)	-
Repayment of government loan	(6,223)	-
Dividends on common shares	(6,600)	(14,705)
	(18,212)	(8,689)
Net increase in cash and cash equivalents	5,458	(1)
Cash and cash equivalents at beginning of year	-	1
Cash and cash equivalents at end of year	$ 5,458	$ -
Supplemental cash flow information		
Interest paid in the year	$ 20,321	$ 18,384
Income taxes paid in the year	8,102	15,558
Non-cash transactions		
Mark to market on certain gas derivatives deferred in gas cost variance account	5,996	-
Government loan capitalized in property, plant and equipment	1,438	-
Property, plant and equipment purchases included in accounts payable and accrued liabilities	578	587
Deferred charges included in accounts payable and accrued liabilities	-	295

Cash is defined as cash or bank indebtedness
The accompanying notes are an integral part of these financial statements.

1. SIGNIFICANT ACCOUNTING POLICIES

The preparation of these 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 these estimates.

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

(a) REGULATION

The Company is engaged in the transmission and retail distribution of natural gas for residential, commercial and large industrial customers on Vancouver Island and the Sunshine Coast of British Columbia. The Company is regulated by the British Columbia Utilities Commission ("BCUC") and its natural gas operations are governed by an agreement (hereinafter referred to as the Vancouver Island Natural Gas Pipeline Agreement or "VINGPA") among the Province of British Columbia (the "Province"), the Company and its shareholder, and other affected parties. The Company has a multi-year agreement that will expire at the end of 2007. On March 23, 2007 the company received approval of a two year extension to 2009. The following summarizes the main points of the VINGPA.

Under the VINGPA, the Province is to make quarterly payments from 1996 through 2011 related to royalties associated with deemed volumes of natural gas transported through the Vancouver Island Pipeline. The payments for 2006 are estimated to be $37,007 (2005 - $46,899). The actual payment for 2005 amounted to approximately $46,219. Differences between actual and estimated payments are recorded when payments are received.

For the years 1996 to 2002, the VINGPA provided for a deemed equity component of rate base of 35% and for a return on the equity component of 3.625% over the Government of Canada long-term bond rate. Commencing in 2003, the equity component and the return on equity is set by the BCUC. On March 2, 2006 a decision was issued by the BCUC approving changes to the Company's deemed equity components from 35% to 40%, 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. Return on equity for 2006 was 9.50% (2005 – 9.53%) and the equity component of rate base was set at 40% (2005 – 35%). For 2007, the allowed ROE was set at 9.07%. The VINGPA also provides for a reduction in the return on equity of $1,867 per year for the years 1996 to 2011.

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 this Significant Accounting Policies note and in Note 2 "Property, Plant and Equipment", Note 3 "Other Assets and Liabilities", Note 7 "Financing Costs", Note 8 "Income Taxes" and Note 12 "Commitments and Contingencies".

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(b) 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.

(c) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated 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 BCUC, 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.

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.

(d) 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.

(e) 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 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

(f) DEFERRED CHARGES

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

The Company is authorized by the BCUC to maintain rate stabilization accounts to mitigate the effect on its earnings of unpredictable and uncontrollable factors, primarily natural gas cost volatility and throughput volumes. The Gas Cost Variance Account ("GCVA") accumulates differences between actual natural gas costs and forecast natural gas costs as recovered in base rates. The GCVA is amortized and recovered through rates as approved by the BCUC.

Deferred charges include long-term debt issue costs which are amortized over 5 years representing 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.

(g) DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilizes derivatives and other financial instruments to manage its exposure to changes in foreign currency exchange rates, 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 or 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 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 financial statements.

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, and subject to regulatory approval, realized gains/losses are included in rates and passed on to customers.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

As approved by the regulator, derivatives are used to manage natural gas price risk. 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 used for inclusion in cost of service on a royalty adjusted basis are recorded in the GCVA and, subject to regulatory approval, passed through to customers in future rates.

Foreign currency 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.

(h) 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.

(i) REVENUE RECOGNITION

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

Revenues from the natural gas sales are recorded 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 BCUC approved orders.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(j) 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 BCUC requires costs to be expensed as paid. The Company uses the projected benefit method based on years of service and 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 BCUC 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 and reported as the market-related value of plan assets.

Adjustments, in excess of 10% of the greater of the accrued benefit obligation and plan asset 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.

(k) INCOME TAXES

The Company accounts for and recovers income tax expense in rates as prescribed by the BCUC for ratemaking purposes. 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, as approved by the BCUC. 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(l) 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 has concluded that there are no entities that are required to be consolidated or variable interests that are required to be disclosed under the requirements of the Guideline.

