No securities regulatory authority has expressed an opinion about these securities and it is an offence to claim otherwise. This short form prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and thereby only by persons permitted to sell such securities.

Information has been incorporated by reference in this short form prospectus from documents filed with securities commissions or similar authorities in Canada. *Copies of the documents incorporated herein by reference may be obtained on request without charge from the Secretary of the Corporation at Suite 1201, 139 Water Street, St. John's, Newfoundland and Labrador A1B 3T2 (telephone (709) 737-2800) and are also available electronically at www.sedar.com. For the purpose of the Province of Québec, this simplified prospectus contains information to be completed by consulting the permanent information record. A copy of the permanent information record may be obtained without charge from the Secretary of the Corporation at the above-mentioned address and telephone number and is also available electronically at www.sedar.com. The securities being offered under this short form prospectus have not been and will not be registered under the United States Securities Act of 1933, as amended, or any state securities laws, and, except in limited circumstances, will not be offered or sold within the United States or for the account or benefit of United States persons. See ''Plan of Distribution''.*

New Issue **March 7, 2007**

SHORT FORM PROSPECTUS

FORTIS INC.

FORTIS

$1,001,000,000
38,500,000 Subscription Receipts, each representing the right to receive one Common Share

Fortis Inc. (''Fortis'' or the ''Corporation'') is hereby qualifying for distribution (the ''Offering'') 38,500,000 subscription receipts (the ''Subscription Receipts''), each of which will entitle the holder thereof to receive, upon satisfaction of the Release Conditions (as defined below), and without payment of additional consideration, one common share of Fortis (a ''Common Share''). The gross proceeds from the sale of the Subscription Receipts (the ''Escrowed Funds'') will be held by Computershare Trust Company of Canada, as escrow agent (the ''Escrow Agent'') and invested in short-term interest bearing or discount debt obligations issued or guaranteed by the Government of Canada or a province, or one or more of the five largest Canadian chartered banks, provided that in all cases such obligation is rated at least R1 (middle) by DBRS Limited or an equivalent rating from an equivalent rating service, pending receipt by the Corporation of all regulatory and government approvals required to finalize the acquisition (the ''Acquisition'') by the Corporation of all of the issued and outstanding shares of Terasen Inc. (''Terasen''), a wholly owned subsidiary of Kinder Morgan, Inc., including that of the British Columbia Utilities Commission, and fulfillment or waiver of all other outstanding conditions precedent to closing the Acquisition as itemized in the Acquisition Agreement (as defined below) (collectively, the ''Release Conditions''). At the time of the Acquisition, Terasen will have divested itself of its petroleum transportation operations and will only hold its natural gas distribution business and an interest in CustomerWorks Limited Partnership. See ''The Acquisition'', ''The Acquired Business'' and ''Details of the Offering''.

If the Release Conditions are satisfied prior to 5:00 p.m. (Toronto time) on November 30, 2007, the Corporation will forthwith execute and deliver a notice of satisfaction and will issue and deliver to the Escrow Agent one Common Share for each Subscription Receipt then outstanding (subject to any applicable adjustment). The Common Shares will be available for delivery commencing on the second business day after the delivery of such notice. The holders of Subscription Receipts will receive, without payment of any additional consideration, one Common Share for each Subscription Receipt held plus an amount equal to the dividends declared on the Common Shares by the Corporation, if any, for which record dates have occurred during the period from the Closing Date (as defined below) to the date of issuance of the Common Shares in respect of the Subscription Receipts. Forthwith upon the Release Conditions being satisfied and the required notice being delivered to the Escrow Agent, the Escrowed Funds, together with interest earned and income generated thereon, will be released to Fortis. In the event that the Release Conditions are not satisfied prior to 5:00 p.m. (Toronto time) on November 30, 2007, or if the Acquisition Agreement is terminated prior to such time (in either case, the ''Termination Time''), holders of Subscription Receipts shall, commencing on the second business day following the Termination Time, be entitled to receive from the Escrow Agent an amount equal to the full subscription price thereof plus their *pro rata* share of the interest earned or income generated on such amount. See ''Details of the Offering''.

Price: $26.00 per Subscription Receipt

	Price to the Public	Underwriters' Fee (1)	Net Proceeds to the Corporation (2)
Per Subscription Receipt	$26.00	$1.04	$24.96
Total (3)	$1,001,000,000	$40,040,000	$960,960,000

(1) One-half of the Underwriters' fee is payable at the closing of the Offering. The other half of the Underwriters' fee is payable only if the Release Conditions have been satisfied prior to the Termination Time and the required notice has been delivered to the Escrow Agent. See ''Plan of Distribution''.

(2) Net proceeds to the Corporation exclude any interest earned and income generated on the Escrowed Funds and are calculated before deducting the expenses of the Offering, estimated at $1,250,000, which, together with the Underwriters' fee, will be paid out of the general funds of Fortis. See ''Plan of Distribution''.

(3) The Corporation has granted to the Underwriters an option (the ''Over-Allotment Option''), exercisable in whole or in part at any time until 30 days following the date of closing of the Offering, to purchase at the Offering Price up to 5,775,000 additional Subscription Receipts to cover over-allotments, if any. If the Over-Allotment Option is exercised in full, the total Price to the Public, Underwriters' Fee and Net Proceeds to the Corporation will be $1,151,150,000, $46,046,000 and $1,105,104,000, respectively. See ''Plan of Distribution''. This prospectus also qualifies the grant of the Over-Allotment Option and the distribution of the securities issuable on the exercise of the Over-Allotment Option.

Underwriters' Position	Maximum Size	Exercise Period	Exercise Price
Over-Allotment Option	5,775,000 Subscription Receipts	Within 30 days following the closing of the Offering	$26.00 per Subscription Receipt

There is currently no market through which the Subscription Receipts may be sold and purchasers may not be able to resell securities purchased under this short form prospectus (the ''Prospectus''). This may affect the pricing of the securities in the secondary market, the transparency and availability of trading prices, the liquidity of the securities, and the extent of issuer regulation. See ''Risk Factors''.

The Toronto Stock Exchange (the ''TSX'') has conditionally approved the listing of the Subscription Receipts, as well as the Common Shares issuable on the exchange of the Subscription Receipts. Listing is subject to the Corporation fulfilling all of the requirements of the TSX on or before June 3, 2007. The Corporation's outstanding Common Shares are listed on the TSX under the symbol ''FTS''. On March 6, 2007, the closing price of the Common Shares on the TSX was $26.80. The Subscription Receipts will be issued and sold by Fortis to the Underwriters (as defined below) at the price of $26.00 (the ''Offering Price'') per Subscription Receipt. The Offering Price and other terms of the Offering were determined by negotiation between the Corporation and the Underwriters.

An investment in the Subscription Receipts, and the Common Shares issuable upon the exchange thereof, involves certain risks that should be considered by a prospective purchaser. See ''Risk Factors''.

CIBC World Markets Inc. (''CIBCWM''), Scotia Capital Inc. (''Scotia Capital''), TD Securities Inc. (''TD Securities''), BMO Nesbitt Burns Inc. (''BMO Nesbitt Burns''), RBC Dominion Securities Inc. (''RBCDS''), National Bank Financial Inc. (''NB Financial''), Canaccord Capital Corporation, Beacon Securities Limited and HSBC Securities (Canada) Inc. (''HSBC Securities'') are acting as underwriters (collectively, the ''Underwriters'') of the Offering. The Underwriters, as principals, conditionally offer the Subscription Receipts, subject to prior sale, if, as and when issued, sold and delivered by the Corporation to, and accepted by, the Underwriters in accordance with the terms and conditions contained in the Underwriting Agreement referred to under ''Plan of Distribution'' and subject to the approval of certain legal matters on behalf of the Corporation by Davies Ward Phillips & Vineberg LLP, Toronto and McInnes Cooper, St. John's and on behalf of the Underwriters by Stikeman Elliott LLP, Toronto. Subject to applicable laws, the Underwriters may, in connection with the Offering, effect transactions which stabilize or maintain the market price of the Subscription Receipts or the Common Shares at levels other than those which may prevail on the open market. Such transactions, if commenced, may be discontinued at any time. See ''Plan of Distribution''.

CIBCWM is an affiliate of a Canadian chartered bank that has agreed to extend credit facilities to the Corporation in connection with financing the Acquisition. CIBCWM is also acting as financial advisor to Fortis in connection with the Acquisition and receiving a fee therefor. In addition, each of CIBCWM, Scotia Capital, TD Securities, BMO Nesbitt Burns, RBCDS, NB Financial and HSBC Securities is a subsidiary of a Canadian chartered bank that has, either solely or as a member of a syndicate of financial institutions, extended credit facilities to the Corporation and/or its subsidiaries. Consequently, the Corporation may be considered a ''connected issuer'' of these Underwriters within the meaning of applicable securities legislation. See ''Plan of Distribution''.

Subscriptions for the Subscription Receipts will be received subject to rejection or allotment in whole or in part and the right is reserved to close the subscription books at any time without notice. It is expected that the closing of the Offering will take place on or about March 15, 2007 (the ''Closing Date''), or such other date as may be agreed upon by the Corporation and the Underwriters, but not later than April 18, 2007. A book entry only certificate representing the Subscription Receipts distributed hereunder will be issued in registered form only to CDS Clearing and Depository Services Inc. (''CDS'') or its nominee and will be deposited with CDS on the Closing Date. The Corporation understands that a purchaser of Subscription Receipts will receive only a customer confirmation from the registered dealer who is a CDS participant from or through whom the Subscription Receipts are purchased. See ''Details of the Offering''.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

DOCUMENTS INCORPORATED BY REFERENCE

The disclosure documents of the Corporation listed below and filed with the appropriate securities commissions or similar regulatory authorities in each of the provinces of Canada are specifically incorporated by reference into and form an integral part of this Prospectus:

(a) annual information form dated March 29, 2006 for the year ended December 31, 2005;

(b) audited comparative consolidated financial statements as at December 31, 2005 and for the years ended December 31, 2005 and 2004, together with the notes thereto and the auditors' report thereon dated January 27, 2006 as contained in the Corporation's 2005 Annual Report;

(c) Management Discussion and Analysis of financial condition and results of operations for the year ended December 31, 2005 as contained in the Corporation's 2005 Annual Report;

(d) unaudited comparative interim consolidated financial statements as at September 30, 2006 and for the three- and nine-month periods ended September 30, 2006 and 2005, together with the notes thereto;

(e) Management Discussion and Analysis of financial condition and results of operations for the three- and nine-month periods ended September 30, 2006;

(f) Management Information Circular dated March 17, 2006 prepared in connection with the Corporation's annual meeting of shareholders held on May 2, 2006;

(g) material change report dated September 15, 2006 describing the entering into of an agreement between the Corporation and a syndicate of underwriters led by BMO Nesbitt Burns Inc. for the public offering by the Corporation of 5,000,000 4.90% cumulative redeemable First Preference Shares, Series F;

(h) material change report dated January 5, 2007 describing the entering into of an agreement between the Corporation and Scotia Capital Inc. and CIBCWM for the public offering by the Corporation of 5,170,000 Common Shares;

(i) press release dated February 8, 2007 with respect to the Corporation's unaudited comparative interim consolidated financial statements as at December 31, 2006 and for the three- and twelve-month periods ended December 31, 2006 and 2005, together with the notes thereto, and with respect to the related Management Discussion and Analysis of financial condition and results of operations for the three- and twelve-month periods ended December 31, 2006; and

(j) material change report dated February 28, 2007 describing the entering into of (i) an agreement pursuant to which the Corporation will acquire all of the outstanding shares of Terasen for a purchase price of $3.7 billion, including the assumption of approximately $2.3 billion of debt, and (ii) an agreement between the Corporation, CIBCWM, Scotia Capital and TD Securities for the public offering by the Corporation of 38,500,000 subscription receipts and up to an additional 5,775,000 subscription receipts pursuant to an over-allotment option.

Any document of the type referred to in the preceding paragraph (other than any confidential material change report) subsequently filed by the Corporation with such securities commissions or regulatory authorities after the date of the Prospectus, and prior to the termination of the Offering, shall be deemed to be incorporated by reference into the Prospectus.

Any statement contained in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this Prospectus to the extent that a statement contained herein, or in any other subsequently filed document which also is incorporated or is deemed to be incorporated by reference herein, modifies or supersedes such statement. The modifying or superseding statement need not state that it has modified or superseded a prior statement or include any other information set forth in the document that it modifies or supersedes. The making of a modifying or superseding statement will not be deemed an admission for any purpose that the modified or superseded statement, when made, constituted a misrepresentation, an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.

Copies of the documents incorporated herein by reference may be obtained on request without charge from the Secretary of the Corporation at Suite 1201, 139 Water Street, St. John's, Newfoundland and Labrador A1B 3T2 (telephone (709) 737-2800). These documents are also available through the Internet on the Corporation's website at www.fortisinc.com or on the Canadian System for Electronic Document Analysis and Retrieval (''SEDAR'') which can be accessed at www.sedar.com. Reference is also made to information regarding Terasen Inc. (''Terasen'') which is available through the internet at Terasen's website at www.terasen.com. The information contained on, or accessible through, any of these websites is not incorporated by reference into the Prospectus and is not, and should not be considered to be, a part of the Prospectus, unless it is explicitly so incorporated.

ELIGIBILITY FOR INVESTMENT

In the opinion of Davies Ward Phillips & Vineberg LLP, counsel to the Corporation, and Stikeman Elliott LLP, counsel to the Underwriters, the Subscription Receipts and the Common Shares issuable on the exchange of the Subscription Receipts, if issued on the date hereof, would be qualified investments under the *Income Tax Act* (Canada) (the ''Tax Act'') for a trust governed by a registered retirement savings plan, registered retirement income fund, deferred profit sharing plan or registered education savings plan provided that, in the case of the Subscription Receipts, the Corporation deals at arm's length (within the meaning of the Tax Act) with each person who is an annuitant, beneficiary, employer or subscriber under the governing plan of such trust.

DEFINED TERMS

For an explanation of certain terms and abbreviations used in the Prospectus, reference is made to the ''Glossary of Terms''.

SUMMARY

The following information is a summary only and is to be read in conjunction with, and is qualified in its entirety by, the more detailed information appearing elsewhere in the Prospectus and in the documents incorporated by reference herein.

The Offering

Issuer:	Fortis Inc. (''Fortis'' or the ''Corporation'').
Offering:	38,500,000 subscription receipts (the ''Subscription Receipts''), each representing the right to receive one common share of Fortis (a ''Common Share'').
Amount:	$1,001,000,000 ($1,151,150,000 if the Over-Allotment Option is exercised in full).
Over-Allotment Option:	The Corporation has granted to the Underwriters (as defined below) an option (the ''Over-Allotment Option''), exercisable in whole or in part at any time until 30 days following the date of closing of this offering (the ''Offering''), to purchase at the Offering Price up to 5,775,000 additional Subscription Receipts to cover over-allotments, if any. See ''Plan of Distribution''.
Price:	$26.00 per Subscription Receipt.
Date of Closing:	On or about March 15, 2007 or such date as agreed to by the Corporation and the Underwriters, but not later than April 18, 2007 (the ''Closing Date'').
Escrow of Proceeds:	The gross proceeds from the sale of the Subscription Receipts (the ''Escrowed Funds'') will be held by Computershare Trust Company of Canada, as escrow agent (the ''Escrow Agent'') and invested in short-term interest bearing or discount debt obligations issued or guaranteed by the Government of Canada or a province, or one or more of the five largest Canadian chartered banks, provided that in all cases such obligation is rated at least R1 (middle) by DBRS Limited or an equivalent rating from an equivalent rating service, pending receipt by the Corporation of all regulatory and government approvals required to finalize the acquisition (the ''Acquisition'') by the Corporation of all of the issued and outstanding shares of Terasen Inc. (''Terasen''), a wholly owned subsidiary of Kinder Morgan, Inc. (''Kinder Morgan''), including that of the British Columbia Utilities Commission (the ''BCUC''), and fulfillment or waiver of all other outstanding conditions precedent to closing the Acquisition as itemized in the Acquisition Agreement (as defined below) (collectively, the ''Release Conditions''). If the Release Conditions are satisfied prior to 5:00 p.m. (Toronto time) on November 30, 2007, the Corporation will forthwith execute and deliver a notice of satisfaction and will issue and deliver to the Escrow Agent one Common Share for each Subscription Receipt then outstanding (subject to any applicable adjustment). The Common Shares will be available for delivery commencing on the second business day after the delivery of such notice. The holders of Subscription Receipts will receive, without payment of any additional consideration, one Common

	Share for each Subscription Receipt held plus an amount equal to the dividends declared on the Common Shares by the Corporation, if any, for which record dates have occurred during the period from the Closing Date (as defined below) to the date of issuance of the Common Shares in respect of the Subscription Receipts. Forthwith upon the Release Conditions being satisfied and the required notice being delivered to the Escrow Agent, the Escrowed Funds, together with interest earned and income generated thereon, will be released to Fortis. In the event that the Release Conditions are not satisfied prior to 5:00 p.m. (Toronto time) on November 30, 2007, or if the Acquisition Agreement is terminated prior to such time (in either case, the ''Termination Time''), holders of Subscription Receipts shall, commencing on the second business day following the Termination Time, be entitled to receive from the Escrow Agent an amount equal to the full subscription price thereof plus their *pro rata* share of the interest earned or income generated on such amount. See ''Details of the Offering''.
Use of Proceeds:	The proceeds of the Offering, after deducting the fee payable to CIBC World Markets Inc. (''CIBCWM''), Scotia Capital Inc. (''Scotia Capital''), TD Securities Inc. (''TD Securities''), BMO Nesbitt Burns Inc. (''BMO Nesbitt Burns''), RBC Dominion Securities Inc. (''RBCDS''), National Bank Financial Inc. (''NB Financial''), Canaccord Capital Corporation, Beacon Securities Limited and HSBC Securities (Canada) Inc. (''HSBC Securities'') (collectively, the ''Underwriters'') and expenses of the Offering, which are estimated to be $1,250,000, and assuming no exercise of the Over-Allotment Option, together with funds to be advanced under acquisition financing arranged by the Corporation, will be used to finance the cash portion of the consideration payable for the Acquisition. If the Over-Allotment Option is exercised in full, the estimated proceeds of the Offering will be $1,103,854,000 (after deducting the fee payable to the Underwriters and expenses of the Offering). The gross proceeds from the sale of the Subscription Receipts will be held in escrow pending the satisfaction of the Release Conditions, which is expected to occur in mid-2007. See ''Financing of the Acquisition'', ''Details of the Offering'' and ''Use of Proceeds''.
Subscription Receipts:	Each Subscription Receipt entitles the holder thereof to receive, without payment of additional consideration and upon satisfaction of the Release Conditions, one Common Share, plus an amount equal to the dividends declared on the Common Shares by the Corporation, if any, for which record dates have occurred during the period from the Closing Date to the date of issuance of the Common Shares in respect of the Subscription Receipts. If the Release Conditions are not met prior to the Termination Time, the Corporation will repay to holders of Subscription Receipts an amount equal to the full subscription price thereof plus their *pro rata* share of the interest earned or income generated on such amount. See ''Details of the Offering''.
Risk Factors:	An investment in the Subscription Receipts and the Common Shares issuable upon exchange thereof involves certain risks which should be carefully considered by prospective investors, including: regulation, forecasting accuracy, asset maintenance, operational risks, weather and other natural disasters, the supply and prices of natural gas, seasonality, risks relating to Terasen Gas (Vancouver Island) Inc., obtaining and maintaining government permits, impact of changes in economic

conditions, availability of capital resources and credit ratings, exposure to interest rate changes, counterparty credit risk, potential undisclosed liabilities associated with the Acquisition, ability to maintain satisfactory labour relations, matters relating to insurance, environmental matters, First Nations' Lands, results of operations and financing risks, management of expanding operations, the ability to realize benefits from the Acquisition, the Subscription Receipt structure and the lack of an existing market for the Subscription Receipts. See ''Risk Factors''.

The Acquisition

Overview

On February 26, 2007, Fortis entered into an agreement (the ''Acquisition Agreement'') with 3211953 Nova Scotia Company and Kinder Morgan for the purchase of all of the issued and outstanding shares of Terasen for aggregate consideration of $3.7 billion, including the assumption of approximately $2.3 billion of consolidated indebtedness of Terasen. Terasen is a holding company headquartered in Vancouver, British Columbia, operating two principal lines of business: natural gas distribution and petroleum transportation. Prior to the closing of the Acquisition, Kinder Morgan will cause Terasen to divest itself of its petroleum transportation operations, leaving only the natural gas distribution business operated by Terasen Gas (as defined below). As part of such divestiture, on March 5, 2007, Kinder Morgan announced that it had agreed to sell the Corridor pipeline system, which is owned by Terasen and serves the Athabasca oil sands, to Inter Pipeline Fund.

The closing of the Acquisition is subject to receipt of required regulatory and other approvals, including that of the BCUC, and the satisfaction of certain closing conditions. The closing of the Acquisition is expected to occur in mid-2007. See ''Acquisition Agreement''.

Based on financial information as at September 30, 2006, following the Acquisition, Fortis' total assets will increase by approximately 94% to $8.9 billion. Following the Acquisition, Fortis' regulated rate base assets will increase to approximately $6.0 billion, of which approximately 93% will be located in Canada.

Kinder Morgan

Kinder Morgan is one of the largest energy transportation, storage and distribution companies in North America. It owns an interest in or operates approximately 65,000 kilometers of pipelines that transport primarily natural gas, crude oil, petroleum products and carbon dioxide, and serves more than 1.1 million natural gas distribution customers in British Columbia, Colorado, Nebraska and Wyoming. Kinder Morgan owns the general partner interest of Kinder Morgan Energy Partners, L.P., one of the largest publicly traded pipeline limited partnerships in the United States.

On November 30, 2005, Kinder Morgan completed the acquisition of Terasen (formerly, BC Gas Inc.). On May 19, 2006, Terasen completed the disposition of its water, wastewater and utility services business carried on by Terasen Water and Utility Services Inc. to a consortium led by CAI Capital Management Co.

On August 14, 2006, Kinder Morgan announced that it was selling its natural gas retail distribution operations serving customers in Colorado, Nebraska, Wyoming and Hermosillo, Mexico, to GE Energy Financial Services. On December 19, 2006, management of Kinder Morgan received shareholder approval of a US$22 billion leveraged management buyout offer led by Richard Kinder, Chairman and Chief Executive Officer, Kinder Morgan. The completion of this buyout is pending.

Terasen Gas

The natural gas distribution business of Terasen is carried on by Terasen Gas Inc. (''TGI''), Terasen Gas (Vancouver Island) Inc. (''TGVI'') and Terasen Gas (Whistler) Inc. (''TGWI''). Terasen also owns a 30% interest in

CustomerWorks Limited Partnership (''CWP''). CWP is a non-regulated shared services business in partnership with Enbridge Inc. that provides customer service contact, meter reading, billing, support and credit and collection services primarily to Terasen Gas (as defined below) and Enbridge Gas Distribution Inc. CWP outsources these services to a company owned and operated by Accenture Inc. In this Prospectus, TGI, TGVI, TGWI and CWP are collectively referred to as ''Terasen Gas''.