(m) COMPARATIVE FIGURES

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

(Amounts in thousands of Canadian dollars, except where stated otherwise)

2. PROPERTY, PLANT AND EQUIPMENT

2006	Weighted average depreciation rate	Cost	Accumulated depreciation	Net book Value
Natural gas distribution systems	**2.25%**	**$ 663,522**	**$ 177,210**	**$ 486,312**
Plant, buildings and equipment	**5.93%**	**41,358**	**14,165**	**27,193**
Land and land rights	**0.19%**	**12,904**	**1,108**	**11,796**
		717,784	**192,483**	**525,301**
Government loans, net of accumulated amortization of $4,976 (see note 12(b))		**(67,339)**	**(4,976)**	**(62,363)**
		$ 650,445	**$ 187,507**	**$ 462,938**

2005	Weighted average depreciation rate	Cost	Accumulated depreciation	Net book Value
Natural gas distribution systems	**2.24%**	$ 599,417	$ 124,324	$ 475,093
Plant, buildings and equipment	**6.04%**	35,020	13,019	22,001
Land and land rights	**0.19%**	12,840	996	11,844
		647,277	138,339	508,938
Government loans, net of accumulated amortization of $5,223 (see note 12(b))		(75,000)	(5,223)	(69,777)
		$ 572,277	$ 133,116	$ 439,161

In 2003, the Company, pursuant to regulatory approval, commenced adjusting the balance of government loan assistance. During the year ended December 31, 2006, accumulated amortization has been reduced by $247 (2005 – $990) with an offsetting charge to amortization expense. In 2006, the Company made a repayment of $6,223 on the government loans (Note 12 (b)).

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 $541 (2005 - $449) and approved capitalized overhead of $4,695 (2005 - $4,626), with offsetting inclusions in earnings.

(Amounts in thousands of Canadian dollars, except where stated otherwise)

3. OTHER ASSETS AND LIABILITIES

	2006	2005
Accumulated revenue deficiency	$ 42,029	$ 48,728
Deferred charges subject to rate regulation and approved for recovery in rates:		
Gas cost variance account	$ 9,055	$ 2,662
Liquefied Natural Gas ("LNG") storage facility	1,669	2,087
Start up costs	1,271	1,315
Financing costs	862	311
Other items approved for recovery in rates	518	1,409
Deferred charges subject to rate regulation but not yet approved for recovery in rates:		
Corporate capital tax	7,627	7,338
Other items not yet approved	-	350
Goodwill	2,700	2,700
	23,702	18,172
Less current portion of deferred charges	9,531	3,072
	$ 14,171	$ 15,100
Deferred credits subject to rate regulation and approved for refund in rates	$ (1,177)	$ (1,014)

(a) ACCUMULATED REVENUE DEFICIENCY

Under the VINGPA, the Company agreed to phase out its existing oil-based rate structure over a seven year period and in 2003 commenced setting its rates according to regulatory practices based on full recovery of cost of service. During the phase-out period, prior to 2003, the rates set for residential and commercial customers of the Company were determined independently from the actual cost of service, and therefore, annual revenue deficiencies have arisen. The revenue deficiencies are recorded as a credit on the statement of earnings and as an accumulated revenue deficiency deferred charge on the statement of financial position. The Company commenced recovery of the accumulated revenue deficiency in 2003 and expects it to be fully recovered from customers through rates. Terasen Inc., the parent company, has committed to fund these deficiencies up to $120,000 from 1996 to 2011, plus $17,481 for 1995. This funding commitment does not extend to the financing costs incurred by the Company in any year in respect of the funding of revenue deficiencies for any previous year.

3. OTHER ASSETS AND LIABILITIES (CONTINUED)

(b) DEFERRED CHARGES SUBJECT TO RATE REGULATION

Amortization of deferred charges for the year ended December 31, 2006 totaled $2,134 (2005- $881).

The current portion of the Gas Cost Variance Account represents the amounts expected to be recovered or refunded in rates over the next twelve months. Actual recoveries/(refunds) will vary depending on natural gas consumption and recovery amounts approved by the BCUC.

Preliminary development costs associated with the possible development of a LNG storage facility on Vancouver Island have been approved for recovery in rates by the BCUC over a five year amortization period commencing January 1, 2006.

Start up costs relate to costs incurred prior to commencement of natural gas operations and are being amortized over a period of forty years as approved by the regulator.

Financing costs relate to the refinancing of the long term debt in 2006. The costs are being amortized over the life of the debt as approved by the regulator.

The deferral for corporate capital tax relates to tax payments that were made to the Province of British Columbia ("the Province") related to assessments for corporate capital tax. 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. The eventual refund will be credited to the deferral account with the balance expected to be recovered from customers in future rates.

Deferred charges that have been aggregated in the table above relate to 13 deferral accounts none of which equal more than $200 individually. Accounts that have been approved by the regulators in prior annual rate approvals or orders are being amortized over various periods depending on the nature of the costs.

(c) DEFERRED CREDITS SUBJECT TO RATE REGULATION

The deferred credit relates to an accrual for servicing five compressors and has been approved by the regulator as a long term deferral account.

In the absence of rate regulation, the other assets and liabilities in the above table would have been expensed, except for the amount related to goodwill. This would have resulted in decreased margin of $9,542 (2005 - $2,825), decreased operation and maintenance expense of $1,866 (2005 – increased $174), increased financing costs of $551 (2005 - $17), increased property and other taxes of $289 (2005 - $227), decreased current income taxes of $3,149 (2005 - $932) and increased net income of $6,699 (2005 – $12,369) related to the accumulated revenue deficiency.

(Amounts in thousands of Canadian dollars, except where stated otherwise)

4. LONG-TERM DEBT

	2006	2005
(a) Syndicate of banks:		
Utility Tranche, interest payable based on 90 day average Canadian Interbank bankers' acceptance rates plus 0.75% per annum (December 31, 2005 – 3.9%), principal repayable at $4,375 per year, due in 2006	$ -	$ 134,639
Pioneer Tranche, interest payable based on 90 day average Canadian Interbank bankers' acceptance rates plus 1% per annum (December 31, 2005 – 4.1%), principal repayable on maturity in 2009	-	32,747
Expansion Tranche, interest payable on 90 day average Canadian Interbank bankers' acceptance rates plus 0.75% per annum (December 31, 2005 – 3.8%), revolving loan with established facility of $50 million reducing by 2.5% per annum, due in 2006	-	40,533
Senior Facility, interest payable on 30-90 day average Canadian Interbank bankers' acceptance rates plus 0.70% per annum (December 31, 2006 - 5.1%), revolving loan with established facility of $350 million, due in 2011.	296,000	-
PCEPA, interest payable on 30-180 day average Canadian Interbank bankers' acceptance rates plus 0.70% per annum (December 31, 2006 – 5.3%), revolving loan with established facility of $20 million, due in 2013.	3,734	-
	299,734	207,919
(b) Promissory notes payable to Terasen Inc.:		
Class B instruments, cumulative interest rate of Government of Canada five year bond rate plus 2.75%:		
7.28% Interest reset date January 09, 2011	17,481	17,481
7.42% Interest reset date July 31, 2007	10,633	10,633
6.82% Interest reset date May 14, 2009	10,929	10,929
5.95% Interest reset date July 06, 2010	1,224	1,241
8.14% Interest reset date September 20, 2006	-	5,713
7.42% Interest reset date June 26, 2007	5,590	12,226
6.30% Interest reset date July 31, 2008	2,874	2,874
	48,731	61,097
(c) Government repayable loan (Note 12 (b))	1,438	-
Total long-term debt	349,903	269,016
Less: current portion of long-term debt	38,874	187,541
	$ 311,029	$ 81,475

(Amounts in thousands of Canadian dollars, except where stated otherwise)

4. LONG-TERM DEBT (CONTINUED)

(a) SYNDICATE OF BANKS

On January 13, 2006, the Company entered into a five-year $350,000 unsecured committed revolving credit facility with a syndicate of banks. The Company issued bankers' acceptances under this facility to completely refinance the Company'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, the Company entered into a $20,000 seven-year unsecured committed non-revolving credit facility with one bank. This facility will be utilized for purposes of refinancing any annual prepayments that the Company may be required to make on non-interest bearing government contributions. The terms and conditions are primarily the same as the aforementioned facility except this facility ranks junior to repayment of the Company's Class B subordinated debt, which is held by Terasen Inc. 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 $350,000 credit facility, borrowings outstanding at December 31, 2006 of $269,000 have been classified as long-term debt and an estimated $27,000 as current maturities. Borrowings outstanding against the $20,000 credit facility at December 31, 2006 were $3,734.

(b) PROMISSORY NOTES PAYABLE TO TERASEN INC.

During 2006, the Company repaid promissory notes to Terasen Inc. for $12,369 (2005 - $14,227).

Interest paid on the notes in 2006 was $3,954 (2005 – $5,538).

(c) REQUIRED PRINCIPAL REPAYMENTS OVER THE NEXT FIVE YEARS ARE AS FOLLOWS:

2007	$	8,141
2008		-
2009		-
2010		-
2011		296,000

The 2007 principle repayment includes the repayable government loan (Note 12 (b)).

(Amounts in thousands of Canadian dollars, except where stated otherwise)

5. SHARE CAPITAL

The Company is authorized to issue 100,000,000 common shares and 200,000,000 Class A preference shares, all without par value. The Company is also authorized to issue 1,000,000 Class B, 1,000,000 Class C and 1,000,000 Class D preference shares, all non-cumulative, non-voting redeemable retractable without par value. Issued share capital is comprised of the following:

	2006	2005
Common shares, 4,714 shares issued	$ 91,977	$ 77,477

During the year the Company issued 285 common shares to Terasen Inc for $14,500. During 2006, the Company paid $6,600 (2005 - $14,705) of dividends on common shares to Terasen Inc.