Terasen Gas is the principal gas distribution utility in British Columbia, serving the populous lower mainland, Vancouver Island and the southern interior of the province. With approximately 900,000 customers in 125 communities, Terasen Gas provides service to over 95% of the gas customers in British Columbia. Terasen Gas owns and operates approximately 44,100 kilometers of natural gas distribution pipelines and approximately 4,300 kilometers of natural gas transmission pipelines. As of September 30, 2006, Terasen Gas had an aggregate of $3.6 billion of assets, an aggregate rate base of almost $3.0 billion and approximately 1,200 employees.

Acquisition Rationale

The business operated by Terasen Gas is attractive to Fortis for the following reasons: (i) Terasen Gas will significantly increase the earnings of Fortis from regulated utilities and be immediately accretive to earnings per share; (ii) the regulated gas distribution business of Terasen Gas complements the regulated electric distribution business of Fortis; and (iii) the service territory of Terasen Gas is experiencing strong economic growth and includes substantially all of the service territory of FortisBC Inc.

Fortis believes that the principal benefits of the Acquisition are as follows:

(a) the purchase price represents approximately 1.2 times the approved rate base of Terasen Gas for 2007 and the Acquisition is expected to be immediately accretive to earnings per share;

(b) the Acquisition will increase the regulated rate base assets and utility earnings of Fortis. Similar to the electric distribution utilities of Fortis, Terasen Gas operates under principally cost-of-service regulation under which an appropriate return on capital is recovered in addition to prudently incurred operating and commodity costs;

(c) Terasen Gas has an attractive gas distribution franchise with a well-diversified, mature, principally residential, customer base. The Acquisition is expected to improve the risk profile of Fortis by providing it with a more economically diverse portfolio of assets;

(d) following the Acquisition, Fortis will be the largest investor-owned utility in gas and electric distribution in Canada with regulated electricity distribution utilities in five Canadian provinces and three Caribbean countries and regulated gas distribution utilities in British Columbia. Following the Acquisition, a large proportion of the business of Fortis will serve the high-growth economies of western Canada; and

(e) Fortis believes the regulated gas distribution business of Terasen Gas is complementary to the Corporation's proven core competencies in managing regulated electric distribution utilities. The Acquisition affords Fortis management an opportunity to deploy its regulatory, operating and financial management expertise to additional Canadian regulated utilities.

See ''Risk Factors — Realization of Acquisition Benefits'' and ''Special Note Regarding Forward-Looking Statements''.

Utility Management Approach of Fortis

Fortis' approach to utility management is based on creating value for customers that ultimately translates into long-term value for shareholders. Fortis structures its operations as separate operating companies in each jurisdiction. Focused local management teams have the benefit of access to utility management experience and expertise of Fortis. The senior management team of Terasen Gas, which Fortis expects to retain, will add valuable operational expertise in natural gas distribution to existing expertise in the electric distribution operations of Fortis. This approach allows local managers to build relationships with, and be responsive to, both customers and regulators. Fortis recognizes that regulation is a key aspect of its core business and has developed a disciplined, cost-conscious asset investment and operating philosophy which is responsive to regulation.

The management of Fortis has substantial experience in integrating newly acquired enterprises into the Fortis Group. In 2004, Fortis acquired all of the issued and outstanding shares of FortisBC Inc. (formerly, Aquila Networks Canada (British Columbia) Ltd.) and FortisAlberta Inc. (formerly, Aquila Networks Canada (Alberta) Ltd.), and has successfully integrated these utilities into the Fortis Group.

FORTIS

Fortis Inc. (''Fortis'' or the ''Corporation'') was incorporated as 81800 Canada Ltd. under the *Canada Business Corporations Act* on June 28, 1977. The Corporation was continued under the *Corporations Act* (Newfoundland) on August 28, 1987 and on October 12, 1987 the Corporation amended its articles to change its name to ''Fortis Inc.'' The address of the head office and principal place of business of the Corporation is The Fortis Building, Suite 1201, 139 Water Street, St. John's, Newfoundland and Labrador A1B 3T2.

Fortis is principally a diversified, international electric utility holding company that owns subsidiaries engaged in the regulated distribution of electricity. Regulated utility assets comprise approximately 86% of the Corporation's total assets, with the balance comprised primarily of non-regulated electricity generating assets, and commercial real estate and hotel investments owned and operated through its non-utility subsidiary. Fortis is the indirect owner of all of the common shares of FortisAlberta Inc. (''FortisAlberta'') (formerly, Aquila Networks Canada (Alberta) Ltd.) and FortisBC Inc. (''FortisBC'') (formerly, Aquila Networks Canada (British Columbia) Ltd.). FortisAlberta is a regulated electric utility that distributes electricity generated by other market participants in Alberta. FortisBC is a regulated electric utility that generates, transmits and distributes electricity in British Columbia. Fortis also holds all the common shares of Newfoundland Power Inc. (''Newfoundland Power'') and, through its wholly owned subsidiary Fortis Properties Corporation (''Fortis Properties''), holds all the common shares of Maritime Electric Company, Limited (''Maritime Electric''), which are the principal distributors of electricity in Newfoundland and on Prince Edward Island, respectively. As well, through its wholly owned subsidiary FortisOntario Inc. (''FortisOntario'') and its subsidiaries, Canadian Niagara Power Inc. (''CNPI'') and Cornwall Street Railway, Light and Power Company, Limited (''Cornwall Electric''), Fortis distributes electricity to customers primarily in Fort Erie, Port Colborne, Gananoque and Cornwall, Ontario.

The Corporation's regulated electric utility assets in the Caribbean consist of its ownership, through wholly owned subsidiaries, of a 70.1% interest in Belize Electricity Limited (''Belize Electricity''), the primary distributor of electricity in Belize, Central America, and an approximate 54% interest in Caribbean Utilities Company, Ltd. (''Caribbean Utilities''), the sole provider of electricity to the island of Grand Cayman, Cayman Islands. On August 28, 2006, Fortis acquired, through a wholly owned subsidiary, all of the outstanding shares of P.P.C. Limited (''PPC'') and Atlantic Equipment & Power (Turks and Caicos) Ltd. (''Atlantic''), (collectively, ''Fortis Turks and Caicos''), which together generate and distribute electricity to approximately 80% of electricity customers in the Turks and Caicos Islands.

The Corporation's non-regulated electricity generation operations consist of its 100% interest in each of Belize Electric Company Limited (''BECOL''), FortisUS Energy Corporation (''FortisUS Energy''), and FortisOntario, as well as non-regulated electricity generation assets owned by FortisBC and Fortis Properties.

Fortis Properties is the direct owner of a 51% interest in the Exploits River Hydro Partnership (the ''Exploits Partnership''). The Exploits Partnership was established with Abitibi-Consolidated Company of Canada (''Abitibi-Consolidated''), which holds the remaining 49% interest, to develop additional capacity at Abitibi-Consolidated's hydroelectric plant at Grand Falls-Windsor and redevelop the forestry company's hydroelectric plant at Bishop's Falls, both in Newfoundland and Labrador. Fortis Properties' assets also include six small hydroelectric generating stations in eastern Ontario with a combined capacity of 8 megawatts (''MW'').

BECOL owns and operates both the 25-MW Mollejon and 7-MW Chalillo hydroelectric facilities, both of which are located on the Macal River in Belize. Through FortisUS Energy, a wholly owned subsidiary of Fortis Properties, the Corporation owns and operates four hydroelectric generating stations in upper New York State with a total combined capacity of approximately 23 MW. FortisOntario includes 75 MW of water right entitlement associated with the Rankine Generating Station at Niagara Falls and the operation of a 5-MW gas-fired cogeneration plant that provides district heating to 17 commercial customers in Cornwall. The Rankine Generating Station assets have been written down following the lay-up of the Station as a result of the implementation of a water and power exchange agreement (the ''Niagara Exchange Agreement'') with Ontario Power Generation Inc. (''OPGI''). The Niagara Exchange Agreement assigns FortisOntario's water rights on the Niagara River to OPGI and facilitates the irrevocable exchange of 75 MW of wholesale electric power supply to FortisOntario from OPGI until April 30, 2009 in exchange for FortisOntario's agreement not to seek renewal of the water entitlement at that time. The non-regulated electricity generation operations of FortisBC consist of the 16-MW run-of-river Walden hydroelectric power plant near Lillooet, British Columbia.

Through its wholly owned subsidiary, Fortis Properties, the Corporation owns and operates hotels in seven provinces in Canada and commercial real estate in Atlantic Canada. Its holdings include 18 hotels with more than 3,200 rooms and approximately 2.7 million square feet of commercial real estate.

Regulated Utilities — Canadian

FortisAlberta

On May 31, 2004, Fortis, through an indirect wholly owned subsidiary, acquired all of the issued and outstanding shares of FortisAlberta. FortisAlberta distributes electricity to approximately 430,000 customers using approximately 104,000 kilometers of power lines and met a peak demand of 2,584 MW in 2006. FortisAlberta's business is the ownership and operation of regulated electricity distribution facilities that distribute electricity generated by other market participants from high-voltage transmission substations to end-use customers in southern and central Alberta. FortisAlberta is not involved in the generation, transmission or direct sale of electricity.

FortisBC

On May 31, 2004, Fortis, through an indirect wholly owned subsidiary, acquired all of the issued and outstanding shares of FortisBC. FortisBC is an integrated regulated electric utility that owns a network of generation, transmission and distribution assets located in the southern interior of British Columbia. FortisBC serves a diverse mix of more than 152,000 customers, with residential customers representing the largest customer segment, and met a peak demand of 718 MW in 2006. FortisBC owns four regulated hydroelectric generating plants with an aggregate capacity of 235 MW that provide approximately 45% of the Corporation's energy and 30% of its capacity needs. FortisBC's remaining electricity supply is acquired through long-term power purchase contracts and short-term market purchases. FortisBC includes non-regulated operating, maintenance and management services relating to the 450-MW Waneta hydroelectric generation facility owned by Teck Cominco Metals Ltd., the 149-MW Brilliant Hydroelectric Plant and the 185-MW Arrow Lakes Hydroelectric Plant owned by Columbia Power Corporation and Columbia Basin Trust, respectively, and the distribution system owned by the City of Kelowna.

FortisBC's assets include the electric utility formerly owned by Princeton Light and Power Company, Limited (the ''PLP Utility''). The PLP Utility serves approximately 3,500 customers, mainly in Princeton, British Columbia. The PLP Utility was purchased by Fortis through an indirect subsidiary on May 31, 2005 and became part of FortisBC on December 31, 2006 as the result of an internal corporate reorganization.

Newfoundland Power

Fortis holds all of the common shares of Newfoundland Power. Newfoundland Power is an electric utility that operates an integrated generation, transmission and distribution system throughout the island portion of the Province of Newfoundland and Labrador. Newfoundland Power serves approximately 230,000 customers, or approximately 85% of electricity customers in the Province, and met a peak demand of 1,166 MW in 2006. Approximately 90% of the electricity that Newfoundland Power sells to its customers is purchased from Newfoundland and Labrador Hydro Corporation (''Newfoundland Hydro''). Currently, Newfoundland Power has an installed generating capacity of 136 MW, of which 92 MW is hydroelectric generation.

Maritime Electric

Through its subsidiary, Fortis Properties, Fortis owns all of the common shares of Maritime Electric, which is the principal distributor of electricity on Prince Edward Island. Maritime Electric directly supplies approximately 71,000 customers, or approximately 90% of the electricity consumers on the Island, and met a peak demand of 216 MW in 2006. Maritime Electric purchases most of the energy it distributes to its customers from New Brunswick Power Corporation and maintains on-Island generating facilities at Charlottetown and Borden-Carleton with a combined capacity of 150 MW.

FortisOntario

The Corporation's regulated utility investments in Ontario are comprised of CNPI, including the operations of Port Colborne Hydro, and Cornwall Electric, all of which are owned through FortisOntario. In total, FortisOntario's distribution operations serve approximately 52,000 customers in the Fort Erie, Port Colborne, Cornwall and Gananoque areas of Ontario and met a combined peak demand of 233 MW in 2006. CNPI owns international transmission facilities at Fort Erie as well as a 10% interest in each of Westario Power Holdings Inc. and Rideau St. Lawrence Holdings Inc., two regional electric distribution companies formed in 2000 that, together, serve more than 27,000 customers.

Regulated Utilities — Caribbean

Belize Electricity

Fortis, through wholly owned subsidiaries, holds a 70.1% interest in Belize Electricity. Belize Electricity is the primary distributor of electricity in the Central American country of Belize. Belize Electricity directly supplies approximately 71,000 customers in Belize and met a peak demand of 67 MW in 2006.

Caribbean Utilities

Fortis, through a wholly owned subsidiary, holds an approximate 54% interest in Caribbean Utilities, the only public electric utility on Grand Cayman, Cayman Islands. Caribbean Utilities has the exclusive right to generate, distribute, transmit and supply electricity to the island of Grand Cayman, Cayman Islands, pursuant to a 25-year licence. The current licence remains in effect until January 2011 or until replaced by a new licence by the mutual consent of Caribbean Utilities and the Government of the Cayman Islands. Negotiations regarding the renewal of the licence are ongoing. Caribbean Utilities currently serves more than 22,000 customers, owns 120 MW of installed generating capacity, and met a peak demand of 87 MW in 2006.

The Class A Ordinary Shares of Caribbean Utilities are listed for trading on the Toronto Stock Exchange (the ''TSX'') under the symbol CUP.U. The Corporation's investment in Caribbean Utilities resulted from a series of transactions from March 2000 through November 2006, as a result of which Fortis beneficially owns 13,565,511, or approximately 54%, of the outstanding Class A Ordinary Shares. See ''Recent Developments''.

Fortis Turks and Caicos

The Corporation owns, through a wholly owned subsidiary, all of the outstanding shares of Fortis Turks and Caicos which serves approximately 7,700 customers, or approximately 80% of electricity customers, in the Turks and Caicos Islands. Fortis Turks and Caicos is the principal distributor of electricity in Providenciales, North Caicos and Middle Caicos pursuant to a 50-year licence that expires in 2037 and is the principal distributor of electricity in South Caicos pursuant to a 50-year licence that expires in 2036. Fortis Turks and Caicos has installed generating capacity of approximately 35 MW and met a peak demand of 25 MW in 2006.

Fortis Turks and Caicos is regulated under a traditional rate of return on rate base approach, with a fixed rate of return of 17.5% on a defined asset base of approximately US$50 million.

Non-Regulated — Fortis Generation

Ontario

Non-regulated generation assets in Ontario include the operations of FortisOntario and Fortis Properties. Fortis Properties' operations in Ontario consist of six small hydroelectric generating stations with a combined capacity of approximately 8 MW. FortisOntario's assets include 75 MW of water entitlement associated with the Rankine Generating Station at Niagara Falls and the operation of a 5-MW gas-fired cogeneration plant that provides district heating to 17 commercial customers in Cornwall. The Rankine Generating Station assets have been written down following the lay-up of the Station as a result of the implementation of the Niagara Exchange Agreement. The Niagara Exchange Agreement assigns FortisOntario's water rights on the Niagara River to OPGI and facilitates the irrevocable exchange of 75 MW of wholesale electric power supply to FortisOntario from OPGI until April 30, 2009 in exchange for FortisOntario's agreement not to seek renewal of the water entitlement at that time.

Belize

Non-regulated generation operations in Belize are conducted through the Corporation's wholly owned indirect subsidiary, BECOL, under a franchise agreement with the Government of Belize. BECOL owns and operates the 25-MW Mollejon hydroelectric facility and the 7-MW Chalillo hydroelectric facility, which was placed in service on November 15, 2005. Both facilities are located on the Macal River in Belize. These generating plants have the capability of delivering average annual energy production of approximately 160 gigawatt hours (''GWh''). BECOL sells its entire output to Belize Electricity under a 50-year power purchase agreement expiring in 2055.

Central Newfoundland

Non-regulated generation operations in central Newfoundland are conducted through the Corporation's indirect 51% interest in the Exploits Partnership. The Exploits Partnership is a partnership with Abitibi-Consolidated that constructed, installed and operates additional capacity at Abitibi-Consolidated's hydroelectric plant at Grand Falls-Windsor and redeveloped the forestry company's hydroelectric plant at Bishop Falls, both in Newfoundland and Labrador. The 51% interest in the partnership is owned by Fortis Properties. Abitibi-Consolidated continues to utilize the historical annual generation of approximately 450 GWh while the additional energy produced from the new facilities, approximately 140 GWh, is sold to Newfoundland Hydro under a 30-year take-or-pay power purchase agreement expiring in 2033, which is exempt from regulation.

Upper New York State

Non-regulated generation operations in upper New York State are conducted through the Corporation's wholly owned indirect subsidiary FortisUS Energy, which became a direct subsidiary of Fortis Properties on January 1, 2005 by way of a transfer from its subsidiary, Maritime Electric. Generating operations in upper New York State include the operations of four hydroelectric generating stations with a combined generating capacity of approximately 23 MW operating under licences from the United States Federal Energy Regulatory Commission.

British Columbia

Non-regulated generation operations in British Columbia were acquired as part of FortisBC in May 2004. Generating assets in British Columbia consist of the 16-MW run-of-river Walden hydroelectric power plant near Lillooet, British Columbia. This plant sells its entire output to British Columbia Hydro & Power Authority (''BC Hydro'') under a power purchase agreement expiring in 2013.

Non-Regulated — Fortis Properties

Fortis has owned all of the issued and outstanding shares of Fortis Properties since its inception in 1989. In addition to its non-regulated generation operations, Fortis Properties owns and operates hotels in seven provinces in Canada and commercial real estate in Atlantic Canada. Its holdings include 18 hotels with more than 3,200 rooms and approximately 2.7 million square feet of commercial real estate. On November 1, 2006, Fortis Properties completed the purchase of four hotels located in Alberta and British Columbia from Lodge Motel (Kelowna) Ltd. for approximately $52 million. See ''Recent Developments''.

RECENT DEVELOPMENTS

Acquisition of Hotels in Western Canada

On November 1, 2006, Fortis Properties completed the purchase of four hotels located in Alberta and British Columbia from Lodge Motel (Kelowna) Ltd. for approximately $52 million. The purchased hotels were: the Holiday Inn Express and Suites and the Best Western, both in Medicine Hat, Alberta; the Ramada Hotel and Suites, in Lethbridge, Alberta; and the Holiday Inn Express, in Kelowna, British Columbia. Through the purchase, Fortis Properties' hospitality operations were expanded by 454 rooms.

Acquisition of Additional Shares of Caribbean Utilities

On November 7, 2006, Fortis acquired an aggregate of 4,113,116, or approximately 16%, of the outstanding Class A Ordinary Shares of Caribbean Utilities from International Power and four other vendors affiliated with International Power for US$11.89 per share under a private agreement. Pursuant to this purchase, Fortis acquired control of Caribbean Utilities raising its beneficial ownership to 13,565,511, or approximately 54%, of the outstanding Class A Ordinary Shares. As a result of acquiring control of Caribbean Utilities, Fortis now consolidates the financial results of Caribbean Utilities into the financial statements of Fortis. Immediately prior to November 1, 2006, Fortis accounted for its investment in Caribbean Utilities on an equity basis, pursuant to which only its *pro rata* share of earnings of Caribbean Utilities was recorded in the consolidated statements of earnings of Fortis.

Private Placement of Convertible Debentures

On November 7, 2006, Fortis issued, by way of private placement, US$40 million aggregate principal amount of unsecured subordinated convertible debentures (the ''Debentures''). The Debentures bear interest at an annual rate of 5.5% and mature on November 7, 2016. The Debentures may be redeemed by Fortis at par at any time on or after November 7, 2011 and are convertible into common shares of Fortis (''Common Shares'') at the option of the holder at any time prior to their maturity, at US$29.11 per share.

Regulatory Matters

During the fourth quarter of 2006, the allowed regulated rate of return on common equity (''ROE'') for each of FortisBC, FortisAlberta and Newfoundland Power was reset in accordance with an automatic adjustment formula by each utility's respective regulator. The allowed ROEs for FortisAlberta, FortisBC and Newfoundland Power were reduced from 8.93%, 9.20% and 9.24% to 8.51%, 8.77% and 8.60%, respectively, effective January 1, 2007.

On December 5, 2006, Newfoundland Power received approval of its 2007 Amortization and Cost Deferral Accounting application from the Newfoundland and Labrador Board of Commissioners of Public Utilities. The order provided for a portion of the 2005 unbilled revenue balance amortization to offset increased taxes in 2007 and the deferral of increased amortization and replacement energy expenses in 2007. Recovery of these amounts will be addressed in Newfoundland Power's next general rate proceeding.

During the fourth quarter of 2006, the British Columbia Utilities Commission (the ''BCUC'') approved FortisBC's 2007 and 2008 capital plans of $135.8 million (before customer contributions of $7.2 million) and $119.6 million (before customer contributions of $8.0 million), respectively, subject to further approval processes for certain projects. Earlier in 2006, a Negotiated Settlement Agreement, approved by the Alberta Energy and Utilities Board, dealing with FortisAlberta's 2006/2007 Distribution Access Tariff Application included a 2007 capital expenditure program of $201 million (before customer contributions of $24 million and including $10 million in contributions to the Alberta Electric System Operator (''AESO'') for investment in transmission facilities). During the fourth quarter, FortisAlberta's 2007 capital plan was increased to approximately $273 million (before customer contributions of $33 million and including $17 million in contributions to the AESO for investment in transmission facilities), primarily driven by customer growth. The increase in the 2007 capital expenditure program will be included as part of FortisAlberta's 2008 rate application.

Issuance of Debentures by FortisAlberta

On January 3, 2007, FortisAlberta issued $110 million aggregate principal amount of senior unsecured debentures bearing interest at a rate of 4.99% per annum, payable semi-annually, due January 2047.

Issuance of Common Shares by Fortis

On January 18, 2007, Fortis completed the public offering of 5,170,000 Common Shares at a price of $29.00 per share for gross proceeds of $149,930,000.

Second Quarter Dividend

On February 8, 2007, Fortis announced that its Board of Directors had declared a second quarter dividend of $0.21 per Common Share payable on June 1, 2007 to holders of record on May 4, 2007. This dividend represents an increase of 10.5% in the quarterly Common Share dividend of the Corporation, which is the second increase in twelve months. Fortis has increased its annual dividend paid for 34 consecutive years.

2006 Results of Operations

On February 8, 2007, Fortis issued a media release announcing its unaudited results of operations for the year ended December 31, 2006 and the Corporation's unaudited interim consolidated financial statements and related Management Discussion and Analysis of financial condition and results of operations for the three- and twelve-month periods ended December 31, 2006.