CONTRIBUTED SURPLUS

Income tax benefits in the amount of $2,721 (2005 - $0) relating to transactions with entities under common control were recorded as a credit to contributed surplus in 2006.

DIVIDEND POLICY

As part of its approval of the acquisition of Terasen Inc. by Kinder Morgan, Inc., the BCUC imposed a number of conditions intended to ring-fence the Company from its parent companies. These restrictions included a prohibition on the payment of dividends unless the Company 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 described in Note 1(a), the Company 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. Dividends from the Company will not be allowed by the regulator if the requisite equity is not in place. The Company's dividend policy is intended to ensure that it maintains at least as much common equity as that deemed by the BCUC for rate-making purposes.

6. 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 the date of the next required valuations is December 31, 2007. The expected weighted average remaining service life of employees covered by the defined benefit pension plans is 12.0 years (2005 – 16.7 years).

6. EMPLOYEE BENEFIT PLANS (CONTINUED)

DEFINED CONTRIBUTION PLAN

Effective July 1999, all new non-union employees are members of a defined contribution pension plan. Company contributions to the plan are based upon pensionable earnings.

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, 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 valuation was 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 16 years (2005 – 17 years).

(Amounts in thousands of Canadian dollars, except where stated otherwise)

6. EMPLOYEE BENEFIT PLANS (CONTINUED)

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	**$ 17,338**	$ 15,475	**$ -**	$ -
Actual return on plan assets	**2,413**	1,361	**-**	-
Employers' contributions	**977**	1,558	**194**	137
Employees' contributions	**48**	43	**-**	-
Benefits and settlements paid	**(1,358)**	(1,012)	**(178)**	(125)
Other	**(91)**	(87)	**(16)**	(12)
Fair value, end of year	**19,327**	17,338	**-**	-
Accrued benefit obligation				
Obligation, beginning of year	**23,601**	20,115	**5,649**	4,576
Current service cost	**913**	865	**199**	154
Interest cost	**1,164**	1,229	**295**	280
Employees' contributions	**48**	43	**-**	-
Benefits and settlements paid	**(1,358)**	(1,012)	**(178)**	(125)
Prior service cost	**-**	-	**142**	-
Actuarial (gain) loss	**(305)**	-	**3,232**	-
Change in discount rate	**-**	2,361	**-**	-
Change in other actuarial assumptions	**-**	-	**-**	764
Balance, end of year	**24,063**	23,601	**9,339**	5,649
Funded status - plan deficit	**(4,736)**	(6,263)	**(9,339)**	(5,649)
Unamortized transitional benefit	**(628)**	(673)	**-**	-
Unamortized actuarial loss	**5,060**	7,025	**7,801**	4,836
Unamortized past service costs	**1,067**	1,157	**(1,465)**	(1,713)
Accrued benefit asset (liability)	**$ 763**	$ 1,246	**$ (3,003)**	$ (2,526)
Represented by				
Employee benefit plan asset	**$ 1,676**	$ 2,134	**$ -**	$ -
Employee benefit plan liabilities	**(913)**	(888)	**(3,003)**	(2,526)
	$ 763	$ 1,246	**$ (3,003)**	$ (2,526)

(Amounts in thousands of Canadian dollars, except where stated otherwise)

6. EMPLOYEE BENEFIT PLANS (CONTINUED)

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	**$ 891**	$ 1,453	**$ 9,339**	$ 5,649
Funded plans	**23,172**	22,148	**-**	-
	24,063	23,601	**9,339**	5,649
Fair value of plan assets	**19,327**	17,338	**-**	-
Funded status deficit	**$ (4,736)**	$ (6,263)	**$ (9,339)**	$ (5,649)

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	**$ 913**	$ 865	**$ 199**	$ 154
Interest cost on projected benefit obligations	**1,164**	1,229	**295**	280
Actual return on plan assets	**(2,413)**	(1,361)	**-**	-
Net actuarial (gain) loss	**(305)**	2,361	**3,232**	764
Past service cost	**-**	-	**142**	-
Net benefit plan expense before adjustments	**(641)**	3,094	**3,868**	1,198
Adjustments to recognize the long-term nature of employee future benefit costs:				
Difference between actual and expected return on plan assets	**1,231**	227	**-**	-
Difference between actual and recognized actuarial gains (losses) in year	**734**	(2,141)	**(2,965)**	(538)
Difference between actual and recognized past service costs in year	**90**	90	**(248)**	(114)
Amortization of transitional benefit	**(45)**	(45)	**-**	-
Other	**91**	87	**16**	12
Net benefit plan expense	**$ 1,460**	$ 1,312	**$ 671**	$ 558
Defined contribution plan expense	**$ 42**	$ 43		
	$ 1,502	$ 1,355		

(Amounts in thousands of Canadian dollars, except where stated otherwise)

6. EMPLOYEE BENEFIT PLANS (CONTINUED)

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	**57%**	55%
Fixed income securities	**43%**	45%
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's parent.