Net earnings applicable to Common Shares in 2006 were $147.2 million, 7.4% higher than net earnings of $137.1 million in 2005. Earnings per Common Share were $1.42 compared to $1.35 in 2005. Earnings in 2005 included a $7.9 million after-tax gain resulting from the settlement of contractual matters between FortisOntario and OPGI (the ''Ontario Settlement''). Growth in annual earnings was primarily driven by the performance of FortisAlberta and FortisBC, hydroelectric generation in Belize, Fortis Properties, Belize Electricity and contributions from recently acquired Fortis Turks and Caicos.

Net earnings applicable to Common Shares for the fourth quarter of 2006 were $33.9 million, or $0.33 per Common Share, compared to $22.3 million, or $0.22 per Common Share in the fourth quarter of 2005. The increase in fourth quarter earnings was driven by earnings growth at FortisAlberta, the contribution from Fortis Turks and Caicos and a change in revenue recognition policy by Newfoundland Power in 2006.

Fortis' Canadian Regulated Utilities contributed $112.7 million to earnings in 2006, $7.9 million higher than earnings of $104.8 million in the previous year. The increase was primarily driven by earnings derived from the significant investments in electrical infrastructure made by FortisAlberta and FortisBC and lower corporate income taxes at FortisAlberta.

In 2006, FortisAlberta and FortisBC continued to maintain, enhance and expand their electricity systems to accommodate new customers and to improve system reliability and invested approximately $354 million in aggregate, before customer contributions, in capital projects, up 26% from 2005. The rate bases of FortisAlberta and FortisBC have increased approximately 29% and 36%, respectively, since the utilities were acquired in May 2004.

Fortis' Caribbean Regulated Utilities, comprised of Fortis Turks and Caicos, Belize Electricity and Caribbean Utilities, contributed earnings of $23.6 million in 2006, 21.6% higher than earnings of $19.4 million in 2005. Earnings growth was primarily attributable to $3.5 million of contribution from Fortis Turks and Caicos and improved earnings at Belize Electricity due to lower finance charges, growth in electricity sales and an overall 11% increase in electricity rates, effective July 1, 2005.

In 2006, Fortis Non-regulated Generation operations contributed earnings of $26.7 million compared to $29.6 million in the previous year. Excluding the $7.9 million after-tax Ontario Settlement gain in 2005, earnings were $5.0 million higher year over year. Improved performance in Belize driven by increased hydroelectric production and lower finance charges was partially offset by the impact of lower average wholesale energy prices in Ontario. Hydroelectric production in Belize was 178 GWh, more than two-and-a-half times the level of production in 2005 due to the first full year of operations for the Chalillo hydroelectric generation plant and storage facility. Energy sales in Ontario, which on an annual basis remained relatively consistent at approximately 700 GWh, were at an average annual wholesale energy price per megawatt hour of $46.38 compared to $68.49 in 2005.

Fortis Properties contributed earnings of $18.7 million in 2006, 32.6% higher than earnings of $14.1 million in 2005. The increase in earnings was largely driven by a $1.6 million after-tax gain on the sale of the Days Inn Sydney hotel, reduced corporate income taxes and growth at hotel operations in western Canada.

THE ACQUISITION

Overview

On February 26, 2007, Fortis entered into an agreement (the ''Acquisition Agreement'') with 3211953 Nova Scotia Company and Kinder Morgan Inc. (''Kinder Morgan'') for the purchase (the ''Acquisition'') of all of the issued and outstanding shares of Terasen Inc. (''Terasen'') for aggregate consideration of $3.7 billion, including the assumption of approximately $2.3 billion of consolidated indebtedness of Terasen. Terasen is a holding company headquartered in Vancouver, British Columbia, operating two principal lines of business: natural gas distribution and petroleum transportation. Prior to the closing of the Acquisition, Kinder Morgan will cause Terasen to divest itself of its petroleum transportation operations. As part of such divestiture, on March 5, 2007, Kinder Morgan announced that it had agreed to sell the Corridor pipeline system, which is owned by Terasen and serves the Athabasca oil sands, to Inter Pipeline Fund.

The closing of the Acquisition is subject to receipt of required regulatory and other approvals, including that of the BCUC, and the satisfaction of certain closing conditions. The closing of the Acquisition is expected to occur in mid-2007. See ''Acquisition Agreement''.

Under the Acquisition Agreement, Kinder Morgan or the Corporation may elect to terminate the Acquisition Agreement if the Acquisition is not completed prior to November 30, 2007. The Corporation intends to finance the cash portion of the purchase price for the Acquisition from the net proceeds of this offering (the ''Offering'') and funds to be advanced under acquisition financing arranged by the Corporation for this purpose. See ''Financing of the Acquisition'', ''Use of Proceeds'' and ''Acquisition Agreement''.

Based on financial information as at September 30, 2006, following the Acquisition, Fortis' total assets will increase by approximately 94% to $8.9 billion. Following the Acquisition, Fortis' regulated rate base assets will increase to approximately $6.0 billion, of which approximately 93% will be located in Canada.

Kinder Morgan

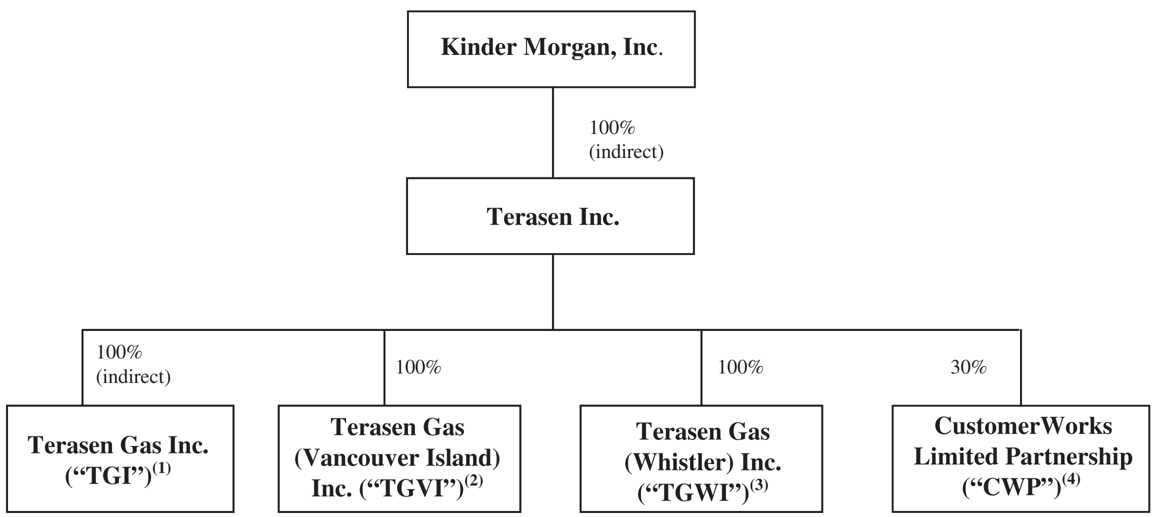
Kinder Morgan is one of the largest energy transportation, storage and distribution companies in North America. It owns an interest in or operates approximately 65,000 kilometers of pipelines that transport primarily natural gas, crude oil, petroleum products and carbon dioxide, and serves more than 1.1 million natural gas distribution customers in British Columbia, Colorado, Nebraska and Wyoming. Kinder Morgan owns the general partner interest of Kinder Morgan Energy Partners, L.P., one of the largest publicly traded pipeline limited partnerships in the United States.

On November 30, 2005, Kinder Morgan completed the acquisition of Terasen (formerly, BC Gas Inc.). On May 19, 2006, Terasen completed the disposition of its water, wastewater and utility services business carried on by Terasen Water and Utility Services Inc. to a consortium led by CAI Capital Management Co.

On August 14, 2006, Kinder Morgan announced that it was selling its natural gas retail distribution operations serving customers in Colorado, Nebraska, Wyoming and Hermosillo, Mexico, to GE Energy Financial Services. On December 19, 2006, management of Kinder Morgan received shareholder approval of a US$22 billion leveraged management buyout offer led by Richard Kinder, Chairman and Chief Executive Officer, Kinder Morgan. The completion of this buyout is pending.

Prior to the closing of the Acquisition, Kinder Morgan will cause Terasen to divest itself of its petroleum transportation operations (the ''Pre-Closing Reorganization''), leaving only the natural gas distribution business operated by Terasen Gas (as defined below). As part of the Pre-Closing Reorganization, on March 5, 2007, Kinder Morgan announced that it had agreed to sell the Corridor pipeline system, which is owned by Terasen and serves the Athabasca oil sands, to Inter Pipeline Fund. Under the Acquisition Agreement, Fortis will be indemnified with respect to claims relating to the Pre-Closing Reorganization. See ''Acquisition Agreement — Indemnities''.

The chart below sets out the material subsidiaries of Terasen following the Pre-Closing Reorganization.



(1) Terasen Gas Inc. provides gas distribution services to approximately 734,000 residential and 82,000 commercial and industrial customers in a service area extending from Vancouver to the Fraser Valley and the interior of British Columbia.

(2) Terasen Gas (Vancouver Island) Inc. owns a combined distribution and transmission system and serves approximately 85,000 residential, commercial and industrial customers along the Sunshine Coast and in various communities on Vancouver Island including Victoria and surrounding areas.

(3) Terasen Gas (Whistler) Inc. owns and operates the propane distribution system in the Whistler area of British Columbia and provides service to approximately 2,350 residential and commercial customers.

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

Terasen Gas

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

Terasen Gas is the principal gas distribution utility in British Columbia, serving the populous lower mainland, Vancouver Island and the southern interior of the province. With approximately 900,000 customers in 125 communities, Terasen Gas provides service to over 95% of the gas customers in British Columbia. Terasen Gas owns and operates approximately 44,100 kilometers of natural gas distribution pipelines and approximately 4,300 kilometers of natural gas transmission pipelines. As of September 30, 2006, Terasen Gas had an aggregate of $3.6 billion of assets, an aggregate rate base of almost $3.0 billion and approximately 1,200 employees.

Acquisition Rationale

The business operated by Terasen Gas is attractive to Fortis for the following reasons: (i) Terasen Gas will significantly increase the earnings of Fortis from regulated utilities and be immediately accretive to earnings per share; (ii) the regulated gas distribution business of Terasen Gas complements the regulated electric distribution business of Fortis; and (iii) the service territory of Terasen Gas is experiencing strong economic growth and includes substantially all of the service territory of FortisBC.

Fortis believes that the principal benefits of the Acquisition are as follows:

(a) the purchase price represents approximately 1.2 times the approved rate base of Terasen Gas for 2007 and the Acquisition is expected to be immediately accretive to earnings per share;

(b) the Acquisition will increase the regulated rate base assets and utility earnings of Fortis. Similar to the electric distribution utilities of Fortis, Terasen Gas operates under principally cost-of-service regulation under which an appropriate return on capital is recovered in addition to prudently incurred operating and commodity costs;

(c) Terasen Gas has an attractive gas distribution franchise with a well-diversified, mature, principally residential, customer base. The Acquisition is expected to improve the risk profile of Fortis by providing it with a more economically diverse portfolio of assets;

(d) following the Acquisition, Fortis will be the largest investor-owned utility in gas and electric distribution in Canada with regulated electricity distribution utilities in five Canadian provinces and three Caribbean countries and regulated gas distribution utilities in British Columbia. Following the Acquisition, a large proportion of the business of Fortis will serve the high-growth economies of western Canada; and

(e) Fortis believes the regulated gas distribution business of Terasen Gas is complementary to the Corporation's proven core competencies in managing regulated electric distribution utilities. The Acquisition affords Fortis management an opportunity to deploy its regulatory, operating and financial management expertise to additional Canadian regulated utilities.

See ''Risk Factors — Realization of Acquisition Benefits'' and ''Special Note Regarding Forward-Looking Statements''.

Utility Management Approach of Fortis

Fortis' approach to utility management is based on creating value for customers that ultimately translates into long-term value for shareholders. Fortis structures its operations as separate operating companies in each jurisdiction. Focused local management teams have the benefit of access to utility management experience and expertise of Fortis. The senior management team of Terasen Gas, which Fortis expects to retain, will add valuable operational expertise in natural gas distribution to existing expertise in the electric distribution operations of Fortis. This approach allows local managers to build relationships with, and be responsive to, both customers and regulators. Fortis recognizes that regulation is a key aspect of its core business and has developed a disciplined, cost-conscious asset investment and operating philosophy which is responsive to regulation.

The management of Fortis has substantial experience in integrating newly acquired enterprises into the Fortis Group. In 2004, Fortis acquired all of the issued and outstanding shares of FortisBC (formerly, Aquila Networks Canada (British Columbia) Ltd.) and FortisAlberta (formerly, Aquila Networks Canada (Alberta) Ltd.), and has successfully integrated these utilities into the Fortis Group.

THE ACQUIRED BUSINESSES

The description of Terasen Gas contained in the Prospectus is based on publicly available information filed by Terasen, TGI and Kinder Morgan and information provided by Kinder Morgan in connection with the Acquisition Agreement. Fortis, after making its purchase investigations, believes it to be accurate in all material respects.

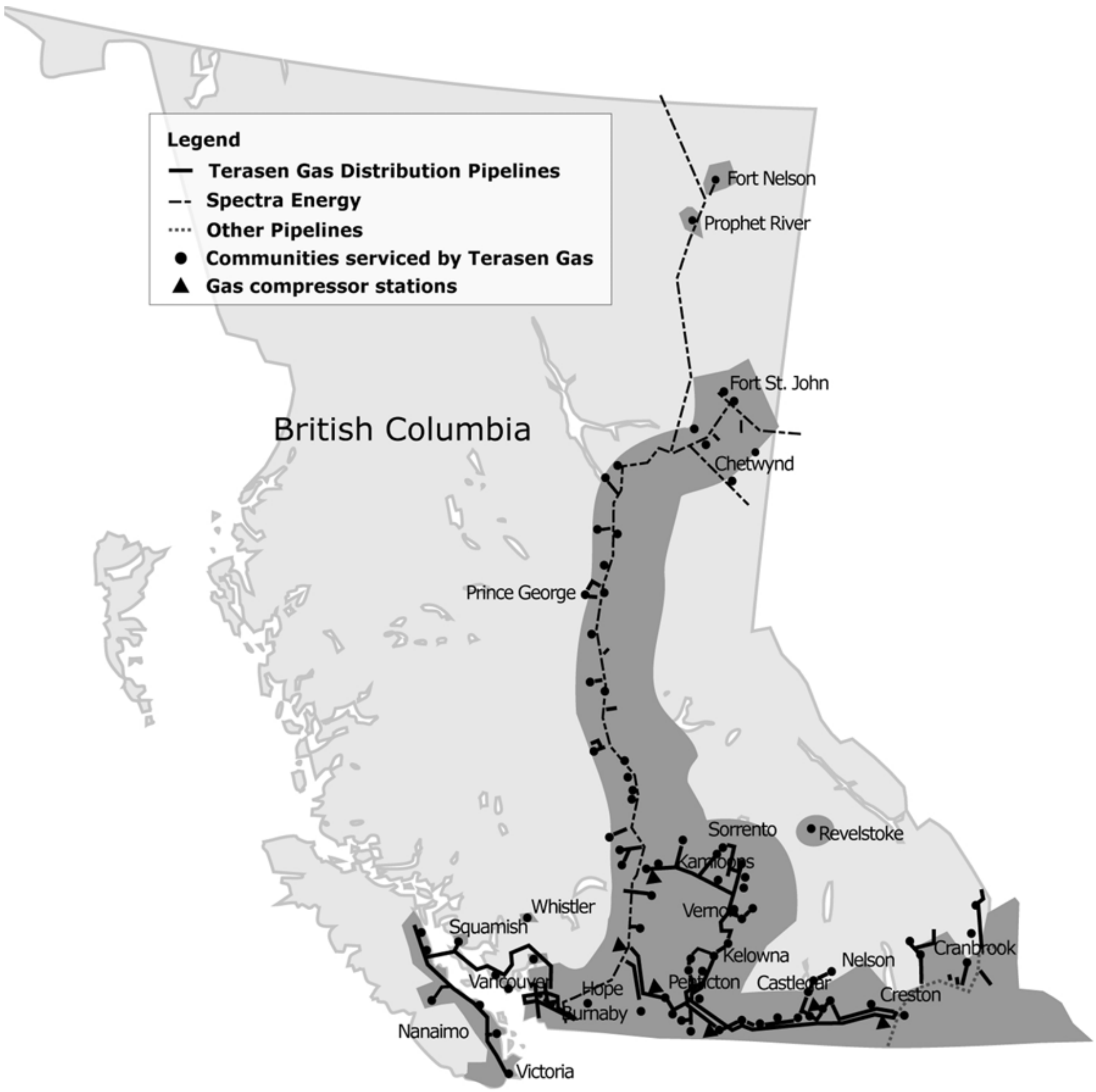
Terasen Inc.

Terasen is a holding company headquartered in Vancouver, British Columbia, operating two principal lines of business: natural gas distribution and petroleum transportation. Prior to the closing of the Acquisition, Kinder Morgan will cause Terasen to divest itself of its petroleum transportation operations. The natural gas distribution business of Terasen is carried on by TGI, TGVI and TGWI. Terasen also owns a 30% interest in CWP, a non-regulated shared services business in partnership with Enbridge that provides customer service contact, meter reading, billing, support and credit and collection services primarily to Terasen Gas and Enbridge Gas. CWP outsources these services to a company owned and operated by Accenture. Terasen has approximately 20 employees principally involved with finance, tax and legal matters.

Terasen was incorporated on August 15, 1985 under the *Company Act* (British Columbia), a predecessor to the *Business Corporations Act* (British Columbia). On April 25, 2003, its name was changed from BC Gas Inc. to Terasen Inc. For further information on Terasen, reference is made to the audited consolidated financial statements of Terasen for the years ended December 31, 2005 and 2004 and related Management Discussion and Analysis of financial condition and results of operations, and the unaudited consolidated financial statements of Terasen for the three- and nine-month periods ended September 30, 2006 and related Management Discussion and Analysis of financial condition and results of operations, which are included in this Prospectus.

Terasen Gas Service Territory

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



Terasen Gas Inc.

TGI provides service to more than 100 communities with a service territory that has an estimated population of approximately 4,000,000. As at September 30, 2006, TGI and its subsidiaries transported and distributed natural gas to approximately 734,000 residential and 82,000 commercial and industrial customers, representing approximately 87% of the natural gas users in British Columbia. TGI's service area extends from Vancouver to the Fraser Valley and the interior of British Columbia. The transmission and distribution business is carried on under statutes and franchises or operating agreements granting the right to operate in the municipalities or areas served. TGI is regulated by the BCUC. The average rate base of TGI approved by the BCUC for 2007 is approximately $2,474 million.

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

By early 2006, 16,000 commercial and industrial customers had arranged for some or all of their own gas supply and used TGI's transportation services for delivery. Notwithstanding shifts over time between utility supply and direct purchases, TGI's earnings remain unaffected since TGI's margins remain substantially the same whether or not customers choose to buy natural gas from TGI or arrange their own supply. Customers arranging for their own supply in fact reduce the credit risk to TGI. See ''— Terasen Gas Inc. — Unbundling'' below.

Of TGI's industrial customers, 158 are on interruptible service. The majority of these customers are capable of switching to alternative fuels. Of the various industries that comprise TGI's industrial market, the pulp and paper and wood products industries combined comprise approximately 47% of total system throughput. All other industries individually represent less than 10% of total consumption.

Gas Purchase Agreements

In order to acquire supply resources that ensure reliable natural gas deliveries to its customers, TGI purchases supply from a select list of producers, aggregators, and marketers by adhering to strict standards of counterparty creditworthiness and contract execution/management procedures. TGI contracts for approximately 137 petajoules (''PJ'') of baseload and seasonal supply, of which 120 PJ is delivered off the Spectra Energy Gas Transmission system (the ''Spectra Pipeline System''), and 17 PJ is comprised of Alberta-sourced supply transported into British Columbia via the Alberta and British Columbia systems of TransCanada Pipelines Limited (''TransCanada''). The majority of supply contracts in the current portfolio are one year in length, with the exception of one long-term contract expiring in October 2009. In order to recover its costs, TGI obtains advance BCUC approval of the supply agreements it proposes to enter into.

Peak Shaving Arrangements

TGI incorporates peak shaving and gas storage facilities into its portfolio to (i) manage the load factor of baseload supply contracts throughout the year, (ii) eliminate the risk of supply shortages during a peak throughput day, (iii) reduce the cost of gas during winter months, and (iv) balance daily supply and demand on the distribution system. TGI's peak shaving and storage assets and contracts for 2006 included up to 30 PJ in storage capacity at various locations throughout British Columbia, Alberta and the Pacific Northwest of the United States. These facilities can deliver a maximum daily rate of 600 TJ on a combined basis.

Unbundling

Over the past several years, TGI, the BCUC and a number of interested parties have laid the groundwork for the introduction of natural gas commodity unbundling. As of November 1, 2004, commercial customers of TGI became eligible to sign up to buy their natural gas commodity supply directly from third-party suppliers. TGI continues to provide delivery of the natural gas. Approximately 78,000 commercial customers are eligible to participate in commodity unbundling.

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

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

Transmission Services

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

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

In addition, TGI provides high-pressure transmission services to customers, such as TGVI, which moves natural gas from the Spectra Pipeline System or the TransCanada system across TGI's system to customers' own facilities.

Transportation tolls on the Spectra Pipeline System and the TransCanada system are regulated by the National Energy Board. TGI pays both fixed and variable charges for use of the pipelines, which are recovered through rates paid by TGI's customers.

Properties

As of September 30, 2006, TGI owned approximately 3,700 kilometers of natural gas transmission pipelines and approximately 41,000 kilometers of natural gas distribution pipelines. In addition to the pipelines, TGI owns properties and equipment utilized for service shops, warehouses, metering, and regulating stations, as well as its main operations center in Surrey, British Columbia.

Title to Properties

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

Franchise and Operating Agreements

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

Historically, approximately one quarter of the agreements relating to the interior of British Columbia contained a provision enabling the municipality to purchase the distribution system at the end of the term of the agreement. Some of these agreements have expired and TGI has negotiated or is currently negotiating renewals and extensions of others whereby TGI enters into an arrangement whereby the relevant municipality leases TGI's gas distribution assets within the municipality's boundaries for a term of 35 years for an initial cash payment paid by the municipality to TGI. TGI, in turn, enters into a 17-year operating lease with the municipality whereby TGI operates the gas distribution assets and has the option to terminate the lease of the assets to the municipality at the end of the 17-year term in exchange for a payment to the municipality equal to the unamortized portion of prepaid rent initially paid by the municipality. As at December 31, 2005, TGI had entered into such arrangements having a total value of $153 million.