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 3.50% thereafter	**4.50%**	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%	**-**	-

(Amounts in thousands of Canadian dollars, except where stated otherwise)

6. EMPLOYEE BENEFIT PLANS (CONTINUED)

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	**10.0%**	8.0%
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	**$ 96**	**$ (90)**
Effect on accrued benefit obligation	**1,137**	**(1,014)**

CASH FLOWS

Total cash contributions for employee benefit plans consist of:

	Pension benefit plans	
	2006	2005
Funded plans	**$ 935**	$ 1,510
Beneficiaries of unfunded plans	**236**	185
Defined contribution plans	**42**	44
Total	**$ 1,213**	$ 1,739

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

(Amounts in thousands of Canadian dollars, except where stated otherwise)

7. FINANCING COSTS

	2006	2005
Interest expense on long-term debt	$ 17,049	$ 15,140
Interest on short-term debt	982	2,882
Interest capitalized	(541)	(449)
	$ 17,490	$ 17,573

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 $541 (2005 - $449).

(Amounts in thousands of Canadian dollars, except where stated otherwise)

8. INCOME TAXES

VARIATION IN EFFECTIVE INCOME TAX RATE

Income taxes vary from the amount that would be computed by applying the federal and provincial combined statutory income tax rate of 34.12% (2005 – 34.80%) to earnings before income taxes as shown in the following table:

	2006	2005
Earnings before income taxes and revenue surplus	$ 37,985	$ 44,778
Statutory income tax rate	34.12%	34.80%
Income taxes at statutory rate	$ 12,960	$ 15,584
(Decrease) increase in income taxes resulting from:		
Capital cost allowance and other deductions claimed for income tax purposes over amounts recorded for accounting purposes	(1,716)	(1,786)
Large Corporations Tax in excess of surtax	-	504
Surtax recovered through prior years Large Corporation tax	(382)	-
Permanent differences	409	222
Other	309	(128)
Current income taxes	$ 11,580	$ 14,396
Effective income tax rate	30.49%	32.15%

FUTURE INCOME TAXES

As a result of the Company accounting for income taxes following the taxes payable method, the Company has not recognized net future income tax liabilities amounting to $47,204 at December 31, 2006 (2005 - $48,481) and has not recognized a future income tax recovery of $1,277 for the year ended December 31, 2006 (2005 – tax expense of $1,049), all of which were calculated using the asset and liability method.

9. FINANCIAL INSTRUMENTS

FAIR VALUE ESTIMATES

The carrying values of cash and cash equivalents, accounts receivable, finance contracts, security deposits, customer deposits 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 external long-term debt approximates its carrying value due to floating interest rates on the debt. The Company's long-term debt relates to regulated operations which enables the Company to recover the existing financing charges through rates or tolls.

9. FINANCIAL INSTRUMENTS (CONTINUED)

The fair value of the promissory notes payable to Terasen Inc. is not determinable due to their related party nature.

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 and foreign currency exchange rates.

Asset (Liability)	**2006**				2005	
December 31 *(in millions)*	Number of swaps	Term to maturity (years)	Carrying Value	Fair Value	Carrying Value	Fair Value
Interest Rate Swaps	2	2	-	**(0.3)**	-	(0.6)
Natural Gas Commodity Swaps	25	Up to 3	**6.0**	**6.0**	0.7	7.7

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.

As at December 31, 2006, the Company has entered into interest rate swap contracts on a notional principal amount of $65,000 (2005 - $108,148) that oblige it to pay interest at fixed rates and entitle it to receive interest at floating rates based on 90 day average Canadian Interbank bankers' acceptance rates. There is a netting arrangement between the fixed rate payable and the floating rate receivable. The agreements to fix the interest rate on $65,000 of notional debt expires in 2008. As at December 31, 2006, the weighted average floating rate of interest under the swaps was 4.11% (December 31, 2005 – 2.73%) and the weighted average fixed rate of interest was 4.46% (December 31, 2005 – 4.88%).

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.

(Amounts in thousands of Canadian dollars, except where stated otherwise)

10. AMOUNTS DUE TO/(FROM) RELATED PARTIES

	2006	2005
Due from related parties		
Terasen Gas Inc.	$ 6,633	$ -
Terasen Gas (Squamish) Inc.	330	-
Terasen Gas (Whistler) Inc.	622	-
	$ 7,585	$ -
Due to related parties		
Terasen Inc.	$ 1,143	$ 88,458
Terasen Gas Inc.	-	4,092
Terasen Gas (Squamish) Inc.	-	117
Terasen Gas (Whistler) Inc.	-	226
	$ 1,143	$ 92,893

The Company in 2005 had operating credit facilities with a Canadian chartered bank available through its parent company, Terasen Inc. The advances drawn on these facilities bear interest at a monthly rate calculated as the 30 day bankers' acceptance rate plus 80 basis points (December 31, 2005 – 4.1%) and are recorded as due to Terasen Inc. At December 31, 2005, the balance drawn on this facility was $86,388. On January 13, 2006 the Company entered into a unsecured revolving credit facility with a syndicate of banks that replaced the operating credit facilities that were available through its parent company, Terasen Inc. (Note 4(a)).

(a) The Company paid approximately $479 in 2006 (2005 – $639) for administration fees and corporate charges to Terasen Inc.

(b) The Company paid approximately $4,090 in 2006 (2005 – $4,047) to Terasen Gas Inc. a subsidiary company of Terasen Inc., for transporting gas through their pipeline system. The Company paid $4,500 in 2006 (2005 - $3,457) to Terasen Gas Inc. for management services and $1,028 (2005 - $866) for administrative services.

(c) The Company received approximately $262 in 2006 (2005 - $257) from Terasen Gas (Whistler) Inc. for administrative services provided by the Company.

11. ECONOMIC DEPENDENCE

The Company derives 25.1% (2005 – 27.9%) of its transportation revenue from the Vancouver Island Gas Joint Venture and 73.1% (2005 – 70.6%) from BC Hydro. At December 31, 2006, 1.2% (2005 – 1.9%) of accounts receivable was attributable to the Vancouver Island Gas Joint Venture and 4.3% (2005 – 5.0%) was attributable to BC Hydro.

12. COMMITMENTS & CONTINGENCIES

(a) The Company has entered into operating leases for certain building space and natural gas distribution assets. The payments for the next five years are as follows: $3,067 in 2007, $2,951 in 2008, $1,778 in 2009, $929 in 2010, and $940 in 2011. Future commitments payable after 2011 total $792.

(b) In prior years, the Company received non-interest bearing, repayable loans from the Federal and Provincial governments of $50,000 and $25,000 respectively, in connection with the construction and operation of the Vancouver Island natural gas pipeline. The government loans are repayable in any fiscal year after 2002 and prior to 2012 under certain circumstances and subject to the ability of the Company to obtain non-government subordinated debt financing on reasonable commercial terms. 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. In 2006, all of the repayment criteria were met when the Company obtained additional financing through a new credit agreement (Note 4(a)) which resulted in a repayment on the government loans of $6,223. In addition, since the conditions continue to be met (an annual test) the Company is expected to make a repayment on the loans in 2007 of approximately $1,438. As the loans are repaid and replaced with non-governmental loans, 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 note 4 or note 12(a) 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.

13. SUBSEQUENT EVENT

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.

FINANCIAL STATEMENTS OF

TERASEN GAS (SQUAMISH) INC.

YEARS ENDED DECEMBER 31, 2006 AND 2005

PRICEWATERHOUSECOOPERS

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AUDITORS' REPORT

To the Shareholder of Terasen Gas (Squamish) Inc.

We have audited the statement of financial position of Terasen Gas (Squamish) Inc. (the "Company") as at December 31, 2006 and the statement 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 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 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.

PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, British Columbia
March 30, 2007

TERASEN GAS (SQUAMISH) INC.
STATEMENTS OF FINANCIAL POSITION

AS AT DECEMBER 31, 2006 AND 2005
(Expressed in Canadian dollars)

	2006	2005
ASSETS		
Current assets		
Accounts receivable	$ 720,296	$ 658,321
Due from related parties (note 3)	8,031	129,721
Income taxes recoverable	469,917	311,854
Inventories	77,918	156,881
	1,276,162	1,256,777
Property, plant and equipment (note 2)	6,805,518	6,383,353
Deferred charges (note 4)	84,890	-
	$ 8,166,570	$ 7,640,130
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Bank indebtedness	$ 1,996,088	$ 2,489,548
Accounts payable and accrued liabilities (note 7)	2,046,060	874,172
Due to related parties (note 3)	489,763	488,422
	4,531,911	3,852,142
Customer Advances for Construction	655,992	480,575
Future income taxes	245,205	245,205
	5,433,108	4,577,922
Shareholder's equity		
Capital stock		
Authorized and issued		
30,000 6% non-cumulative preferred shares, par value $10 each, redeemable at par	300,000	300,000
125,000 common shares without par value	125,000	125,000
	425,000	425,000
Retained earnings	2,308,462	2,637,208
	2,733,462	3,062,208
	$ 8,166,570	$ 7,640,130

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

Approved by the Board:

____________________ Director

____________________ Director

TERASEN GAS (SQUAMISH) INC.
STATEMENTS OF EARNINGS AND RETAINED EARNINGS

YEARS ENDED DECEMBER 31, 2006 AND 2005
(Expressed in Canadian dollars)