Capital Program

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

Operations

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

Environment

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

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

Employees

TGI has approximately 1,100 employees. Its organized employees are represented by the Canadian Office and Professional Employees Union (''COPEU'') and the International Brotherhood of Electrical Workers (''IBEW'') under collective agreements which expire on March 31, 2007 and March 31, 2011, respectively.

Tax Assessment

TGI has received a Notice of Assessment dated July 31, 2006 from the British Columbia Social Service Tax authority (the ''BC Tax Authority'') for the payment of $37.1 million of additional provincial sales tax and interest on the Southern Crossing Pipeline which was completed in 2000 (the ''Assessment''). In October 2006, TGI made a payment of $10 million pending its appeal of the Assessment as a good faith payment to forestall an order from the BC Tax Authority to provide full payment or security. On October 26, 2006, TGI filed an objection to the Assessment with the BC Tax Authority. The BCUC has allowed TGI to defer the $10 million payment pending resolution of TGI's objection to the Assessment.

Terasen Gas (Vancouver Island) Inc.

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

TGVI has been operating for almost 15 years. Its combined system consists of approximately 615 kilometers of natural gas transmission pipelines and 3,250 kilometers of distribution mains. The combined system has a designed throughput capacity of 144 million cubic feet per day (155 TJ per day). TGVI serves approximately 85,000 residential, commercial and industrial customers along the Sunshine Coast and in various communities on Vancouver Island including Victoria and surrounding areas. TGVI's largest customers are the Vancouver Island Gas Joint Venture, representing seven large pulp and paper mills on Vancouver Island and the Sunshine Coast, and BC Hydro's contracted gas-fired electricity cogeneration facility at Elk Falls, Vancouver Island. During 2005, TGVI delivered approximately 33.6 PJ of gas through its system. The average rate base of TGVI approved by the BCUC for 2007 is approximately $482 million.

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

Vancouver Island Natural Gas Pipeline Agreement

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

Under the VINGPA, which runs through to December 31, 2011, the Province has agreed to provide TGVI with financial support in the form of gas royalties on deemed volumes of natural gas transported through the Vancouver

Island pipeline from 1996 through 2011, which decreases the cost of purchased gas by approximately 20%. The royalty payment recognized in 2006 was approximately $36.3 million.

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

Prior to 2003, rates charged by TGVI to its customers were insufficient to recover the cost of service of TGVI in aggregate, meaning that revenues from the sale and transportation of natural gas resulted in an annual revenue deficiency. Terasen and TGVI's former shareholder funded these annual revenue deficiencies in accordance with the VINGPA. The aggregate of the annual revenue deficiencies was funded with Class B Instruments bearing interest at a rate of 275 basis points over the applicable five-year Canada bond rate. The accumulated revenue deficiency resulting from overall revenues being below the cost of service has been recorded in a revenue deficiency deferral account (''RDDA''). Since 2003, the aggregate annual revenues have exceeded the full cost of service and therefore TGVI has been in a revenue surplus position. The revenue surplus is used, in part, to pay down the RDDA balance as well as to pay the interest on the Class B Instruments described above. The BCUC has been directed to include in the cost of service an amount to amortize the RDDA balance over the shortest period reasonably possible, having regard to competitive energy sources and the desirability of rates. As at September 30, 2006, TGVI had issued and outstanding approximately $42 million of Class B Instruments.

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

Vancouver Island Gas Joint Venture Transportation Agreement

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

Contractual Arrangements

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

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

Gas Purchase Agreements

In order to acquire effective supply resources that ensure reliable natural gas deliveries to its customers, TGVI purchases supply from a select list of producers, aggregators and marketers by adhering to strict standards of counterparty credit worthiness and contract execution/management procedures. As of November 1, 2005, TGVI contracted approximately 12.5 TJ per day of baseload supply delivered off the Spectra Pipeline System. TGVI also purchased approximately 31.8 TJ per day of seasonal supply to meet the higher loads during the winter months of December 2005 to February 2006.

TGVI maintains storage contracts with Unocal Canada Limited at Aitken Creek Storage facility in northern British Columbia and Northwest Natural Gas Company at Mist Storage facility in Oregon. As at March 14, 2006, TGVI's Aitken Creek Storage contract consisted of 2.1 PJ of capacity with 13.6 TJ of daily deliverability and its Mist storage agreement consisted of 0.69 PJ of capacity with 26.4 TJ of daily deliverability. As at March 14, 2006, TGVI also had access to an estimated 21.1 TJ of daily peaking supply deliverability from various peaking supply arrangements.

Capital Program

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

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

Employees

TGVI has approximately 105 employees. Its organized employees are represented by the COPEU and the IBEW under the TGI Collective Agreements. See ''— Terasen Gas Inc. — Employees'' above.

Terasen Gas (Whistler) Inc.

TGWI has owned and operated the propane distribution system at Whistler since 1987. It provides service to approximately 2,350 residential and commercial customers in the Whistler area of British Columbia. TGWI owns and operates two propane storage and vaporization plants and approximately 100 kilometers of distribution pipelines serving customers in the Whistler area. The propane distribution system in Whistler has grown far beyond the original expectations and beyond the size and scale of other similar propane distribution systems in British Columbia and Canada. Today, with annual deliveries exceeding 750,000 GJ, TGWI's propane system is unique in terms of the size of the customer base it serves and the scale of the facilities required by its continued operations. The average rate base of TGWI for 2006 was approximately $16.5 million.

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

Non-Regulated — CustomerWorks Limited Partnership

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

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

The services provided under the Customer Service Agreement include customer contact, meter reading, billing, support, and credit and collection services. The Customer Service Agreement has been approved by the BCUC. The rates under the Customer Service Agreement have both a fixed and service volume based component, include minimum service standards and penalties and are based on market prices. In providing these services, CWP uses a customer information services system under a licence from Enbridge Commercial Services, a subsidiary of Enbridge. During the nine-month period ended September 30, 2006, TGI paid approximately $33.1 million to CWP under the Customer Service Agreement.

Regulation

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

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

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

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

The table below summarizes regulatory information pertaining to decisions made by the BCUC with respect to TGI and TGVI. While also regulated by the BCUC, similar regulatory information with respect to TGWI is not available from publicly available BCUC filings.

	Regulated Values				
	2007(1)	2006	2005	2004	2003
TGI					
Rate base ($M)	2,474	2,506	2,406	2,310	2,281
Deemed common equity component of total capital structure (%)	35	35	33	33	33
Allowed ROE (%)	8.37	8.80	9.03	9.15	9.42
TGVI					
Rate base ($M)	482	470	453	441	437
Deemed common equity component of total capital structure (%)	40	40	35	35	35
Allowed ROE (%)	9.07	9.50	9.53	9.65	9.92

(1) As approved by the BCUC.

Terasen Gas Inc.

TGI's allowed ROE is determined annually based on a formula that applies a risk premium to a forecast of long-term Government of Canada Bond yields. On June 30, 2005, TGI applied to the BCUC to increase the deemed equity components from 33% to 38%. The application also requested an increase in allowed ROEs from the levels that result from the then-current formula, which would have yielded 8.29% for TGI in 2006. The BCUC rendered its decision on the application on March 2, 2006, to be effective as of January 1, 2006. The generic ROE formula for a benchmark utility in British Columbia was changed such that it will be reset annually from a forecast of 30-year Canada Bonds plus a 3.90% risk premium when the forecast yield on 30-year Government of Canada Bonds is 5.25%. The risk premium is adjusted annually by 75% of the difference between 5.25% and the forecast yield on 30-year Government of Canada Bonds. For 2007, the forecast 30-year Canada Bond yield is 4.22% resulting in an ROE for TGI of 8.37%.

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

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

The net balances of the RSAM and CCRA/MCRA accounts increased to a receivable of approximately $148.8 million as at September 30, 2006 from a payable of approximately $9.0 million as at December 31, 2005. In order to ensure that the balances in the CCRA/MCRA accounts are recovered on a timely basis, TGI prepares and files quarterly calculations with the BCUC to determine whether customer rate adjustments are needed to reflect prevailing market prices for natural gas costs.

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

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

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

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

TGI Earned ROEs and Shared Earnings through PBR

	2006(1)	2005	2004
Allowed ROE (%)	8.80	9.03	9.15
Earned ROE (%)	10.10	10.78	9.34
Customer share (pre-tax)($M)	8.2	10.5	1.1

(1) Projected as filed by TGI in the 2007 Revenue Requirement Filing.

Terasen Gas (Vancouver Island) Inc.

Pursuant to BCUC orders from 2003 onwards, TGVI's rates have been set so as to fully recover its cost of service plus an amount for the timely amortization of the RDDA in accordance with the government directives. To permit recovery of the outstanding balance in the RDDA, TGVI's rates for residential and commercial customers are set at levels in excess of TGVI's cost of service, but are effectively capped at a comparable price of competitive alternative fuels. TGVI renewed its regulatory settlement in late 2005 for a two-year period, effective January 1, 2006. It provides for a continuation of the operation and maintenance cost incentive arrangements previously in place. The allowed ROE for TGVI was 9.53% for 2005 compared to 9.65% in 2004. TGVI's ROE for 2006 is 9.50% and TGVI's deemed equity component of its capital structure for 2006 is 40%. The 2007 approved ROE for TGVI has been set at 9.07%.

TGVI's approved rate design methodology provides, in effect, that to the extent that cost of service inputs change over time, TGVI's rates will reflect a variable RDDA amortization. The rates generally are set to be equivalent to 90% of comparable electricity price. The RDDA amortization was approximately $12.4 million in 2005 and approximately $6.9 million in 2006. The RDDA has been amortized from approximately $87.9 million as at December 31, 2002 to approximately $41.4 million as at December 31, 2006.

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

Competition

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

Hedging

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

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

Financing Arrangements

Debentures

Terasen has issued and outstanding two series of unsecured medium term note debentures (''Terasen MTN Debentures''), which are governed by a Trust Indenture dated November 21, 2001 between Terasen (as successor to BC Gas Inc.) and CIBC Mellon Trust Company (the ''2001 Indenture''), as amended and supplemented by a First Series Supplement dated November 22, 2001 (the ''First Supplement''). The aggregate principal amount of debentures that may be issued under the 2001 Indenture is unlimited, subject to the restrictions set forth therein. As at September 30, 2006, Terasen had issued and outstanding $200 million principal amount of 6.30% Series 1 MTN Debentures due December 1, 2008 and $125 million principal amount of 5.56% Series 3 MTN Debentures due September 15, 2014. The First Supplement includes a positive covenant of Terasen that, so long as any MTN Debentures remain outstanding, it shall not create, assume, issue or otherwise incur or become liable for any Funded Indebtedness unless immediately thereafter the Funded Indebtedness of Terasen and its subsidiaries will not be in excess of 75% of Total Consolidated Capitalization. Funded Indebtedness means indebtedness that matures more than 18 months after such indebtedness was incurred, except for non-recourse debt to finance specific assets or subordinated debt. Total Consolidated Capitalization means the sum of (a) the principal amount of consolidated Funded Indebtedness of Terasen and its subsidiaries, (b) the total capital of Terasen, (c) the principal amount of all subordinated debt of Terasen, (d) the sum of consolidated contributed or capital surplus and retained earnings of Terasen, and (e) provision for future income taxes of Terasen.

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

TGI has issued and outstanding unsecured debentures and medium-term note debentures which are governed by a Trust Indenture dated November 1, 1977 between TGI (as successor to Inland Natural Gas Co. Ltd.) and CIBC Mellon Trust Company (as successor to National Trust Company, Limited), as amended and supplemented (the ''1977 Indenture''). The aggregate principal amount of debentures that may be issued under the 1977 Indenture is unlimited, subject to the restrictions set forth therein. As at September 30, 2006, TGI had issued and outstanding $59.9 million principal amount of 10.75% debentures, Series E due June 8, 2009, and an aggregate of $1,008 million of medium-term note debentures with fixed rates of interest ranging from 5.55% to 6.95% or with floating interest rates, and maturities of not less than one year. The Fourth Supplemental Indenture dated June 1, 1989 and the Tenth Supplemental Indenture dated November 15, 1993 contain certain restrictions on the ability of TGI to issue any debt securities with maturities of more than 18 months, unless certain financial tests are met and subject to certain exceptions.

TGI also has issued and outstanding Series A and Series B Purchase Money Mortgages (the ''Purchase Money Mortgages''), which are secured equally and rateably by a first fixed and specific mortgage and charge on TGI's gas distribution system in the lower mainland of British Columbia that was acquired by TGI from BC Hydro. The Purchase Money Mortgages are governed by a Trust Indenture dated December 3, 1990 between TGI (as successor to B.C. Gas Inc.), Inland Energy Corp. and CIBC Mellon Trust Company (as successor to National Trust Company), as amended and supplemented (the ''1990 Indenture''). The aggregate principal amount of Purchase Money Mortgages that may be issued under the 1990 Indenture is limited to $425 million. As at September 30, 2006, TGI had issued and outstanding $74.9 million aggregate principal amount of 11.80% Series A Purchase Money Mortgages due September 30, 2015 and $200 million aggregate principal amount of $10.30% Series B Purchase Money Mortgages due September 30, 2016.

Credit Facilities

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

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

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

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

The following summary outlines the credit facilities of Terasen, TGI and TGVI as at September 30, 2006.

(in millions of dollars)	Terasen	TGI	TGVI	Total
Total credit facilities	450	500	370	1,320
Credit facilities utilized Borrowings	176	207	284	667
Letters of credit outstanding	73	43.6	—	116.6
Credit facilities available	201	249.4	86	536.4

ACQUISITION AGREEMENT

Fortis has entered into the Acquisition Agreement dated February 26, 2007 with 3211953 Nova Scotia Company (''3211953'') and Kinder Morgan for the purchase of all of the issued and outstanding shares of Terasen. The Acquisition Agreement provides that prior to the closing of the Acquisition, Kinder Morgan will transfer all of the issued and outstanding shares of Terasen which it currently owns to 3211953. In this section of the Prospectus, ''Vendor'' means Kinder Morgan prior to such transfer, and 3211953 upon the occurrence of such transfer. The Acquisition is not a transaction with an informed person, associate or affiliate of Fortis (as such terms are defined in National Instrument 51-102 — *Continuous Disclosure Obligations*).

Purchase Price

The purchase price under the Acquisition Agreement is $3.7 billion, including the assumption of approximately $2.3 billion of consolidated indebtedness of Terasen and the balance in cash. The cash portion of the purchase price (the ''Cash Purchase Price'') will be equal to $1.801 billion minus the unconsolidated indebtedness of Terasen outstanding on the closing of the Acquisition, which management of Fortis expects to be at least $450 million.

Representations and Warranties

Under the Acquisition Agreement, the Vendor and Fortis have made various representations and warranties. The Vendor's representations and warranties relate to, among other things, organization and status, capitalization, title, authority to enter into the Acquisition Agreement and no conflict, consents and approvals, absence of defaults under constating documents or material agreements, absence of certain material changes or events since December 31, 2006, employment matters, pension and employee benefits, securities regulatory filings, reports and financial statements, compliance with laws, possession of permits, restrictions on business activities, legal or regulatory proceedings, material contracts, tax matters, intellectual property, books and records, environmental matters, insurance, brokerage fees, management controls and no U.S. operations. Fortis' representations and warranties relate to, among other things, organization and status, authority to enter into the Acquisition Agreement and no conflict, consents and approvals, availability of financing, legal proceedings, no knowledge of a breach of the Vendor's representations or warranties or disclosure, brokerage fees, nature of investment and independent investigation.

Covenants

The Vendor and Fortis have made covenants relating to the closing of the Acquisition and related matters. In particular, the Vendor has agreed to the following during the period from the date of the Acquisition Agreement until the closing:

(a) Conduct of Business. Terasen and Terasen Gas will carry on business in the usual and ordinary course of business consistent with past practices, maintain material properties and assets in good repair and use commercially reasonable efforts to preserve present business organizations, officers, employees, customers and suppliers;

(b) Dividends. Terasen and Terasen Gas will not declare or pay any dividends on capital stock, except for dividends (i) by TGI or TGVI to Terasen up to an amount such that, immediately after giving effect to such payment, TGI or TGVI, as the case may be, will have a ratio of common equity to total capital of at least 35% and 40%, respectively, and (ii) by Terasen up to but not exceeding the aggregate amount of dividends received by it from TGI and TGVI.

(c) Capital Expenditures. Terasen and Terasen Gas will not make or commit to make any capital expenditures in excess of $5 million, other than (i) to replace or repair damaged or destroyed facilities, (ii) budgeted capital expenditures, (iii) expenditures approved by the BCUC, or (iv) expenditures required by law;

(d) Employees and Benefits. Terasen and Terasen Gas will not increase compensation or benefits for employees, except nominal increases for people who are not officers or directors made in the ordinary course of business consistent with past practice;

(e) Rates. Subject to applicable law, Terasen and Terasen Gas will not implement any changes in any rates or charges (other than changes under existing tariffs, rate schedules or performance-based rate-making arrangements authorized by the BCUC), standards of service or accounting, or execute any agreement relating thereto that could reasonably be expected to materially decrease the revenues of the business unit implementing the change;

(f) Borrowings. Terasen and Terasen Gas will not incur any indebtedness other than in the ordinary course of business and subject to the specified exceptions in the Acquisition Agreement;

(g) Pre-Closing Reorganization. Terasen will complete the Pre-Closing Reorganization prior to closing; and

(h) Discharge of Guarantees. The Vendor shall cause Terasen and Terasen Gas to be discharged from all obligations under certain guarantees by Terasen and Terasen Gas for the benefit of the petroleum transportation business of Terasen.

In addition, the Vendor and Fortis have agreed to use their reasonable efforts to obtain all material authorizations, consents, orders and approvals and to make all necessary filings with the relevant government authorities as required under the Acquisition Agreement.

Indemnities

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

Closing Conditions

The Acquisition Agreement provides that the obligation of Fortis or the Vendor to complete the Acquisition is subject to the fulfillment of a number of conditions, each of which may be waived by such party, including the following:

(a) Accuracy of Representations and Warranties. The representations and warranties of the other party under the Acquisition Agreement are true and correct as of the date of the Acquisition Agreement and as of the closing date (except for representations and warranties made as of an earlier date, which must be true and correct as of such earlier date), except where the failure of such representations and warranties to be true and correct would not be reasonably likely, individually or in the aggregate, to have a Material Adverse Effect on the other party. ''Material Adverse Effect'' is defined in the Acquisition Agreement to mean any adverse and material change relating to the condition (financial or otherwise), results of operations or business of either party that is material to such party and its subsidiaries, taken as a whole, or in the case of the Vendor, that is material to Terasen and Terasen Gas, taken as a whole;

(b) Performance of Covenants. The other party has performed and complied with its material covenants and agreements under the Acquisition Agreement in all material respects;

(c) Legal Proceedings. There must not be any decree, injunction or ruling that would prevent or otherwise make the Acquisition illegal;

(d) Consents and Approvals. Each party has received the governmental and regulatory consents and approvals required to be obtained by it under the Acquisition Agreement. The regulatory approvals that must be obtained prior to the closing of the Acquisition include:

   (i) approval by the BCUC of the transfer of the shares of Terasen to Fortis or a subsidiary of Fortis pursuant to the *Utilities Commission Act* (British Columbia); and

   (ii) one of the following has occurred: (i) an advance ruling certificate has been issued in respect of the Acquisition pursuant to section 102 of the *Competition Act* (Canada) (the ''Competition Act''); (ii) the parties have received written advice that the Commissioner has concluded that she does not have sufficient grounds to initiate proceedings before the Competition Tribunal to challenge the Acquisition under the merger provisions of the Competition Act; or (iii) any applicable waiting period pursuant to section 123 of the Competition Act has expired or been earlier terminated or waived.

(e) Pre-Closing Reorganization. The Pre-Closing Reorganization has been completed.

Termination

The Acquisition Agreement may be terminated by Fortis or the Vendor at any time prior to closing in certain circumstances, including:

(a) the mutual agreement of Fortis and the Vendor;

(b) if the other party has not satisfied the conditions that its representations and warranties under the Acquisition Agreement be true and correct and that it has performed in all material respects the material covenants and agreements required to be performed by it prior to the closing date, and such condition has not been waived on or before the closing date by the party wishing to terminate;

(c) if a government authority issues a final order or injunction restraining or prohibiting the Acquisition;

(d) if prior to the closing, the other party provides additional information disclosing facts that would constitute a breach of such other party's representations and warranties under the Acquisition Agreement and such breach would have a Material Adverse Effect on the party wishing to terminate the Acquisition Agreement, if notice of termination is provided within 10 days of receipt of the relevant information; or

(e) if the closing has not occurred on or before November 30, 2007, unless the failure to close by such date is due to the party wishing to terminate the Acquisition Agreement not having fulfilled its obligations under the agreement.

Kinder Morgan Guarantee

Pursuant to the Acquisition Agreement, Kinder Morgan has irrevocably and unconditionally guaranteed the full and complete performance by 3211953 of all of the obligations of 3211953 under the Acquisition Agreement, such guarantee to be effective upon the transfer by Kinder Morgan of all of the issued and outstanding shares of Terasen to 3211953 prior to the closing of the Acquisition.

FINANCING OF THE ACQUISITION

For purposes of financing the Acquisition, on February 26, 2007, Fortis obtained a commitment letter from Canadian Imperial Bank of Commerce providing for an aggregate of $1.425 billion non-revolving term credit facilities in favour of Fortis consisting of a facility in the amount of $925 million (''Facility A'') and a facility in the amount of $500 million (''Facility B'') (together with ''Facility A'', the ''Credit Facilities''). The Credit Facilities would be sufficient, if necessary, to fund the full Cash Purchase Price for the Acquisition.

The Credit Facilities are unsecured single borrowing credit facilities to be used by Fortis, to the extent required, to finance the payment of the Cash Purchase Price for the Acquisition. Any amount not drawn down under the Credit Facilities will be cancelled after the initial borrowing. Facility A and Facility B will mature on the second and third anniversary of the initial extension of credit under Facility A and Facility B, respectively.

The credit agreement pursuant to which the Credit Facilities will be extended (the ''Credit Agreement'') will contain certain prepayment options in favour of Fortis and certain prepayment obligations upon the occurrence of certain events. In particular, the net proceeds of any equity or debt offering by Fortis (other than certain permitted equity or debt offerings for strategic investments) will be required to be used to prepay the Credit Facilities and any prepayment under the Credit Facilities may not be re-borrowed. Fortis may prepay any balance outstanding under the Credit Facilities without penalty, provided that any such prepayment is in an amount of at least $10 million and subject to any breakage costs being for the account of Fortis.

The Credit Agreement will contain customary representations and warranties and affirmative and negative covenants of Fortis. As part of these covenants, Fortis will be required to maintain a consolidated debt to consolidated capitalization ratio of not more than 0.85:1 after the date of the Acquisition Agreement until the first anniversary of the closing of the Acquisition and 0.75:1 at any time thereafter. These ratios will reduce automatically to 0.75:1 and 0.70:1 at any time during those respective periods, if Fortis has received, free from any escrow conditions, aggregate proceeds from equity issuances of at least $700 million. The Credit Agreement will contain customary events of default. In addition, any failure by Fortis to maintain an investment grade credit rating will constitute an event of default under the Credit Agreement.

Customary fees are payable by Fortis in respect of the Credit Facilities and amounts outstanding under the Credit Facilities will bear interest at market rates.

The net proceeds from the Offering will be used to reduce the amount of the Credit Facilities. Fortis expects that the remainder of Credit Facilities will be repaid from the proceeds of one or more offerings of Common Shares, preferred shares and/or long-term debt.

CAPITALIZATION

The following table sets out the consolidated capitalization of the Corporation as at September 30, 2006 and after giving effect to the Offering (assuming no exercise of the Over-Allotment Option), the issue of 5,170,000 Common Shares on January 18, 2007, the issue of $110 million aggregate principal amount of senior unsecured debentures by FortisAlberta on January 3, 2007, the drawdown of $139.3 million under the Credit Facilities and completion of the Acquisition. The financial information set out below should be read in conjunction with the unaudited consolidated financial statements incorporated by reference into the Prospectus and the unaudited *pro forma* consolidated financial statements included in the Prospectus and, in each case, the notes thereto.

	Outstanding at September 30, 2006	*Pro forma* outstanding at September 30, 2006
	(in millions of dollars)	
Total debt (net of cash)	2,296.1	4,863.0[2]
Preference shares [1]	319.5	319.5
Shareholders' equity		
Securities offered hereby	Nil	974.2
Common shares	822.5	968.1[2]
Preference shares	122.5	122.5
Contributed surplus	4.3	4.3
Equity portion of convertible debentures	1.4	1.4
Foreign currency translation adjustment	(17.8)	(17.8)
Retained earnings	472.2	472.2
Total capitalization	4,020.7	7,707.4

(1) These preference shares are classified as long-term liabilities in the financial statements of Fortis.

(2) After giving effect to the Offering (assuming no exercise of the Over-Allotment Option), the issue of 5,170,000 Common Shares on January 18, 2007, the issue of $110 million aggregate principal amount of senior unsecured debentures by FortisAlberta on January 3, 2007, the drawdown of $139.3 million under the Credit Facilities and completion of the Acquisition.

PRICE RANGE AND TRADING VOLUME OF THE COMMON SHARES

The outstanding Common Shares of Fortis are traded on the TSX under the trading symbol ''FTS''. The following table sets forth the reported high and low trading prices and trading volumes of the Common Shares as reported by the TSX from January 2006.

Period	High	Low	Volume
2006			
January	$24.60	$22.76	3,981,812
February	23.76	22.00	7,087,013
March	23.50	21.65	6,775,211
April	22.95	20.89	3,813,271
May	24.84	20.36	7,241,148
June	24.60	21.16	3,707,157
July	23.40	21.99	2,328,812
August	25.48	22.15	6,214,513
September	25.40	24.00	2,553,872
October	25.65	24.12	7,362,894
November	28.74	25.15	6,234,745
December	30.00	28.01	2,793,265
2007			
January	30.00	26.72	6,030,480
February	27.96	26.00	8,612,015
March 1 to 6	26.81	26.16	2,204,514

On March 6, 2007, the closing price of the Common Shares was $26.80.

SHARE CAPITAL OF FORTIS

The authorized share capital of the Corporation consists of an unlimited number of Common Shares, an unlimited number of First Preference Shares issuable in series and an unlimited number of Second Preference Shares issuable in series, in each case without nominal or par value. As at March 6, 2007, 109,407,397 Common Shares, 5,000,000 First Preference Shares, Series C, 7,993,500 First Preference Shares, Series E and 5,000,000 First Preference Shares, Series F were issued and outstanding.

DIVIDEND POLICY

Dividends on the Common Shares are declared at the discretion of the Board of Directors of Fortis. The Corporation paid cash dividends on its Common Shares of $0.67 in 2006, $0.59 in 2005 and $0.54 in 2004. On December 7, 2006, the Fortis Board of Directors declared a first quarter dividend of $0.19 per Common Share, payable on March 1, 2007 to holders of record on February 2, 2007. On February 8, 2007, Fortis announced that its Board of Directors had declared a second quarter dividend of $0.21 per Common Share, payable on June 1, 2007 to holders of record on May 4, 2007. This dividend represents an increase of 10.5% in the quarterly Common Share dividend of the Corporation, which is the second increase in twelve months. Fortis has increased its annual dividend paid for 34 consecutive years.

Regular quarterly dividends at the prescribed annual rate have been paid on all of the First Preference Shares, Series C, the First Preference Shares, Series E and the First Preference Shares, Series F, respectively. On December 7, 2006, the Fortis Board of Directors also declared a first quarter dividend on each such series of First Preference Shares in accordance with the applicable prescribed annual rate, in each case payable on March 1, 2007 to holders of record on February 2, 2007.

DESCRIPTION OF COMMON SHARES

Dividends

Holders of Common Shares are entitled to dividends on a *pro rata* basis if, as and when declared by the Board of Directors of Fortis. Subject to the rights of the holders of the First Preference Shares and Second Preference Shares and any other class of shares of the Corporation entitled to receive dividends in priority to or rateably with the holders of the Common Shares, the Board of Directors of Fortis may declare dividends on the Common Shares to the exclusion of any other class of shares of the Corporation.

Liquidation, Dissolution or Winding-Up

On the liquidation, dissolution or winding-up of Fortis, holders of Common Shares are entitled to participate rateably in any distribution of assets of Fortis, subject to the rights of holders of First Preference Shares and Second Preference Shares and any other class of shares of the Corporation entitled to receive the assets of the Corporation on such a distribution in priority to or rateably with the holders of the Common Shares.

Voting Rights

Holders of the Common Shares are entitled to receive notice of and to attend all annual and special meetings of the shareholders of Fortis, other than separate meetings of holders of any other class or series of shares, and to one vote in respect of each Common Share held at such meetings.

DETAILS OF THE OFFERING

Subscription Receipts

The Subscription Receipts will be issued on the Closing Date (as defined below) pursuant to the Subscription Receipt Agreement. The Escrowed Funds will be delivered to and held by the Escrow Agent and invested in short-term interest bearing or discount debt obligations issued or guaranteed by the Government of Canada or a province, or one or more of the five largest Canadian chartered banks, provided in all cases that such obligation is rated at least R1 (middle) by DBRS Limited or an equivalent rating from an equivalent rating service, pending satisfaction of the Release Conditions.

If the Release Conditions are satisfied prior to 5:00 p.m. (Toronto time) on November 30, 2007, the Corporation will forthwith execute and deliver a notice of satisfaction and will issue and deliver to the Escrow Agent one Common Share for each Subscription Receipt then outstanding (subject to any applicable adjustment). The Common Shares will be available for delivery commencing on the second business day after the delivery of such notice. The holders of Subscription Receipts will receive, without payment of any additional consideration, one Common Share for each Subscription Receipt held plus an amount equal to the dividends declared on the Common Shares by the Corporation, if any, for which record dates have occurred during the period from the Closing Date to the date of issuance of the Common Shares in respect of the Subscription Receipts. Forthwith upon the Release Conditions being satisfied and the required notice being delivered to the Escrow Agent, the Escrowed Funds, together with interest earned and income generated thereon, will be released to Fortis.

In the event that the Release Conditions are not satisfied, or if the Acquisition Agreement is terminated, prior to the Termination Time, holders of Subscription Receipts shall, commencing on the second business day following the Termination Time, be entitled to receive from the Escrow Agent an amount equal to the full subscription price thereof plus their *pro rata* share of the interest earned or income generated on such amount. The Escrowed Funds will be applied toward payment of such amount.

In the event that, prior to the date of issue of a Common Share in respect of a Subscription Receipt, there is a subdivision, consolidation, reclassification or other change of the Common Shares or any reorganization, amalgamation, merger or sale of all or substantially all of the Corporation's assets, the Subscription Receipts will thereafter evidence the right of the holder to receive the securities, property or cash deliverable in exchange for or on the conversion of or in respect of the Common Shares to which the holder of a Common Share would have been entitled immediately after such event. Similarly, any distribution to all or substantially all of the holders of Common Shares of rights, options, warrants, evidences of indebtedness or assets will result in an adjustment in the number of Common Shares to be issued to holders of Subscription Receipts. Alternatively, such securities, evidences of indebtedness or assets may, at the option of the Corporation, be issued to the Escrow Agent and delivered to holders of Subscription Receipts on exercise thereof. In case the Corporation, after the Closing Date, takes any action affecting the Common Shares, other than the actions described above, which, in the reasonable opinion of the directors of the Corporation, would materially affect the rights of the holders of Subscription Receipts and/or the rights attached to the Subscription Receipts, then the number of Common Shares which are to be received pursuant to the Subscription Receipts shall be adjusted in such manner, if any, and at such time as the directors of the Corporation may, in their discretion, reasonably determine to be equitable to the holders of Subscription Receipts in such circumstances. The adjustments provided for in this paragraph are cumulative and shall apply to successive subdivisions, consolidations, changes, distributions, issues or other events resulting in any adjustment.

Under the Subscription Receipt Agreement, purchasers of Subscription Receipts will have a contractual right of rescission entitling the purchaser to receive the amount paid for the Subscription Receipts upon surrender of the Subscription Receipts or the Common Shares, as applicable, if the Prospectus and any amendment contains a misrepresentation, as such term is defined in the *Securities Act* (Ontario), provided such remedy for rescission is exercised within 180 days of the Closing Date.

Subject to applicable law, the Corporation will be entitled to purchase the Subscription Receipts in the open market or by private agreement or otherwise.

Subscriptions for the Subscription Receipts will be received subject to rejection or allotment in whole or in part and the right is reserved to close the subscription books at any time without notice. It is expected that the closing of the Offering will take place on or about March 15, 2007, or such other date as may be agreed upon by the Corporation and the Underwriters, but not later than April 18, 2007 (the ''Closing Date''). The Subscription Receipts will be issued in ''book entry only'' form and must be purchased or transferred through a registered dealer who is a CDS participant (a ''CDS Participant''). The Corporation will cause a global certificate or certificates representing newly issued Subscription Receipts to be delivered to and registered in the name of CDS or its nominee. All rights of Subscription Receipt holders must be exercised through, and all payments or other money to which such holders are entitled will be made or delivered by, CDS or the CDS Participant through which the holders hold such Subscription Receipts. Each person who acquires Subscription Receipts will receive only a customer confirmation of purchase from the registered dealer from or through which the Subscription Receipts are acquired in accordance with the practices and procedures of that registered dealer. The practices of registered dealers may vary, but generally customer confirmations are issued promptly after execution of a customer order. CDS is responsible for establishing and maintaining book entry accounts for its CDS Participants having interests in the Subscription Receipts.

The Subscription Receipt Agreement provides for modifications and alternations to the Subscription Receipts issued thereunder by way of an extraordinary resolution. The term ''extraordinary resolution'' is defined in the Subscription Receipt Agreement to mean, in effect, a resolution proposed at a meeting of holders of Subscription Receipts duly convened for that purpose and held in accordance with the Subscription Receipt Agreement at which there are present in person or by proxy at least two holders of Subscription Receipts entitled to receive more than 25% of the aggregate number of Common Shares issuable upon the exchange of the Subscription Receipts which could be received pursuant to all the then-outstanding Subscription Receipts and passed by the affirmative votes of holders of Subscription Receipts entitled to receive not less than 66⅔% of the aggregate number of such Common Shares which could be received pursuant to all the then-outstanding Subscription Receipts represented at the meeting and voted on the poll upon such resolution.

The holders of Subscription Receipts are not shareholders of the Corporation. Holders of Subscription Receipts are entitled only to receive Common Shares on the exchange of their Subscription Receipts and an amount equal to the dividends declared on the Common Shares by the Corporation, if any, for which record dates have occurred during the period from the Closing Date to the date of issuance of the Common Shares in respect of the Subscription Receipts, or to require the Corporation to purchase the Subscription Receipts at the issue price and to be paid a *pro rata* share of interest earned or income generated thereon as described above.

CHANGES IN SHARE AND LOAN CAPITAL STRUCTURE

The following describes the changes in the share and loan capital structure of Fortis since September 30, 2006:

- During the period from October 1, 2006 up to and including March 6, 2007, Fortis issued an aggregate of 531,345 Common Shares pursuant to the Corporation's Consumer Share Purchase Plan, Dividend Reinvestment Plan, Employee Share Purchase Plan and upon the exercise of options granted pursuant to the 2002 Stock Option Plan, the Executive Stock Option Plan and the Director Stock Option Plan for aggregate consideration of approximately $10.2 million.
- On October 30, 2006, Fortis made a draw down of $20.0 million under its credit facilities for the purpose of funding the acquisition by Fortis Properties of four hotels located in Alberta and British Columbia. See ''Recent Developments''.
- On November 7, 2006, Fortis made a draw down under its credit facilities of an amount of US$48.6 million for the purpose of funding, on an interim basis, the acquisition of approximately 16% of the outstanding Class A Ordinary Shares of Caribbean Utilities. See ''Recent Developments''.
- On November 7, 2006, Fortis issued, by way of private placement, US$40 million aggregate principal amount of Debentures. The Debentures bear interest at an annual rate of 5.5% and mature on November 7, 2016. The Debentures may be redeemed by Fortis at any time on or after November 7, 2011 and are convertible into Common Shares at the option of the holder at any time prior to their maturity at US$29.11 per share. The Debentures are subordinated to all other indebtedness of Fortis, other than subordinated indebtedness ranking equally with the Debentures. On November 7, 2006, Fortis repaid US$40 million owing under its credit facilities from the proceeds of the private placement.
- On January 3, 2007, FortisAlberta issued $110 million aggregate principal amount of senior unsecured debentures bearing interest at a rate of 4.99% per annum, payable semi-annually, due January 2047. The proceeds of the offering were primarily used to repay indebtedness under a credit facility.
- On January 18, 2007, the Corporation completed the public offering of 5,170,000 Common Shares at a price of $29.00 per share for gross proceeds of $149,930,000. As a result, shareholders' equity in the Corporation increased by approximately $145.6 million, being the gross proceeds of the offering net of tax-effected issue costs, to a total of $1.55 billion. Fortis used a portion of the proceeds of this offering to repay approximately $84.5 million owing under its credit facilities.

USE OF PROCEEDS

The proceeds to the Corporation from the Offering, after deducting the fee payable to the Underwriters and estimated expenses of the Offering, are expected to be $959,710,000, assuming no exercise of the Over-Allotment Option. If the Over-Allotment Option is exercised in full, the estimated proceeds of the Offering, after deducting the fee payable to the Underwriters and estimated expenses of the Offering, are expected to be $1,103,854,000.

The net proceeds of the Offering, together with funds to be advanced pursuant to the Credit Facilities, will be used to finance the Cash Purchase Price for the Acquisition. See ''Financing of the Acquisition'' and ''Acquisition Agreement''. The gross proceeds from the sale of the Subscription Receipts will be held in escrow pending the satisfaction of the Release Conditions. See ''Details of the Offering''.

PLAN OF DISTRIBUTION

Pursuant to an underwriting agreement dated February 27, 2007 (the ''Underwriting Agreement'') between Fortis and the Underwriters, Fortis has agreed to issue and sell, and the Underwriters have agreed to purchase, as principals, on the Closing Date, 38,500,000 Subscription Receipts offered hereby at the Offering Price of $26.00 per Subscription Receipt, subject to compliance with all the necessary legal requirements and to the conditions contained in the Underwriting Agreement. The Offering Price and other terms of the Offering were determined by negotiation between the Corporation and the Underwriters.

Pursuant to the Underwriting Agreement, the Corporation has granted the Underwriters an over-allotment option (the ''Over-Allotment Option''), exercisable at any time until 30 days following the closing of the Offering, to purchase up to an additional 5,775,000 Subscription Receipts at the Offering Price. The Over-Allotment Option is exercisable in whole or in part only for the purpose of covering over-allotments, if any. This Prospectus also qualifies the grant of the Over-Allotment Option and the distribution of the securities issuable on the exercise of the Over-Allotment Option.

The Underwriting Agreement provides that the Underwriters will be paid a fee of $40,040,000 (assuming no exercise of the Over-Allotment Option) ($1.04 per Subscription Receipt) in consideration for its services in connection with the Offering. One-half of the Underwriters' fee in respect of the Offering is payable on the Closing Date and the other half of the Underwriters' fee is payable only if the Release Conditions have been satisfied prior to the Termination Time and the required notice has been delivered to the Escrow Agent.

Pursuant to rules and policy statements of certain Canadian securities regulators, the Underwriters may not, at any time during the period ending on the date the selling process for the Subscription Receipts ends and all stabilization arrangements relating to the Subscription Receipts are terminated, bid for or purchase Subscription Receipts or Common Shares. The foregoing restrictions are subject to certain exceptions including (a) a bid for or purchase of Subscription Receipts or Common Shares if the bid or purchase is made through the facilities of the TSX, in accordance with the Universal Market Integrity Rules of Market Regulation Services Inc., (b) a bid or purchase on behalf of a client, other than certain prescribed clients, provided that the client's order was not solicited by the Underwriter, or if the client's order was solicited, the solicitation occurred before the commencement of a prescribed restricted period, and (c) a bid or purchase to cover a short position entered into prior to the commencement of a prescribed restricted period. The Underwriters may engage in market stabilization or market balancing activities on the TSX where the bid for or purchase of the Subscription Receipts or the Common Shares is for the purpose of maintaining a fair and orderly market in the Subscription Receipts or Common Shares, subject to price limitations applicable to such bids or purchases. Such transactions, if commenced, may be discontinued at any time.

The Subscription Receipts and the Common Shares for which such Subscription Receipts may be exchanged have not been, and will not be, registered under the United States *Securities Act of 1933*, as amended (the ''1933 Act'') or any state securities laws and, subject to certain exceptions, may not be offered, or delivered, directly or indirectly, or sold in the United States except in certain transactions exempt from the registration requirements of the 1933 Act and in compliance with any applicable state securities laws. The Underwriters have agreed that they will not offer or sell the Subscription Receipts within the United States, its territories, its possessions and other areas subject to its jurisdiction or to, or for the account or benefit of, a ''U.S. person'' (as defined in Regulation S under the 1933 Act), except in accordance with the Underwriting Agreement pursuant to an exemption from the registration requirements of the 1933 Act provided by Rule 144A thereunder and in compliance with applicable state securities laws. In addition, until 40 days after the commencement of the Offering, an offer or sale of Subscription Receipts or Common Shares within the United States by any dealer (whether or not participating in the Offering) may violate the registration requirements of the 1933 Act if such offer is made otherwise than in reliance on Rule 144A.

The obligations of the Underwriters under the Underwriting Agreement are several and may be terminated at their discretion in certain circumstances, including upon the occurrence of certain stated events. The Underwriters are, however, obligated to take up and pay for all of the Subscription Receipts if any are purchased under the Underwriting Agreement. Under the terms of the Underwriting Agreement, the Underwriters may be entitled to indemnification by the Corporation against certain liabilities, including liabilities for misrepresentation in the Prospectus.

CIBCWM is an affiliate of a Canadian chartered bank that has agreed to extend credit facilities to the Corporation in connection with financing the Acquisition. CIBCWM is also acting as financial advisor to Fortis in connection with the Acquisition and receiving a fee therefor. In addition, each of CIBCWM, Scotia Capital, TD Securities, BMO Nesbitt Burns, RBCDS, NB Financial and HSBC Securities is a subsidiary of a Canadian chartered bank that has, either solely or as a member of a syndicate of financial institutions, extended credit facilities to the Corporation and/or its subsidiaries (the ''Existing Facilities''). Consequently, the Corporation may be considered a ''connected issuer'' of these Underwriters within the meaning of applicable securities legislation. None of these Underwriters will receive any direct benefit from the Offering other than the underwriting commission relating to the Offering. The decision to distribute the Subscription Receipts hereunder and the determination of the terms of the Offering were made through negotiation between the Corporation and the Underwriters. No bank had any involvement in such decision or determination. The proceeds of the Offering will be used to finance the Cash Purchase Price for the Acquisition and will not be used to repay the Existing Facilities. As at January 31, 2007, an aggregate of approximately $338 million was outstanding under the Existing Facilities. Fortis and/or its subsidiaries are in compliance with their respective obligations under the Existing Facilities. Since the execution of the Existing Facilities, no breach thereunder has been waived by the lenders thereunder. See ''Use of Proceeds''.

The TSX has conditionally approved the listing of the Subscription Receipts, as well as the Common Shares issuable on the exchange of the Subscription Receipts. Listing is subject to the Corporation fulfilling all of the requirements of the TSX on or before June 3, 2007.

CANADIAN FEDERAL INCOME TAX CONSIDERATIONS

In the opinion of Davies Ward Phillips & Vineberg LLP, counsel to the Corporation, and Stikeman Elliott LLP, counsel to the Underwriters, the following is a general summary of the principal Canadian federal income tax considerations generally applicable to a holder who acquires Subscription Receipts pursuant to the Offering who, within the meaning of the *Income Tax Act* (Canada) (the ''Tax Act''), and at all relevant times, is or is deemed to be resident in Canada, deals at arm's length with, and is not affiliated with, the Corporation and holds or will hold the Subscription Receipts and any Common Shares as capital property. Generally, the Subscription Receipts and the Common Shares will be considered to be capital property to a holder provided the holder does not hold the Subscription Receipts and the Common Shares in the course of carrying on a business and has not acquired them in a transaction or transactions considered to be an adventure in the nature of trade. Certain holders whose Common Shares might not otherwise qualify as capital property may, in certain circumstances, make the irrevocable election under subsection 39(4) of the Tax Act to have their Common Shares and every ''Canadian security'' (as defined in the Tax Act) owned by such holder in the taxation year of the election, and in all subsequent years, deemed to be capital property.

The Tax Act contains certain provisions (the ''Mark-to-Market Rules'') relating to securities held by certain financial institutions, registered securities dealers and corporations controlled by one or more of the foregoing. This summary does not take into account the Mark-to-Market Rules and taxpayers that are ''financial institutions'' as defined for the purpose of the Mark-to-Market Rules should consult their tax advisors. This summary is not applicable to a purchaser that is a ''specified financial institution'' or to a purchaser an interest in which is a tax shelter investment, as defined in the Tax Act. Such purchasers should consult their own tax advisors.

This summary is based upon the provisions of the Tax Act and regulations thereunder (the ''Regulations'') in force as at the date hereof, all specific proposals (the ''Tax Proposals'') to amend the Tax Act or Regulations that have been publicly announced by or on behalf of the Minister of Finance (Canada) prior to the date hereof and counsel's understanding of the current published administrative practices of the Canada Revenue Agency. This summary does not otherwise take into account or anticipate any changes in applicable law, whether by legislative, governmental or judicial decision or action, nor does it take into account provincial, territorial or foreign tax laws or considerations, which might differ significantly from those discussed herein.