	2006	2005
Revenues		
Sale of gas		
Natural gas	$ 3,854,017	$ 3,720,646
Propane	21,963	32,579
	3,875,980	3,753,225
Cost of gas		
Natural gas	2,954,075	2,820,463
Propane	16,683	30,865
	2,970,758	2,851,328
Gas sales margin	905,222	901,897
Rate stabilization adjustment (note 1(a))	618,612	664,217
Gain on sale of land (note 2)	323,903	-
Other operating revenue	15,764	27,549
	1,863,501	1,593,663
Expenses		
Operations and maintenance	842,922	700,213
Provision for main extension liability (note 7)	1,094,169	655,831
Depreciation and amortization	175,233	180,733
Management fees (note 5)	168,248	167,969
Property and capital taxes	92,678	95,688
Interest expense	117,115	115,459
	2,490,365	1,915,893
Loss before income taxes	(626,864)	(322,230)
Income tax recovery	(298,118)	(86,524)
Net loss	(328,746)	(235,706)
Dividends	-	(510,000)
Retained earnings, beginning of year	2,637,208	3,382,914
Retained earnings, end of year	$ 2,308,462	$ 2,637,208

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

TERASEN GAS (SQUAMISH) INC.
STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2006 AND 2005
(Expressed in Canadian dollars)

	2006	2005
Cash flows provided by (used for)		
Operating activities		
Net loss	$ (328,746)	$ (235,706)
Gain on sale of land	(323,903)	-
Depreciation and amortization	175,233	180,733
	(477,416)	(54,973)
Changes in operating working capital	1,122,453	728,433
	645,037	673,460
Financing activities		
Dividends paid	-	(510,000)
Decrease in advances from and due to parent	-	(2,834,323)
	-	(3,344,323)
Investing Activities		
Customer advances for construction	175,417	420,575
Proceeds on sale of land	336,043	-
Property, plant and equipment	(578,147)	(432,947)
Deferred charges	(84,890)	-
	(151,577)	(12,372)
Net increase (decrease) in cash	493,460	(2,683,235)
(Bank indebtedness) cash at beginning of year	(2,489,548)	193,687
Bank indebtedness at end of year	$ (1,996,088)	$ (2,489,548)
Supplemental cash flow information		
Interest paid in the year	$ 112,082	$ 120,724
Income taxes (received) paid in the year	(184,353)	186,000
Non-cash transactions		
Property, plant and equipment purchases included in accounts payable and accrued liabilities	$ 31,391	$ 25,936
Deferral of Revenue Stabilization Facility accrual	-	(947,421)

Cash is defined as cash or bank indebtedness

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

Terasen Gas (Squamish) Inc. (the Company) is incorporated under the Company Act (British Columbia) and is primarily engaged in the retail distribution of natural gas in British Columbia.

1. SIGNIFICANT ACCOUNTING POLICIES

The preparation of these financial statements in conformity with Canadian generally accepted accounting principles 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 financial statements have been properly prepared within reasonable limits of materiality and reflect the following summary of significant accounting policies.

(a) REGULATION

The Company is subject to the regulation of the British Columbia Utilities Commission ("the BCUC"), an independent regulatory authority. The BCUC exercises statutory authority over such matters as construction and operation of facilities, accounting practices, rates, 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.

Under a Rate Stabilization Agreement between the Company, Terasen Gas (Vancouver Island) Inc. and the Province of British Columbia (the "Province"), the Company is guaranteed a fixed return on its rate base. Under this agreement, any revenue collected in excess of that required to provide the guaranteed return is paid by the Company to the Province and any revenue shortfall is paid to the Company by the Province. Terasen Gas (Vancouver Island) Inc. acts as an intermediary to facilitate payments between the Company and the Province. The Rate Stabilization Agreement was terminated on December 31, 2006. After that time, the operations of the Company will be amalgamated with those of its parent, and will be regulated under the existing agreement between the BCUC and Terasen Gas Inc.

For 2006, the Company's allowed rate of return was 9.3% (2005 – 9.53%). The allowed rate of return is based on a notional debt-equity ratio of 60% debt and 40% equity.

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 the Significant Accounting Policies, Note 4 "Deferred Charges", and Note 7 "Provision for Main Extension Liability".

(b) 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost less accumulated depreciation and unamortized contributions in aid of construction. Cost includes all direct expenditures for system expansions, betterments and replacements.

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.

Depreciation of regulated assets is recorded on a straight-line basis over their useful lives. Depreciation rates for regulated assets are approved by the BCUC.

Assets	Rates
Natural gas and propane distribution systems	2% - 3%
Plant, building and equipment	3% - 15%

(d) 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.

(e) 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 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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 systems are not currently determinable, the Company has not recognized an asset retirement obligation at December 31, 2006 and 2005. For regulated operations there is a reasonable expectation that asset retirement costs would be recoverable through future rates.

(f) DEFERRED CHARGES

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

(g) REVENUE RECOGNITION

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

Revenues from natural gas sales are recorded on the basis of regular meter readings and estimates of customer usage since the last meter reading date to the end of the year.