This summary is of a general nature only and is not intended to be, nor should it be construed to be, legal or tax advice to any particular holder. This summary is not exhaustive of all possible income tax considerations under the Tax Act that may affect a holder. The income tax consequences of acquiring and disposing of Subscription Receipts and Common Shares will vary depending on a number of facts, including the legal status of the holder as an individual, corporation, trust or partnership. Accordingly, prospective holders of Subscription Receipts and Common Shares should consult their own tax advisors with respect to their particular circumstances and the tax consequences to them of holding and disposing of Subscription Receipts and Common Shares.

Exchange of Subscription Receipts

No gain or loss will be realized by a holder on the exchange of Subscription Receipts for Common Shares.

The cost of a Common Share issued to a holder of a Subscription Receipt acquired pursuant to the Offering will be equal to the cost of the Subscription Receipt to the holder. The adjusted cost base to the holder of Common Shares so acquired will be determined by averaging the cost of such Common Shares with the adjusted cost base of all other Common Shares owned at that time by the holder as capital property.

Termination of Subscription Receipts

As described above under ''Details of the Offering'', in the event that the Release Conditions are not satisfied or if the Acquisition Agreement is terminated prior to the Termination Time, holders of Subscription Receipts will be entitled to receive from the Escrow Agent an amount equal to the full subscription price thereof plus their *pro rata* share of the interest earned or income generated thereon. In that event, the amount of such interest or income received or receivable by a holder of Subscription Receipts (depending on the method regularly followed by the holder in computing income) must be included in the income of the holder.

Payment of Dividend Equivalent

As described above under ''Details of the Offering'', if Common Shares are issued in exchange for Subscription Receipts, and if dividends have been declared on the Common Shares of the Corporation to holders of record on a date during the period from the Closing Date to the date of such issuance of Common Shares, the Corporation will make a cash payment to the holders of Subscription Receipts in respect of each Subscription Receipt in an amount equal to the per share amount of such dividend. The equivalent to dividend amount, if any, paid to a holder of Subscription Receipts by the Corporation must be included in the income of the holder. Any amount so included will be taxed as ordinary income and not as a dividend and, as such, will not be subject to the gross-up and dividend tax credit rules described below.

Other Dispositions of Subscription Receipts

A disposition or deemed disposition by a holder of a Subscription Receipt, other than on the exchange of a Subscription Receipt for a Common Share or a disposition of the Subscription Receipt to the Corporation in the event the Release Conditions are not satisfied or if the Acquisition Agreement is terminated prior to the Termination Time, will generally result in the holder realizing a capital gain (or a capital loss) equal to the amount by which the proceeds of disposition exceed (or are less than) the aggregate of the holder's adjusted cost base thereof and any reasonable costs of disposition.

Dividends on Common Shares

Dividends received on Common Shares by a holder who is an individual will be included in the individual's income and will be subject to the gross-up and dividend tax credit rules normally applicable to taxable dividends received from taxable Canadian corporations, including the enhanced gross-up and dividend tax credit for ''eligible dividends'' paid after 2005. A dividend will be eligible for the enhanced gross-up and dividend tax credit if the paying corporation designates the dividend as an eligible dividend. There may be limitations on the ability of a corporation to designate dividends as eligible dividends. The Corporation has advised counsel that it intends to designate all dividends paid on the Common Shares as eligible dividends for these purposes. Taxable dividends received by an individual may give rise to alternative minimum tax under the Tax Act, depending on the individual's circumstances.

Dividends received on Common Shares by a holder that is a corporation will be included in income and normally will be deductible in computing such corporation's taxable income. However, the Tax Act will generally impose a 33⅓% refundable Part IV tax on such dividends received by a corporation that was, at any time in the taxation year in which such dividends were received, a ''private corporation'' as defined in the Tax Act, or a corporation resident in Canada that is controlled by or for the benefit of an individual (other than a trust) or a related group of individuals (other than trusts), to the extent that such dividends are deductible in computing the corporation's taxable income.

Disposition of Common Shares

In general, a disposition or a deemed disposition of a Common Share will give rise to a capital gain (or a capital loss) equal to the amount by which the proceeds of disposition of the Common Share, net of any reasonable costs of disposition, exceed (or are less than) the adjusted cost base to the holder of the Common Share immediately before the disposition.

Tax Treatment of Capital Gains and Losses

Generally, one-half of any capital gain realized by a holder in a taxation year will be included in computing the holder's income in such year. One-half of any capital loss realized by a holder in a taxation year normally may be deducted as an allowable capital loss by the holder against taxable capital gains realized by the holder in the year. Any allowable capital loss not deductible in the year it is realized generally may be carried back and deducted against taxable capital gains in any of the three preceding years or carried forward and deducted against taxable capital gains in any subsequent year (in accordance with the rules contained in the Tax Act). Capital gains realized by an individual will be relevant in computing possible liability for the alternative minimum tax.

The amount of any capital loss realized on the disposition or deemed disposition of a Common Share by a holder that is a corporation may be reduced by the amount of dividends received by the holder on the Common Share to the extent and in the circumstances prescribed by the Tax Act. Similar rules may apply where a corporation is a member of a partnership or a beneficiary of a trust that owns Common Shares and where a trust is a member of a partnership that owns Common Shares or a partnership or trust is a beneficiary of a trust that owns Common Shares. Holders to whom these rules may be relevant should consult their own tax advisors.

Additional Refundable Tax

A holder that is a ''Canadian-controlled private corporation'' (as defined in the Tax Act) may be liable to pay an additional refundable tax of 6⅔% on certain investment income, including amounts in respect of taxable capital gains and interest (but not dividends deductible in computing taxable income).

RISK FACTORS

An investment in the Subscription Receipts offered hereby and the Common Shares issuable upon the exchange thereof involves certain risks in addition to those described in the Management Discussion and Analysis of financial condition and results of operations contained in the Corporation's annual information form dated March 29, 2006 incorporated by reference herein. Before investing, prospective purchasers of Subscription Receipts should carefully consider, in light of their own financial circumstances, the factors set out below, as well as the other information contained or incorporated by reference in the Prospectus.

Regulation

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

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

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

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

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

Forecasting Accuracy

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

Asset Maintenance

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

Operational Risks

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

Natural Gas Prices

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

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

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

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

Weather and Seasonality

Weather during the year has a significant impact on distribution volume as a major portion of the gas distributed by Terasen Gas is ultimately used for space heating. Because of natural gas consumption patterns, the natural gas distribution operations of Terasen Gas normally generate quarterly earnings that vary by season. Typically, higher net earnings are experienced in the first and fourth quarters, but are offset by net losses in the second and third quarters. See ''The Acquired Business — Regulation''.

Risks Related to Terasen Gas (Vancouver Island) Inc.

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

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

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

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

Government Permits

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

Impact of Changes in Economic Conditions

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

Natural Gas Supply

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

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

Access to Capital and Credit Ratings

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

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

Interest Rates

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

Counterparty Credit Risk

Terasen Gas is exposed to credit risk in the event of non-performance by counterparties to derivative instruments. Terasen Gas is also exposed to significant credit risk on physical off-system sales. Because it deals with high credit quality institutions in accordance with established credit approval practices, Terasen Gas does not expect any counterparties to fail to meet their obligations.

Potential Undisclosed Liabilities Associated with the Acquisition

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

Labour Relations

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

Underinsured and Uninsured Losses

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

Environmental Matters

Terasen Gas is subject to numerous laws, regulations and guidelines governing the management, transportation and disposal of hazardous substances and other waste materials and otherwise relating to the protection of the environment and health and safety. Potential environmental damage and costs could arise due to a severe weather event or a major equipment failure. However, there can be no assurance that such costs will be recoverable and, if substantial, unrecovered costs may have a material effect on the business, results of operations and prospects of Terasen Gas.

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

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

First Nations' Lands

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

Results of Operations and Financing Risks

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

Management of Expanding Operations

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

Realization of Acquisition Benefits

As described in ''The Acquisition — Acquisition Rationale'', the Corporation believes that the Acquisition will provide benefits to Fortis. However, there is a risk that some or all of the expected benefits of the Acquisition may fail to materialize, or may not occur within the time periods anticipated by the Corporation. The realization of such benefits may be affected by a number of factors, many of which are beyond the control of the Corporation.

Subscription Receipt Structure

The Subscription Receipts will be automatically exchanged for Common Shares upon the satisfaction of the Release Conditions. The Corporation may, in its sole discretion, waive certain closing conditions in its favour in the Acquisition Agreement or agree with the Vendor to amend the Acquisition Agreement and consummate the Acquisition on terms that may be substantially different from those contemplated in this Prospectus. As a result, the expected benefits of the Acquisition may not be fully realized. See ''Acquisition Agreement''. There can be no assurance that the Release Conditions will be satisfied on or prior to the Termination Time. Until the Release Conditions are satisfied and the Common Shares are delivered pursuant to the Subscription Receipt Agreement, holders of Subscription Receipts have the rights as described under ''Details of the Offering — Subscription Receipts''.

Market for Securities

There is currently no market through which the Subscription Receipts may be sold. There can be no assurance that an active trading market will develop for the Subscription Receipts after the Offering or, if developed, that such a market will be sustained at the price level of the Offering. The TSX has conditionally approved the listing of the Subscription Receipts, as well as the Common Shares issuable on the exchange of the Subscription Receipts. Listing is subject to the Corporation fulfilling all of the requirements of the TSX on or before June 3, 2007.

AUDITORS

The auditors of the Corporation are Ernst & Young LLP, Chartered Accountants (''Ernst & Young''), The Fortis Building, 7th Floor, 139 Water Street, St. John's, Newfoundland and Labrador, A1C 1B2. Ernst & Young report that they are independent of the Corporation in accordance with the Rules of Professional Conduct of the Institute of Chartered Accountants of Newfoundland.

The auditors of Terasen as at December 31, 2005 were KPMG LLP, Chartered Accountants (''KPMG''), of Vancouver, British Columbia. KPMG report that, as at March 31, 2006 and during the years ended December 31, 2005 and 2004 on which they reported, they were independent of Terasen within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of British Columbia.

LEGAL MATTERS

Certain legal matters relating to this Offering will be passed upon on behalf of the Corporation by Davies Ward Phillips & Vineberg LLP, Toronto and McInnes Cooper, St. John's and on behalf of the Underwriters by Stikeman Elliott LLP, Toronto. At the date hereof, partners and associates of each of Davies Ward Phillips & Vineberg LLP, McInnes Cooper and Stikeman Elliott LLP own beneficially, directly or indirectly, less than 1% of any securities of the Corporation or any associate or affiliate of the Corporation.

TRANSFER AGENT AND REGISTRAR

The transfer agent and registrar for the Subscription Receipts is Computershare Trust Company of Canada in Toronto and Montréal.

PURCHASERS' STATUTORY RIGHTS

Securities legislation in certain of the provinces of Canada provides purchasers with the right to withdraw from an agreement to purchase securities. This right may be exercised within two business days after receipt or deemed receipt of a prospectus and any amendment. In several of the provinces, the securities legislation further provides a purchaser with remedies for rescission or, in some jurisdictions, damages if the prospectus and any amendment contains a misrepresentation or is not delivered to the purchaser, provided that the remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's province for the particulars of these rights or consult with a legal advisor.

GLOSSARY OF TERMS

In the Prospectus, unless the context otherwise requires, the following terms have the meanings set forth below.

''1933 Act'' means the United States *Securities Act of 1933*, as amended;

''Acquisition'' means the acquisition by Fortis of all of the issued and outstanding shares of Terasen;

''Acquisition Agreement'' means the acquisition agreement dated February 26, 2007 between Fortis, 3211953 Nova Scotia Company and Kinder Morgan;

''CDS'' means CDS Clearing and Depository Services Inc.;

''Closing Date'' means on or about March 15, 2007, or such other date as agreed to by the Corporation and the Underwriters, but not later than April 18, 2007;

''Corporation'' or **''Fortis''** means Fortis Inc.;

''Credit Facilities'' means the senior unsecured, non-revolving term credit facilities in the aggregate amount of $1.425 billion, consisting of a facility in the amount of $925 million and a facility in the amount of $500 million, to be extended to Fortis pursuant to a commitment letter dated February 26, 2007 from Canadian Imperial Bank of Commerce;

''CWP'' means CustomerWorks Limited Partnership;

''Escrow Agent'' means Computershare Trust Company of Canada or its successor as escrow agent under the Subscription Receipt Agreement;

''Escrowed Funds'' means the gross proceeds from the sale of the Subscription Receipts;

''Offering'' means the distribution of Subscription Receipts pursuant to the Prospectus;

''Release Conditions'' means the receipt by the Corporation of all regulatory and government approvals required to finalize the Acquisition, including that of the BCUC, and fulfillment or waiver of all other outstanding conditions precedent to closing the Acquisition as itemized in the Acquisition Agreement;

''ROE'' means return on equity;

''SEDAR'' means the Canadian System for Electronic Document Analysis and Retrieval;

''Subscription Receipt Agreement'' means the agreement dated as of the Closing Date among the Corporation, CIBC World Markets Inc. and the Escrow Agent governing the terms of the Subscription Receipts;

''Subscription Receipts'' means the subscription receipts of the Corporation offered hereby;

''Terasen'' means Terasen Inc.;

''Terasen Gas'' means, collectively, TGI, TGVI, TGWI and CWP;

''Termination Time'' means the earlier of 5:00 p.m. (Toronto time) on November 30, 2007 or the date on which the Acquisition Agreement is terminated;

''TGI'' means Terasen Gas Inc.;

''TGVI'' means Terasen Gas (Vancouver Island) Inc.;

''TGWI'' means Terasen Gas (Whistler) Inc.;

''TSX'' means the Toronto Stock Exchange;

''Underwriters'' means, collectively, CIBC World Markets Inc., Scotia Capital Inc., TD Securities Inc., BMO Nesbitt Burns Inc., RBC Dominion Securities Inc., National Bank Financial Inc., Canaccord Capital Corporation, Beacon Securities Limited and HSBC Securities (Canada) Inc.; and

''Underwriting Agreement'' means the underwriting agreement dated February 27, 2007, between the Corporation and the Underwriters relating to the sale of the Subscription Receipts offered under the Prospectus.

All dollar amounts in the Prospectus are expressed in Canadian dollars.

AUDITORS' CONSENT

We have read the short form prospectus of Fortis Inc. (the ''Corporation'') dated March 7, 2007 relating to the issue and sale of 38,500,000 subscription receipts of the Corporation. We have complied with Canadian generally accepted standards for an auditor's involvement with offering documents.

We consent to the incorporation by reference, in the above-mentioned prospectus, of our report to the shareholders of the Corporation on the consolidated balance sheets of the Corporation as at December 31, 2005 and 2004 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. Our report is dated January 27, 2006.

St. John's, Canada
March 7, 2007

(Signed) Ernst & Young LLP
Chartered Accountants

AUDITORS' CONSENT

We have read the short form prospectus of Fortis Inc. (the ''Corporation'') dated March 7, 2007 relating to the issue and sale of 38,500,000 subscription receipts of the Corporation. We have complied with Canadian generally accepted standards for an auditor's involvement with offering documents.

We consent to the use in the above-mentioned prospectus of our report to the shareholder of Terasen Inc. on the consolidated statements of financial position of Terasen Inc. as at December 31, 2005 and 2004 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. Our report is 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.

Vancouver, Canada	(Signed) KPMG LLP
March 7, 2007	Chartered Accountants

INDEX TO FINANCIAL STATEMENTS

Terasen Inc.

Consolidated Financial Statements
Years ended December 31, 2005 and 2004

Together with Auditors' Report

AUDITORS' REPORT TO THE SHAREHOLDER

We have audited the consolidated statements of financial position of Terasen Inc. as at December 31, 2005 and 2004 and the consolidated statements of earnings, retained earnings and cash flows for the years 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 audits.

We conducted our audits 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, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) KPMG LLP
Chartered Accountants

Vancouver, Canada
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

TERASEN INC.

CONSOLIDATED STATEMENTS OF EARNINGS

	Years ended December 31	
	2005	2004
		(Restated — notes 1(p) and 3)
	In millions of dollars	
Revenues		
Natural gas distribution	**$1,678.0**	$1,494.1
Petroleum transportation	**227.8**	225.5
Other activities	**46.7**	78.5
	1,952.5	1,798.1
Expenses		
Cost of natural gas	**1,063.7**	885.4
Cost of revenues from other activities	**28.9**	52.8
Operation and maintenance	**320.7**	274.7
Depreciation and amortization	**142.6**	144.5
Property and other taxes	**71.9**	69.9
	1,627.8	1,427.3
Operating Income	**324.7**	370.8
Financing costs (note 14)	**191.4**	175.6
Earnings before share of earnings of equity investments and income taxes	**133.3**	195.2
Equity earnings from Clean Energy net of disposition costs (note 4)	**2.5**	—
Share of earnings of Express System	**21.9**	15.0
Earnings before income taxes and discontinued operations	**157.7**	210.2
Income taxes (note 15)	**51.6**	63.7
Earnings before discontinued operations	**106.1**	146.5
Earnings (loss) from discontinued operations, net of income taxes (note 3)	**(4.9)**	3.3
NET EARNINGS	**$ 101.2**	$ 149.8

TERASEN INC.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

	Years ended December 31	
	2005	2004
		(Restated — note 1(p))
	In millions of dollars	
Retained earnings, beginning of year	**$418.9**	$355.5
Net earnings	**101.2**	149.8
	520.1	505.3
Dividends on common shares	**95.1**	86.4
Retained earnings, end of year	**$425.0**	$418.9

TERASEN INC.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	In millions of dollars As at December 31	
	2005	2004 (Restated — note 1(p))
Assets		
Current assets		
Cash and short-term investments	**$ 79.4**	$ 20.0
Accounts receivable	**468.1**	348.6
Inventories of gas in storage and supplies	**205.7**	189.2
Prepaid expenses	**14.1**	9.5
Current portion of rate stabilization accounts (note 7)	**28.4**	27.1
Current assets held for sale (note 3)	**54.8**	—
	850.5	594.4
Property, plant and equipment (note 6)	**3,907.9**	3,892.5
Long-term investment	**238.3**	218.9
Goodwill	**76.4**	128.0
Rate stabilization accounts (note 7)	**48.3**	60.6
Other assets (note 8)	**84.8**	87.4
Long-lived assets held for sale (note 3)	**109.9**	—
	$5,316.1	$4,981.8
Liabilities and shareholder's equity		
Current liabilities		
Short-term notes	**$ 681.0**	$ 248.0
Accounts payable and accrued liabilities	**433.8**	365.7
Income and other taxes payable	**30.8**	36.4
Current portion of rate stabilization accounts (note 7)	**47.9**	27.6
Current portion of long-term debt (note 9)	**398.2**	416.7
Due to parent company	**0.4**	—
Current liabilities held for sale (note 3)	**24.5**	—
	1,616.6	1,094.4
Long-term debt (note 9)	**2,012.9**	2,291.6
Other long-term liabilities and deferred credits (note 10)	**168.5**	156.0
Future income taxes (note 15)	**88.7**	68.7
Long-term liabilities held for sale (note 3)	**13.7**	—
	3,900.4	3,610.7
Shareholder's equity		
Common shares (note 11)	**904.9**	883.4
Contributed surplus (note 12)	**137.5**	132.5
Retained earnings	**425.0**	418.9
Cumulative currency translation adjustment	**(0.7)**	(12.7)
	1,466.7	1,422.1
Less cost of common shares held by Terasen Pipelines (Trans Mountain) Inc.	**51.0**	51.0
	1,415.7	1,371.1
	$5,316.1	$4,981.8

Approved by the Board:

(Signed) JAMES M. STANFORD
Director

(Signed) DOUGLAS W.G. WHITEHEAD
Director

TERASEN INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	In millions of dollars	
	2005	2004
Cash flows provided by (used for)		
Operating activities		
Net earnings	**$101.2**	$149.8
Adjustments for non-cash items		
Loss (earnings) from discontinued operations	**4.9**	(3.3)
Depreciation and amortization	**142.6**	144.5
Equity earnings from Clean Energy	**(2.5)**	—
Share of earnings from long-term investments, in excess of cash distributions	**(19.4)**	(14.3)
Future income taxes	**2.9**	(0.5)
Other	**18.7**	10.2
	248.4	286.4
Decrease in rate stabilization accounts	**10.1**	31.0
Discontinued operations — Water and Utility Services	**5.2**	3.3
Changes in non-cash working capital	**(68.3)**	14.7
	195.4	335.4
Investing activities		
Property, plant and equipment	**(214.7)**	(154.4)
Acquisition of water and utility services businesses (note 4)	**—**	(57.9)
Proceeds on sale of Clean Energy (note 4)	**43.0**	—
Discontinued operations — Water and Utility Services	**(36.8)**	—
Proceeds on sale of other property, plant and equipment	**—**	0.9
Proceeds on sale of natural gas distribution assets (note 10)	**7.2**	64.6
Other assets and deferred credits	**(11.2)**	(13.4)
	(212.5)	(160.2)
Financing activities		
Increase (decrease) in short-term notes	**433.0**	(305.9)
Increase in long-term debt	**601.5**	339.1
Reduction of long-term debt	**(884.9)**	(118.2)
Advances from parent company	**0.4**	—
Discontinued operations — Water and Utility Services	**0.7**	—
Issue of common shares, net of issue costs (note 11)	**20.9**	14.7
Dividends on common shares	**(95.1)**	(86.4)
	76.5	(156.7)
Net increase in cash	**59.4**	18.5
Cash at beginning of year	**20.0**	1.5
Cash at end of year	**$ 79.4**	$ 20.0
Supplemental cash flow information		
Interest paid in the year	**$187.6**	$162.7
Income taxes paid in the year	**48.4**	78.1
Non-cash transactions		
Mark to market on certain gas derivatives deferred in rate-stabilization accounts	**21.2**	—

Cash is defined as cash or bank indebtedness.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

YEARS ENDED DECEMBER 31, 2005 AND 2004

Terasen Inc. (''Terasen'' or the ''Company'') provides energy transportation and utility asset management services. Terasen operates in three primary business segments which are 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 have been reclassified to Discontinued Operations as described in Note 3.

(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% (2004 — 45%) 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 4).

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 securityholders. The Company has charged to earnings after-tax costs of $42.9 million associated with the transaction in earnings in the year ended December 31, 2005, 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 12, and the write-off of approximately $15.3 million of income tax expense related to restricted tax loss carry-forwards.

1. SIGNIFICANT ACCOUNTING POLICIES

The preparation of these consolidated 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 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 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.

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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

(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. For 2005, Terasen Gas's allowed rate of return was 9.03% and TGVI's allowed rate of return was 9.53%. The allowed rates of return are based on a notional debt-equity ratio of 67% debt and 33% equity for Terasen Gas and 65% debt and 35% 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 memorandum of understanding with shippers on a new five-year agreement 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. FSW is currently operating on an interim rate basis while the Commission is hearing a new rate case.

Approximately 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.

The impacts of rate regulation on the Company's operations for the twelve months ending December 31, 2005 and as at December 31, 2005 are described in these Significant Accounting Policies, and in Note 6 ''Property, Plant and Equipment'', Note 7 ''Rate Stabilization Accounts'', Note 8 ''Other Assets'', Note 10 ''Other Long-Term Liabilities and Deferred Credits'', Note 13 ''Employee Benefit Plans'', Note 14 ''Financing Costs'', and Note 15 ''Income Taxes''.

(d) INVENTORIES

Inventories of gas in storage are valued at weighted-average cost. Supplies and other inventories are valued at the lower of cost and net realizable value.

(e) 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 requires 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.

(f) 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.

(g) 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

1. **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

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, 2005 and 2004. For regulated operations there is a reasonable expectation that asset retirement costs would be recoverable through future rates or tolls.

(h) 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, 2005 and 2004, 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.

In 2004, the Gas Cost Reconciliation Account (''GCRA''), which accumulates differences between actual natural gas costs and forecast natural gas costs as recovered in base rates, was replaced by the Commodity Cost Reconciliation Account (''CCRA'') and the Midstream Cost Reconciliation Account (''MCRA''). The two new accounts were approved by the BCUC to 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.

(i) 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.

(j) 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.

(k) 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 Revenue Stabilization Adjustment Mechanism 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.

(l) 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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

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

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

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

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

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

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

(m) 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, 2005 is calculated as the average of the market value of invested assets at December 31, 2005 and two actuarially determined extrapolated market values of invested assets at December 31, 2005. The two extrapolated market values are calculated by using the market value of invested assets at December 31, 2003 rolled forward to December 31, 2005 using 2004 and 2005 net contributions and assumed investment returns, and the market value of invested assets at December 31, 2004 rolled forward to December 31, 2005 using 2005 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.

(n) 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 and FSW 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(o) STOCK-BASED COMPENSATION

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.

(p) LIABILITIES AND EQUITY

In accordance with recent changes to the CICA Handbook Section 3861 ''Financial Instruments — Disclosures and Presentation'', the Company's $125 million 8% Capital Securities have been reclassified from shareholders' equity to liabilities because the Capital Securities can be settled by issuing equity at a variable price dependent upon the market value of the Company's common shares at the settlement date. As a result of the change, distributions associated with the Capital Securities are now recorded as financing costs and the related income-tax benefits are recorded within income tax expense. Previously, the distributions were recorded on an after-tax basis as a deduction from net earnings to determine earnings applicable to common shares. There is no impact to earnings applicable to common shares or earnings per share. The changes have been applied retroactively and have increased long-term debt and decreased shareholders' equity, both by $125.0 million, compared to the amounts previously reported as at December 31, 2004. The restatement has also increased financing costs by $10.0 million, decreased income tax expense by $3.4 million and capital securities distributions by $6.6 million compared to the amounts previously reported for the year ended December 31, 2004.

(q) VARIABLE INTEREST ENTITIES

Effective January 1, 2005, the Company adopted the CICA Handbook Accounting Guideline 15 ''Consolidation of Variable Interest Entities''. The Company has performed a review of the entities with whom it conducts business and determined that under the definitions in the Guideline the Company's investment in Express US Holdings LP, part of the Express System, 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

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**
Earnings (loss) from discontinued operations	**—**	**—**	**(4.9)**	**(4.9)**
Net earnings (loss)	**90.8**	**64.5**	**(54.1)**	**101.2**
Total assets	**3,656.9**	**1,397.1**	**262.1**	**5,316.1**
Goodwill	**76.4**	**—**	**—**	**76.4**
Capital expenditures	**176.3**	**37.4**	**1.0**	**214.7**

2. SEGMENT DISCLOSURES (CONTINUED)

2004

	Natural gas distribution	Petroleum transportation	Other activities	Total
Revenues	$1,494.1	$ 225.5	$78.5	$1,798.1
Cost of natural gas	885.4	—	—	885.4
Cost of revenues from other activities	—	—	52.8	52.8
Operation and maintenance	190.5	66.0	18.2	274.7
Depreciation and amortization	98.7	35.9	9.9	144.5
Property and other taxes	47.1	22.5	0.3	69.9
	1,221.7	124.4	81.2	1,427.3
Operating income	272.4	101.1	(2.7)	370.8
Financing costs	126.2	22.5	26.9	175.6
Share of (earnings) of Express System	—	(15.0)	—	(15.0)
Income taxes (recovery) on earnings	50.3	22.7	(9.3)	63.7
Net earnings (loss)	95.9	70.9	(20.3)	146.5
Earnings from discontinued operations	—	—	3.3	3.3
Net earnings (loss)	95.9	70.9	(17.0)	149.8
Total assets	3,386.2	1,350.4	245.2	4,981.8
Goodwill	76.4	—	51.6	128.0
Capital expenditures	112.3	31.0	11.1	154.4

The segmented disclosures in these consolidated financial statements have been changed from those reported in the December 31, 2004 annual financial statements and no longer include the water and utility services business which are now reported as discontinued operations. Terasen's 30% share of CWLP is now included in other activities. The comparative segment information has been restated to reflect this change.

3. DISCONTINUED OPERATIONS

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 proceeds are anticipated to approximate the consolidated net carrying value of the discontinued operations at December 31, 2005, and no significant gains or losses are expected to occur upon the disposition. The Company anticipates that the sale will be completed at the end of April 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 have been classified as net earnings (loss) from discontinued operations and the comparative figures have been restated to conform with this presentation. Gross revenues applicable to the Terasen Water and Utility Services group were $205.1 million in 2005 (2004 — $158.9 million) and pre-tax income was $1.4 million (2004 — $6.4 million). The 2005 pre-tax income includes a charge to earnings of $7.2 million related to currency translation losses arising on the Company's investment in self sustaining foreign operations. Income taxes from discontinued operations includes a charge of $3.4 million on operating earnings from the entities and a write-off of $2.9 million of tax losses expiring as a result of the change in control.

4. ACQUISITIONS AND DISPOSITIONS

DISPOSITION OF CLEAN ENERGY

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 totalling $10.9 million and the recognition of currency translation losses previously included in shareholders' equity totalling $8.4 million.

WATER AND UTILITY SERVICES ACQUISITIONS

In 2005 the Company purchased two water and utility services businesses for total cash proceeds of $11.2 million. The cash used to purchase these businesses has been included in Investing activities of Discontinued Operations on the Statements of Cash Flow.

On July 31, 2004, the Company acquired a 50 per cent interest in FSW. FSW provides water and wastewater treatment and water distribution and wastewater collection services to Fairbanks, Alaska. The Company paid $40.8 million for its 50 per cent interest after working capital adjustments. The Company has accounted for the acquisition of FSW using the purchase method and has proportionately consolidated its 50% of operations since the date of acquisition.

The Company and the other owners of FSW each have the option to have Terasen acquire the remaining 50 per cent interest in FSW at fair market value in 2009.

During 2004, the Company also acquired 100% of two businesses and increased its investment in two other businesses that provide meter reading, meter fleet management and installation services in Canada and the United States. The Company paid $17.1 million for the interest in

4. ACQUISITIONS AND DISPOSITIONS (CONTINUED)

these businesses after working capital adjustments. The earnings of these acquired businesses have been included in the statement of earnings from the date of acquisition.

The following table provides the allocation of the purchase price over the assets and liabilities acquired in 2004:

	FSW	Other	Total
Working capital	$ 2.2	$ 7.1	$ 9.3
Property, plant and equipment	27.0	1.6	28.6
Goodwill	24.0	8.0	32.0
Other assets	0.5	0.4	0.9
Future income taxes	(2.0)	—	(2.0)
Long-term debt assumed	(10.9)	—	(10.9)
Total cash paid	$ 40.8	$17.1	$ 57.9

5. INVESTMENTS IN JOINTLY-CONTROLLED ENTITIES

As at December 31, 2005, the Company has a 30% interest in CWLP and a 50% interest in FSW for which it uses the proportionate consolidation method of accounting. The comparative information for 2004 in the table below includes the Company's interest in Clean Energy which was accounted for under the proportionate consolidated method until the first quarter of 2005, and then equity-accounted until the interest in Clean Energy was sold in 2005. The revenue, expenses, and net income for 2004 has been restated to present the net earnings of the Company's 50% interest in FSW's as earnings from discontinued operations. 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 these entities proportionately consolidated is summarized as follows:

	2005	2004
Current assets	**$10.2**	$ 27.1
Long-term assets (including property, plant and equipment and goodwill)	**35.6**	121.0
Current liabilities	**39.4**	41.3
Long-term liabilities	**—**	20.4
Revenues	**43.5**	73.0
Expenses (including financing costs and income tax)	**36.4**	67.7
Net earnings from continuing operations	**7.1**	5.3
Earnings from discontinued operations	**1.7**	0.6
Cash flows from operating activities	**13.9**	7.8
Cash flows from investing activities	**(0.1)**	(7.5)
Cash flows from financing activities	**—**	0.2

6. PROPERTY, PLANT AND EQUIPMENT

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**

2004

	Weighted average depreciation rate	Cost	Accumulated depreciation	Net book Value
Natural gas distribution systems	2.40%	$3,009.6	$ 542.5	$2,467.1
Petroleum pipeline systems	2.51%	1,295.0	295.9	999.1
Water and utility plant and distribution systems	3.71%	34.0	1.8	32.2
Plant, buildings and equipment	8.98%	404.4	160.3	244.1
Land and land rights	0.25%	152.6	2.6	150.0
		$4,895.6	$1,003.1	$3,892.5

6. **PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

As allowed by the regulators, during the year ended December 31, 2005 the Company capitalized an allowance for equity funds during construction at approved rates of $1.0 million (2004 — $1.0 million) and approved capitalized overhead of $31.1 million (2004 — $31.1 million), with offsetting inclusions in earnings.

7. **RATE STABILIZATION ACCOUNTS**

	2005	2004
Current Assets		
RDDA	**$12.8**	$12.9
RSAM	**13.0**	11.1
CCRA	**—**	2.7
Gas Cost Variance Account (TGVI)	**2.6**	0.4
	28.4	27.1
Long-Term Assets		
RDDA	**22.4**	32.7
RSAM	**25.9**	27.9
	48.3	60.6
Current Liabilities		
CCRA	**(21.3)**	—
MCRA	**(26.6)**	(27.6)
	(47.9)	(27.6)
Net rate stabilization accounts	**$28.8**	$60.1

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.

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, which succeeded the GCRA account in 2004, are anticipated to be fully recovered or paid within the next fiscal year.

8. **OTHER ASSETS**

	2005	2004
Deferred charges		
Subject to rate regulation and approved for recovery in rates		
Income taxes recoverable on post-employment benefits	**$10.6**	$ 8.4
Long-term debt issue costs	**9.5**	8.6
Commercial commodity unbundling costs	**3.2**	4.0
Replacement transportation agreement	**3.2**	3.6
Other items included approved for recovery in rates	**12.2**	10.9
Subject to rate regulation but not yet approved for recovery in rates		
Deferred development costs for capital projects	**19.5**	7.9
Corporate capital tax deferrals	**7.5**	7.7
Inland Pacific Connector Development costs	**—**	5.4
Other items subject to rate regulation but not yet approved	**1.7**	0.9
Included in non-regulated entities		
Long-term debt issue costs	**1.0**	1.6
Other items included in non-regulated entities	**2.7**	12.4
	71.1	71.4
Investments	**2.2**	1.3
Long-term receivables	**11.5**	14.7
	$84.8	$87.4

Amortization of these deferred charges in rates for the year ended December 31, 2005 totalled $11.3 million (2004 -$9.0 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 9 ''Long-Term Debt''.

8. OTHER ASSETS (CONTINUED)

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 four years remain at December 31, 2005.

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 four years remain at December 31, 2005.

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 $16.2 million for Trans Mountain TMX expansion costs and $3.3 million for capital projects that are currently in progress by the natural gas distribution operations.

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 for TGVI and Terasen Gas which the Company believes were incorrectly assessed. The Company is currently in the process of appealing the tax assessments and depending on the success of the appeals, the Company will either be refunded these amounts from the Province or alternatively expects to recover the costs from customers in future rates.

On October 5, 2005, the British Columbia Utilities Commission 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. The Company still believes that the project is viable and intends to keep all existing permits and land right approvals in place that have already been granted. Terasen Gas has filed an application to have the decision reconsidered, but has recorded an after-tax provision of $3.6 million at December 31, 2005.

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 10 relate to more than fifty deferral accounts, none of which exceed $1.6 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.

9. LONG-TERM DEBT

	2005	2004
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**	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
	550.0	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**	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 12, due July 20, 2005	**—**	200.0
6.50% Series 13, due October 16, 2007	**100.0**	100.0
6.15% Series 16, due July 31, 2006	**100.0**	100.0
Floating Rate Series 17, interest rate of 2.93% (2004) due September 26, 2005	**—**	150.0
6.50% Series 18, due May 1, 2034	**150.0**	150.0
5.90% Series 19, due February 26, 2035	**150.0**	—
Floating Rate Series 20, interest rate of 3.36% due October 24, 2007	**150.0**	—
Various series, weighted average interest rate of 9.63% (2004 — 9.63%) due in 2005	**—**	45.0
Obligations under capital leases, at 6.07% (2004 — 6.23%)	**8.8**	10.8
	1,351.6	1,448.6
Terasen Gas (Vancouver Island) Inc.		
(e) Syndicated credit facility at short-term floating rates, weighted average interest rate of 3.88% (2004 — 3.35%) with maturities of $176.5 million in 2006 and $33.0 million in 2009	**209.5**	214.9
Terasen Pipelines (Trans Mountain) Inc.		
(f) Debentures:		
11.50% Series C, due June 20, 2010	**—**	35.0
	—	35.0
Terasen Pipelines (Corridor) Inc.		
(g) Debentures:		
4.24% Series A, due February 2, 2010	**150.0**	—
5.033% Series B, due February 2, 2015	**150.0**	—
(h) Commercial Paper at short-term floating rates, weighted average interest rate of 2.61% (2004 — 2.51%)	**—**	446.0
	300.0	446.0
Other long-term debt	**—**	13.8
Total long-term debt	**2,411.1**	2,708.3
Less: current portion of long-term debt	**398.2**	416.7
	$2,012.9	$2,291.6

(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. Distributions on these securities, net of related income taxes, are deducted from net earnings for the purposes of calculating earnings applicable to common shares.

9. LONG-TERM DEBT (CONTINUED)

(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:

The credit facility from the syndicate of banks is secured by a first floating charge over all of the assets of TGVI, assignment of certain material contracts, and assignment of royalty revenue and interruptible incentive payments. Subsequent to year-end the credit facility was renegotiated, and further information is disclosed in Note 19 ''Subsequent Events''.

(f) TERASEN PIPELINES (TRANS MOUNTAIN) INC. DEBENTURES:

The Trans Mountain debentures were unsecured obligations but were subject to the restrictions of the Trust Indenture dated February 18, 1987, as amended and supplemented.

On November 1, 2005, Trans Mountain redeemed the 11.50% Series C Debentures, due June 20, 2010. The total redemption price for the Debentures included a redemption premium of $10.9 million which has been reflected in financing costs for the year ended December 31, 2005. The Company has recognized an income tax benefit associated with the redemption costs of $3.6 million in income taxes for the year ended December 31, 2005.

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

On February 1, 2005, Terasen Pipelines (Corridor) Inc. (''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 16, Series 18, and Series 19 Medium Term Note Debentures, and Terasen Pipelines (Corridor) Inc. 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:

2006	$398.2
2007	251.8
2008	389.7
2009	94.6
2010	151.8

10. OTHER LONG-TERM LIABILITIES AND DEFERRED CREDITS

	2005	2004
Pension and other post-employment benefit liabilities	**$ 39.7**	$ 30.8
Deferred gains on sale of natural gas distribution assets	**59.2**	60.3
Deferred payment	**36.0**	33.9
Deferred credits		
Subject to rate regulation and approved for refund in rates		
Earnings Sharing Mechanism	**8.8**	1.6
Deferred Interest Mechanism	**2.4**	2.5
Other items included approved for repayment in rates	**6.8**	8.2
Other deferred credits in entities subject to rate regulation	**1.7**	1.8
Other deferred credits/liabilities	**13.9**	16.9
	$168.5	$156.0

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.

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

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.

Terasen Gas has a deferred interest mechanism which has been approved by the BCUC which requires that variances due to differences in long-term and short-term borrowings and interest rates from those that have been approved in rates be returned to customers in future rates. The impact of this mechanism was to increase financing costs for the year ended December 31, 2005 by $2.0 million (2004 — $1.4 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 includes 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, 2005 totalled $4.5 million (2004 — $3.8 million).

11. 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.

STOCK SPLIT

On June 14, 2004 the Company carried out a two-for-one stock split effected by paying a stock dividend of one additional common share for each common share held as of June 7, 2004.

All equity-based benefit plans have been amended to reflect the additional shares or options resulting from the stock split. All share and per share data has been amended for comparative and current periods to reflect the stock split.

COMMON SHARES

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

	2005		2004	
	Number	**Amount**	Number	Amount
Outstanding, beginning of year	**114,355,665**	**$883.4**	113,338,942	$868.7
Issued under:				
Share option plan	**1,283,146**	**21.3**	1,009,761	14.5
Employee share purchase plan	**4,351**	**0.2**	6,962	0.2
	115,643,162	**$904.9**	114,355,665	$883.4
Less common shares held by Trans Mountain	**9,184,188**		9,184,188	
Outstanding, end of year	**106,458,974**		105,171,477	

As at December 31, 2005, Trans Mountain owned 7.9% (2004 — 8.0%) 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, 2005 are owned by KMI.

12. 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.

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

REGULAR SHARE OPTIONS OUTSTANDING

	2005		2004	
	Shares under option	**Weighted-average exercise price**	Shares under option	Weighted-average exercise price
Outstanding, beginning of year	**565,868**	**$15.53**	1,118,822	$14.31
Options granted during the year	**5,000**	**29.45**	24,800	23.93
Options exercised	**(287,165)**	**15.15**	(537,716)	13.39
Options forfeited, cancelled and expired	**(82,991)**	**11.59**	(40,038)	17.46
Options purchased by KMI and cancelled	**(200,712)**	**18.12**	—	—
Outstanding, end of year	**—**	**$ —**	565,868	$15.40
Options exercisable, end of year	**—**	**$ —**	348,857	$13.25

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

	2005		2004	
	Shares under option	**Weighted-average exercise price**	Shares under option	Weighted-average exercise price
Outstanding, beginning of year	**2,339,619**	**$19.28**	2,304,398	$17.08
Options granted during the year	**850,200**	**29.45**	716,600	23.88
Options exercised	**(995,981)**	**16.96**	(472,045)	15.53
Options forfeited, cancelled and expired	**(262,574)**	**17.09**	(209,334)	19.68
Options purchased by KMI and cancelled	**(1,931,264)**	**25.12**	—	—
Outstanding, end of year	**—**	**$ —**	2,339,619	$19.24
Options exercisable, end of year	**—**	**$ —**	1,020,508	$16.27

STOCK-BASED COMPENSATION

In 2005, 855,200 stock options were granted (2004 — 741,400) at an average exercise price of $29.45 (2004 — $23.88) 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 (2004 — $1.2 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. Had the Company used the fair value based method to account for stock options granted during 2002, pro forma earnings and earnings per share would have been as follows:

		Year ended December 31, 2004
Net earnings	As reported	$149.8 million
	Pro forma	$148.6 million

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 (2004 — $2.40). Significant assumptions in valuing the options were as follows:

	2005		2004	
	Regular Options	**Performance Based**	Regular Options	Performance Based
Interest rate	3.6%	3.7%	3.5 - 3.7%	3.5%
Expected volatility	16.5%	16.5%	15.1 - 15.4%	15.4%
Expected life	5 years	6 years	5 years	6 years

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

DEFERRED SHARE UNITS

The Company had issued Deferred Share Units (''DSU's'') to certain senior employees and directors. At December 31, 2005, there were no (2004 — 52,859) DSU's outstanding due to the payment of all outstanding DSU's at the acquisition of the Company by KMI on November 30, 2005. The liability at December 31, 2005 was nil (2004 — $1.5 million) and was included in other long-term liabilities and deferred credits.

13. 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, 2002 and the date of the next required valuations are December 31, 2005 and December 31, 2007. The December 31, 2005 valuations will not be completed until the second quarter of 2006. The expected weighted average remaining service life of employees covered by the defined benefit pension plans is 11.8 years (2004 — 11.8 years).

DEFINED CONTRIBUTION PLAN

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

SUPPLEMENTAL PLANS

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

OTHER POST-EMPLOYMENT BENEFITS

The Company provides retired employees with other post-employment benefits that include, depending on circumstances, supplemental health, dental and life insurance coverage. Post-employment benefits are unfunded and annual expense is recorded on an accrual basis based on independent actuarial determinations, considering among other factors, health care cost escalation. The most recent actuarial valuations were completed as at December 31, 2002 and the December 31, 2005 valuation will not be completed until second quarter of 2006. The expected weighted average remaining service life of employees covered by these benefit plans is 9.9 years (2004 — 9.9 years).

13. 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	
	2005	2004	**2005**	2004
Plan assets				
Fair value, beginning of year	**$274.5**	$255.3	**$ —**	$ —
Company contributions	**6.9**	5.5	**1.6**	1.5
Contributions by members	**3.3**	2.9	**—**	—
Actual return on plan assets	**28.6**	26.7	**—**	—
Benefits paid	**(14.3)**	(15.2)	**(1.5)**	(1.4)
Other	**(0.5)**	(0.7)	**(0.1)**	(0.1)
Fair value, end of year	**298.5**	274.5	**—**	—
Accrued benefit obligation				
Balance, beginning of year	**298.0**	276.7	**67.3**	61.0
Service cost	**8.5**	8.1	**1.4**	1.3
Interest cost	**17.9**	17.2	**4.1**	3.9
Benefit payments	**(14.3)**	(15.2)	**(1.5)**	(1.4)
Contributions by members	**3.3**	2.9	**—**	—
Plan amendments and curtailments	**0.9**	—	**—**	—
Past service cost	**0.3**	0.5	**0.4**	—
Actuarial loss	**2.8**	—	**—**	—
Change in discount rate	**27.0**	7.8	**10.2**	2.5
Balance, end of year	**344.4**	298.0	**81.9**	67.3
Plan surplus (deficiency)	**(45.9)**	(23.5)	**(81.9)**	(67.3)
Unamortized transitional obligation (benefit)	**(23.8)**	(27.2)	**4.7**	6.2
Unamortized actuarial loss	**62.7**	43.2	**39.7**	32.0
Unamortized past service costs	**7.4**	9.0	**(2.6)**	(3.2)
Accrued benefit asset (liability)	**$ 0.4**	$ 1.5	**$(40.1)**	$(32.3)

The net accrued benefit liability is included in other long-term liabilities and deferred credits (Note 10).