(h) INCOME TAXES

The Company accounts for and recovers income tax expense in rates as prescribed by the BCUC for ratemaking purposes. This includes accounting for income taxes by the taxes payable method as approved by the BCUC. Therefore, future income taxes related to temporary differences are not recorded. The taxes payable method is followed as there is reasonable expectation that all future income taxes will be recovered in rates when they become payable.

During the period from incorporation until August 6, 1991, future income taxes of $245,205 were recovered in revenues. This amount is set out as future income taxes in the balance sheet and is deducted from rate base for regulatory purposes.

As a result of the Company accounting for income taxes following the taxes payable method, the Company has not recognized net future income tax liabilities amounting to $44,271 as at December 31, 2006 (2005 - $127,762) and has not recognized a future income tax recovery of $83,491 for the year ended December 31, 2006 (2005 – $7,896), all of which were calculated under the asset and liability method.

(Expressed in Canadian dollars)

2. PROPERTY, PLANT AND EQUIPMENT

			2006	2005
	Cost	Accumulated depreciation	Net book Value	Net book value
Natural gas and propane distribution systems	$ 8,161,850	$ 1,587,798	$ 6,574,052	$ 5,998,664
Plant, building and equipment	321,175	275,972	45,203	38,504
Land and land rights	125,347	-	125,347	137,486
Work in progress	60,916	-	60,916	208,699
	$ 8,669,288	$ 1,863,770	$ 6,805,518	$ 6,383,353

In 2006, the Company sold vacant land for proceeds of $336,043 with a net book value of $12,140, resulting in a pre-tax gain of $323,903.

3. AMOUNTS DUE TO/(FROM) RELATED PARTIES

	2006	2005
Due from related parties		
Terasen Gas (Whistler) Inc.	$ 7,046	$ 7,300
Terasen Gas (Vancouver Island) Inc.	-	122,421
Terasen Energy Services	985	-
	$ 8,031	$ 129,721
Due to related parties		
Terasen Gas Inc.	$ 152,013	$ 487,620
Terasen Gas (Vancouver Island) Inc.	336,755	-
Terasen Inc.	995	802
	$ 489,763	$ 488,422

The amount due to the parent company, Terasen Gas Inc., is non-interest bearing.

4. DEFERRED CHARGES

Deferred charges of $84,890 (2005 – nil) consist of after-tax costs incurred related to the amalgamation of the Company with Terasen Gas Inc. and will be recoverable from customers in future periods as approved by the BCUC. In the absence of rate regulation, the deferred charges would have been expensed as operations and maintenance expense.

5. RELATED PARTY TRANSACTIONS

During the year ended December 31, 2006, the Company made gas purchases totalling $3,080,937 (2005 - $3,097,461) from the parent company, Terasen Gas Inc. Management fees in the amount of $159,248 (2005 - $158,969) were charged during the year by Terasen Gas Inc. Management fees in the amount of $9,000 were charged by Terasen Inc. in 2006 (2005 - $9,000).

6. FINANCIAL INSTRUMENTS

The carrying value of cash, accounts receivable, bank indebtedness, and accounts payable and accrued liabilities approximate their fair values due to their short term to maturity. The fair value of amounts due to/(from) related parties have not been determined because it is not practical to do so, given their related party nature.

7. PROVISION FOR MAIN EXTENSION LIABILITY

The Company's recovery of its revenue requirements is facilitated by certain contractual arrangements and Commission directives (see Note 1(a)) including:

- the Rate Stabilization Agreement ("RSA");
- the Rate Stabilization Facility Continuation Agreement;
- Commission Letter L-46-94 outlining the reporting under the terms of the Rate Stabilization Facility Continuation Agreement ("RSFCA");

The Company is liable for variances in performance that result in increased Rate Stabilization Facility funding as a result of capital costs that are higher than forecast, or customer consumption that is less than forecast under the terms of:

- the Company's November 17, 1998 application for approval of the Garibaldi/Brackendale Main Extension ("GBMX"); and
- Ministry of Energy and Mines and Petroleum Resources letter of July 15, 1998 approving the GBMX.
- Commission Letter L-42-98 approving the Brackendale Garabaldi Highlands Main Extension (BGHMX);

In January 2006, the Company received independent legal Council views regarding its liability under the GBMX. Based on this, the Company estimated and recorded the excess draw and amount repayable to the Province at $655,831 at December 31, 2005. The Company made a submission to the BCUC on January 25, 2006 with respect to this, and in subsequent negotiations with the Province regarding the GBMX liability, reached an agreement (the "Squamish Gas Arrangements Termination Agreement") on October 5, 2006 that the total liability under the agreement would be fixed at $1,750,000. This amount has been accrued as at December 31, 2006.

8. SUBSEQUENT EVENT

Effective January 1, 2007, the Company amalgamated its operations with those of its parent company, Terasen Gas Inc.

On February 26, 2007, Kinder Morgan Inc., the parent company of Terasen 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 Inc. 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 is expected to close in mid-2007 subject to the fulfillment of customary closing conditions and required regulatory approvals.