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	
	2005	2004	**2005**	2004
Accrued benefit obligations:				
Unfunded plans	**$ 35.9**	$ 28.0	**$ 81.9**	$ 67.3
Funded plans	**258.0**	156.5	**—**	—
	293.9	184.5	**81.9**	67.3
Fair value of plan assets	**246.2**	151.9	**—**	—
Funded status deficit	**$ (47.7)**	$ (32.6)	**$(81.9)**	$(67.3)

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

13. EMPLOYEE BENEFIT PLANS (CONTINUED)

The net benefit plan expense is as follows:

	Pension benefit plans		Other benefit plans	
	2005	2004	**2005**	2004
Current service cost	**$ 8.7**	$ 8.1	**$1.6**	$1.3
Interest cost on projected benefit obligations	**17.9**	17.2	**4.1**	3.9
Actual return on plan assets	**(28.6)**	(26.7)	**—**	—
Net actuarial gains	**29.8**	7.8	**9.0**	2.5
Past service costs	**0.3**	0.5	**—**	—
Impact of curtailment/settlement	**0.9**	—	**—**	—
Net benefit plan expense before adjustments	**29.0**	6.9	**14.7**	7.7
Adjustments to recognize the long-term nature of employee future benefit costs:				
Difference between actual and expected return on plan assets	**9.2**	7.7	**—**	—
Difference between actual and recognized actuarial gains (losses) in year	**(26.8)**	(5.2)	**(6.4)**	0.1
Difference between actual and recognized past service costs in year	**0.4**	0.1	**(0.3)**	(0.3)
Special termination benefits	**(0.7)**	—	**—**	—
Amortization of transitional obligation (benefit)	**(3.4)**	(3.4)	**1.6**	1.6
Other	**—**	1.5	**—**	—
Net benefit plan expense	**$ 7.7**	$ 7.6	**$9.6**	$9.1
Defined contribution plan expense	**$ 1.6**	$ 2.3		
	$ 9.3	$ 9.9		

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	
	2005	2004
Equity securities	**57%**	55%
Fixed income securities	**38%**	40%
Other assets	**5%**	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	
	2005	2004	**2005**	2004
Accrued benefit obligation				
Discount rate at December 31, based on AA Corporate bonds	**5.00%**	6.00%	**5.00%**	6.00%
Rate of compensation increase	**3.50%**	3.50%	**—**	—
Net benefit plan expense				
Discount rate at January 1, based on AA Corporate bonds	**6.00%**	6.25%	**6.00%**	6.25%
Expected rate of return on plan assets	**7.50%**	7.50%	**—**	—

13. EMPLOYEE BENEFIT PLANS (CONTINUED)

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

	2005	2004
Extended health benefits		
Initial health care cost trend rate	**9.0%**	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	**2008**	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:

2005	**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	$ 1.5	$ (1.2)
Effect on accrued benefit obligation	15.5	(12.9)

CASH FLOWS

Total cash contributions for employee benefit plans consist of:

	Employee benefit plans	
	2005	2004
Funded plans	**$ 5.3**	$4.3
Beneficiaries of unfunded plans	**3.2**	2.7
Defined contribution plans	**1.6**	2.3
Total	**$10.1**	$9.3

The contributions for 2006 are anticipated to be approximately the same as 2005 for both the defined pension benefit plans and other benefit plans.

BENEFIT CHANGES

Effective January 1, 2004, the Company modified its post-employment benefit program for non-union active employees in order to provide future retirees with more choice of coverage and to reduce the Company's exposure to future health and group life cost increases. The new plan is predominantly a defined contribution plan incorporating a Company-paid health spending account, a security health plan and life insurance. Provincial medical services plan premiums will now be paid by the retiree.

All plan members who have retired on or before December 31, 2004 receive benefits under the plans that were in effect when they retired, which includes the payment of provincial medical services plan premiums by the Company. Employees electing to retire during 2005 will have a choice between the new and old plan, and employees retiring after December 31, 2005 will participate in the new plan.

These assumptions, including the post-employment benefit plan changes, were included in the calculation of the accrued benefit obligation at December 31, 2003, 2004 and 2005.

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, 2005 the Company has deferred pension expense of $0.3 million that exceeded the amount approved by the regulator to be recovered in rates for 2005.

14. FINANCING COSTS

	2005	2004
Interest and expense on long-term debt	**$177.9**	$151.6
Interest on short-term debt	**15.0**	25.1
Interest capitalized	**(1.5)**	(1.1)
	$191.4	$175.6

Included in interest expense on long-term debt for the year ended December 31, 2005 is $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, 2005, the Company capitalized interest for borrowing requirements for construction of assets that have not been included in rate base of $1.5 million (2004 — $1.1 million).

15. INCOME TAXES

PROVISION FOR INCOME TAXES

	2005	2004
Current income taxes	**$48.7**	$66.3
Future income taxes	**2.9**	(2.6)
	$51.6	$63.7

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 33.77% (2004 — 34.52%) to earnings before income taxes as shown in the following table:

	2005	2004
Earnings before income taxes	**$157.7**	$210.2
Combined statutory income tax rate	**33.77%**	34.52%
Combined income taxes at statutory rate	**$ 53.3**	$ 72.6
Increase (decrease) in income taxes resulting from:		
Capital cost allowance and other deductions claimed for income tax purposes over amounts recorded for accounting purposes	**(10.0)**	(14.7)
Large Corporations Tax in excess of surtax	**6.1**	6.5
Non-deductible expenses and non-taxable income	**9.6**	5.5
Benefit of tax rate changes on losses	**—**	(0.4)
Equity income not subject to tax	**(4.7)**	(3.3)
Write-off of restricted tax loss carryforwards	**5.9**	—
Other permanent differences	**(8.0)**	(2.6)
Other	**(0.6)**	0.1
Actual consolidated income taxes	**$ 51.6**	$ 63.7
Effective income tax rate	**32.72%**	30.30%

FUTURE INCOME TAXES

The net future income tax liability of the Company of $88.7 million (2004 — $68.7 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 $301.8 million at December 31, 2005 (2004 — $278.7 million) and has not recognized a future income tax expense of $23.1 million for the year ended December 31, 2005 (2004 — $15.2 million), all of which were calculated using the asset and liability method.

16. 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 approximate its carrying value.

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, 2005, or by using available quoted market prices, is estimated at $2,673.4 million (2004 — $2,818.2 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.

16. FINANCIAL INSTRUMENTS (CONTINUED)

Asset (Liability)	Number of swaps and options	Term to maturity (years)	December 31 2005 Carrying Value	2005 Fair Value	2004 Carrying Value	2004 Fair Value
			(in millions)			
Interest Rate Swaps						
Terasen Inc.	**3**	**1 - 9**	**$ —**	**$ 3.6**	$ —	$5.4
TGI	**3**	**2**	**—**	**(1.6)**	—	—
TGVI	**4**	**1 - 4**	**—**	**(0.6)**	—	(3.2)
Corridor	**2**	**5 - 10**	**—**	**0.3**	—	—
Natural Gas Commodity Swaps and Options						
TGI and TGVI	**161**	**Up to 3**	**21.2**	**105.6**	—	(8.3)
Clean Energy	**—**	**—**	**—**	**—**	6.5	6.5
Foreign Currency Swaps						
Terasen Inc.	**—**	**—**	**—**	**—**	(0.6)	(0.6)

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

Included in the carrying value of the natural gas derivatives is $22.2 million of unrealized fair value gains associated with derivative instruments which were deemed to be ineffective at December 31, 2005, and $1.0 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 (2004 — $3.3 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.

17. COMMITMENTS & CONTINGENCIES

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

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

	Operating leases	Purchase obligations	Total
2006	$ 21.3	$ 873.8	$ 895.1
2007	20.2	113.6	133.8
2008	20.6	33.2	53.8
2009	19.3	30.2	49.5
2010	18.2	—	18.2
2011 and later	127.5	—	127.5
	$227.1	$1,050.8	$1,277.9

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, 2005.

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. 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. 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 Company anticipates that all of the repayment criteria may be met in 2006 and, if met, will result in an estimated repayment of $4.5 million of these loans in 2006. 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 the table above as the amounts and timing of

17. COMMITMENTS & CONTINGENCIES (CONTINUED)

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.

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$15.1 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, for a fee, provided indemnities with respect to performance bonds issued on behalf of Clean Energy in the amount of US$3.5 million. These performance bonds secure construction projects undertaken by Clean Energy, and expire at various dates before October 31, 2006.

The Company has letters of credit outstanding at December 31, 2005 totalling $118.5 million to support its operations and capital projects, including $50.8 million for its unfunded supplemental pension benefit plans and $17.6 million for the letter of credit referred to above on behalf of co-investors in the Express System.

19. SUBSEQUENT EVENTS

(a) On January 13, 2006, Terasen Gas (Vancouver Island) Inc. entered into a five-year unsecured, committed, revolving credit facility of $350 million with a syndicate of banks, of which $296 million was drawn against the facility on January 17, 2006. A portion of the facility was used to refinance TGVI's existing term facility of $209.5 million. The facility will also be utilized to finance working capital requirements and general corporate purposes.

Concurrently with executing the above noted 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 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 the Company.

(b) 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 effective 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.

(c) Subsequent to year-end, the Company received a letter dated March 31, 2006 from the British Columbia Social Service tax authority indicating their intention to assess additional provincial sales tax on the Southern Crossing Pipeline which was completed in 2000. The letter received does not indicate the amount to be assessed and a formal notice of assessment has not been received. Any assessment will be appealed when it is received and the Company believes this assessment is without merit and it will not have a material adverse impact on the financial results of the Company.

Terasen Inc.

Unaudited Interim Consolidated Financial Statements
Three and nine months ended September 30, 2006

CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	In millions of dollars			
	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
Revenues				
Natural gas distribution	**$217.0**	$213.7	**$1,204.6**	$1,065.8
Petroleum transportation	**60.4**	57.3	**168.2**	163.0
Other activities	**10.9**	11.6	**33.3**	35.6
	288.3	282.6	**1,406.1**	1,264.4
Expenses				
Cost of natural gas	**108.4**	109.4	**767.4**	637.2
Cost of revenues from other activities	**6.0**	6.5	**21.0**	22.3
Operation and maintenance	**72.1**	68.7	**206.9**	201.3
Depreciation and amortization	**36.1**	35.3	**108.7**	106.0
Property and other taxes	**18.6**	18.0	**56.3**	53.8
	241.2	237.9	**1,160.3**	1,020.6
Operating income	**47.1**	44.7	**245.8**	243.8
Financing costs	**45.6**	44.1	**134.7**	132.9
Earnings before share of equity earnings and income taxes	**1.5**	0.6	**111.1**	110.9
Share of earnings (loss) from Clean Energy	**—**	(4.4)	**—**	2.2
Share of earnings from Express system	**5.8**	5.0	**16.2**	13.7
Earnings before income taxes and discontinued operations	**7.3**	1.2	**127.3**	126.8
Income taxes	**0.7**	0.3	**45.1**	31.9
Earnings before discontinued operations	**6.6**	0.9	**82.2**	94.9
Earnings (loss) from discontinued operations	**(4.1)**	3.1	**(17.0)**	4.9
Net earnings	**$ 2.5**	$ 4.0	**$ 65.2**	$ 99.8

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(Unaudited)

	Nine months ended September 30	
	2006	2005
	In millions of dollars	
Retained earnings, beginning of period	**$425.0**	$418.9
Net earnings	**65.2**	99.8
	490.2	518.7
Dividends on common shares	**—**	71.2
Retained earnings, end of period	**$490.2**	$447.5

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Unaudited)

	In millions of dollars As at	
	September 30, 2006	December 31, 2005
	(unaudited)	
Assets		
Current assets		
Cash and short-term investments	**$ 82.8**	$ 79.4
Accounts receivable	**188.1**	468.1
Inventories of gas in storage and supplies	**249.7**	205.7
Prepaid expenses	**8.8**	14.1
Current portion of rate stabilization accounts	**142.5**	28.4
Current assets held for sale	**—**	54.8
	671.9	850.5
Property, plant and equipment	**3,994.8**	3,907.9
Long-term investment	**254.5**	238.3
Goodwill	**76.4**	76.4
Rate stabilization accounts	**49.8**	48.3
Other assets	**86.8**	84.8
Long-lived assets held for sale	**—**	109.9
	$5,134.2	$5,316.1
Liabilities and shareholder's equity		
Current liabilities		
Short-term notes	**$ 524.0**	$ 681.0
Accounts payable and accrued liabilities	**427.2**	433.8
Income and other taxes payable	**20.0**	30.8
Current portion of rate stabilization accounts	**—**	47.9
Current portion of long-term debt	**41.0**	398.2
Due to parent company	**6.3**	0.4
Current liabilities held for sale	**—**	24.5
	1,018.5	1,616.6
Long-term debt	**2,367.0**	2,012.9
Other long-term liabilities and deferred credits	**176.9**	168.5
Future income taxes	**71.7**	88.7
Long-term liabilities held for sale	**—**	13.7
	3,634.1	3,900.4
Shareholder's equity		
Common shares	**904.9**	904.9
Contributed surplus	**155.9**	137.5
Retained earnings	**490.2**	425.0
Cumulative currency translation adjustment	**0.1**	(0.7)
	1,551.1	1,466.7
Less cost of common shares held by Terasen Pipelines (Trans Mountain) Inc.	**51.0**	51.0
	1,500.1	1,415.7
	$5,134.2	$5,316.1

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
	In millions of dollars			
Cash flows provided by (used for)				
Operating activities				
Net earnings	**$ 2.5**	$ 4.0	**$ 65.2**	99.8
Adjustments for non-cash items				
Loss from discontinued operations	**4.1**	—	**17.0**	—
Depreciation and amortization	**36.1**	35.8	**108.7**	109.0
Share of equity earnings from long-term investments, in excess of cash distributions	**(5.8)**	(1.7)	**(16.2)**	(14.1)
Future income taxes	**(21.0)**	1.2	**(27.5)**	1.5
Other	**5.4**	8.5	**14.1**	11.5
	21.3	47.8	**161.3**	207.7
Change in rate stabilization accounts	**(19.2)**	(21.5)	**21.5**	2.0
Discontinued operations — water/utility services	**(4.1)**	—	**(17.0)**	—
Changes in working capital	**(50.7)**	(43.3)	**57.2**	(49.0)
	(52.7)	(17.0)	**223.0**	160.7
Investing activities				
Property, plant and equipment	**(84.1)**	(43.4)	**(194.2)**	(170.3)
Proceeds on the sale of water business	**8.3**	—	**132.6**	—
Other assets	**(2.2)**	(9.7)	**(3.9)**	(12.6)
	(78.0)	(53.1)	**(65.5)**	(182.9)
Financing activities				
Increase (decrease) in short-term notes	**148.0**	383.0	**(157.0)**	495.5
Increase in long-term debt	**127.1**	—	**407.8**	450.5
Reduction of long-term debt	**(99.8)**	(350.7)	**(410.8)**	(848.1)
Advances from KMI	**1.3**	—	**5.9**	—
Issue of common shares, net of issue costs	**—**	3.2	**—**	8.7
Dividends on common shares	**—**	(23.8)	**—**	(71.2)
	176.6	11.7	**(154.1)**	35.4
Net increase (decrease) in cash	**45.9**	(58.4)	**3.4**	13.2
Cash at beginning of period	**36.9**	91.6	**79.4**	20.0
Cash at end of period	**$ 82.8**	$ 33.2	**$ 82.8**	$ 33.2
Supplemental cash flow information				
Interest paid in the period	**$ 46.8**	$ 48.9	**$ 137.4**	$ 135.3
Income taxes paid in the period	**16.4**	22.7	**41.5**	48.0
Non-cash transaction				
Mark to market on certain gas derivatives deferred in rate stabilization accounts	**89.6**	—	**185.1**	—

Cash is defined as cash or bank indebtedness.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accounting policies and methods of application used in the preparation of these interim consolidated financial statements are consistent with the accounting policies used in the Company's year end audited consolidated financial statements of December 31, 2005. These consolidated financial statements do not include all disclosures required for annual financial statements, and therefore these statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2005. Certain comparative figures have been restated to conform with the current period presentation.

2. SEGMENT DISCLOSURES

	Three months ended September 30			
	Natural gas distribution	Petroleum transportation	Other activities	Total
	(in millions of dollars)			
2006				
Revenues	**$ 217.0**	**$ 60.4**	**$ 10.9**	**$ 288.3**
Earnings (loss) before discontinued operations	**(6.8)**	**17.4**	**(4.0)**	**6.6**
Net earnings (loss)	**(6.8)**	**17.4**	**(8.1)**	**2.5**
Total assets	**3,576.8**	**1,472.7**	**84.7**	**5,134.2**
2005				
Revenues	$ 213.7	$ 57.3	$ 11.6	$ 282.6
Earnings (loss) before discontinued operations	(3.6)	17.2	(12.7)	0.9
Net earnings (loss)	(3.6)	17.2	(9.6)	4.0
Total assets	3,428.3	1,364.5	299.0	5,091.8

	Nine months ended September 30			
	Natural gas distribution	Petroleum transportation	Other activities	Total
	(in millions of dollars)			
2006				
Revenues	**$1,204.6**	**$ 168.2**	**$ 33.3**	**$1,406.1**
Earnings (loss) before discontinued operations	**48.3**	**51.6**	**(17.7)**	**82.2**
Net earnings (loss)	**48.3**	**51.6**	**(34.7)**	**65.2**
Total assets	**3,576.8**	**1,472.7**	**84.7**	**5,134.2**
2005				
Revenues	$1,065.8	$ 163.0	$ 35.6	$1,264.4
Earnings (loss) before discontinued operations	59.8	50.8	(15.7)	94.9
Net earnings (loss)	59.8	50.8	(10.8)	99.8
Total assets	3,428.3	1,364.5	299.0	5,091.8

3. SEASONAL OPERATIONS

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

4. RELATED PARTY TRANSACTIONS

The Company estimates that its parent company, Kinder Morgan Inc., provided management services totalling approximately $1.1 million (2005 — nil) for the three months ended September 30, 2006 and $8.5 million (2005 — nil) for the nine months ended September 30, 2006.

5. EMPLOYEE BENEFIT PLANS

The Company and its subsidiaries have defined benefit pension plans and defined contribution pension plans for employees. The Company also provides post-employment benefits other than pensions for retired employees. Additional information about these benefit plans can be found in the Company's 2005 Annual Report. The Company's estimated contributions to defined benefit pension plans for 2006 are anticipated to be $10.0 million (2005 actual $10.1 million).

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

	Three months ended September 30			
	Pension benefit plans		Other benefit plans	
	2006	2005	**2006**	2005
	(in millions of dollars)			
Current service cost	**$ 2.3**	$ 2.2	**$0.5**	$0.4
Interest cost on projected benefit obligations	**4.3**	4.5	**1.0**	1.0
Expected return on plan assets	**(5.2)**	(4.8)	**—**	—
Net actuarial losses	**(0.1)**	—	**—**	0.1
Plan amendments	**0.1**	0.2	**—**	—
Net benefit plan expense before adjustments of employee benefit costs:	**1.4**	2.1	**1.5**	1.5
Difference between actual and expected return on plan assets	**0.1**	0.1	**—**	—
Difference between actual and recognized actuarial gains in the year	**1.1**	0.6	**0.8**	0.3
Difference between actual and recognized past service	**0.2**	—	**—**	0.2
Amortization of transitional (benefit) obligation	**(0.8)**	(0.8)	**0.3**	0.4
Net benefit plan expense	**$ 2.0**	$ 2.0	**$2.6**	$2.4
Defined contribution plan expense	**$ 0.5**	$ 0.4		
Total pension expense	**$ 2.5**	$ 2.4		

	Nine months ended September 30			
	Pension benefit plans		Other benefit plans	
	2006	2005	**2006**	2005
	(in millions of dollars)			
Current service cost	**$ 7.0**	$ 6.6	**$1.5**	$1.2
Interest cost on projected benefit obligations	**12.9**	13.5	**3.1**	3.0
Expected return on plan assets	**(15.6)**	(14.4)	**—**	—
Net actuarial losses	**(0.4)**	—	**—**	0.3
Plan amendments	**0.3**	0.6	**—**	
Net benefit plan expense before adjustments of employee benefit costs:	**4.2**	6.3	**4.6**	4.5
Difference between actual and expected return on plan assets	**0.3**	0.3	**—**	—
Difference between actual and recognized actuarial gains in the year	**3.4**	1.8	**2.4**	0.9
Difference between actual and recognized past service	**0.6**	—	**—**	0.6
Amortization of transitional (benefit) obligation	**(2.5)**	(2.4)	**0.9**	1.2
Net benefit plan expense	**$ 6.0**	$ 6.0	**$7.9**	$7.2
Defined contribution plan expense	**$ 1.7**	$ 1.4		
Total pension expense	**$ 7.7**	$ 7.4		

6. CONTINGENCY AND COMMITMENTS

Terasen Gas, a subsidiary of 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. 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.

PRO FORMA CONSOLIDATED
FINANCIAL STATEMENTS

FORTIS INC.

(Unaudited)

As at September 30, 2006 and for the nine-month period ended September 30, 2006 and the year ended December 31, 2005

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

The following unaudited *pro forma* consolidated financial statements give effect to the proposed acquisition (the ''Acquisition'') of Terasen Inc. (''Terasen'') under the purchase method of accounting. The unaudited *pro forma* consolidated balance sheet gives effect to the Acquisition as if it had occurred on September 30, 2006. The unaudited *pro forma* consolidated statements of earnings for the nine-month period ended September 30, 2006 and for the year ended December 31, 2005 give effect to the Acquisition as if it was completed on January 1, 2005.

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

Terasen is a holding company headquartered in Vancouver, British Columbia, operating two principal lines of business: natural gas distribution and petroleum transportation. Prior to the closing of the Acquisition, Kinder Morgan, Inc. (''Kinder Morgan'') will cause Terasen to divest itself of its petroleum transportation operations. These unaudited *pro forma* consolidated financial statements are based on Terasen's financial statements as at and for the nine months ended September 30, 2006 and for the year ended December 31, 2005. The financial position and results of the petroleum transportation operations have been excluded from the unaudited *pro forma* consolidated balance sheet and statements of earnings, respectively, by way of *pro forma* adjustments. Refer to Notes 2[b] and 2[d].

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

Fortis Inc.

PRO FORMA CONSOLIDATED BALANCE SHEET
As at September 30, 2006
(Unaudited)
($ millions)

	Fortis Inc.	Terasen Inc.	Note	*Pro forma* adjustments	*Pro forma* consolidated balance sheet
ASSETS					
Current					
Cash and cash equivalents	61.4	82.8		—	**144.2**
Accounts receivable	207.3	188.1	2[b]	(22.3)	**373.1**
Prepaid expenses	21.5	8.8	2[b]	(3.2)	**27.1**
Regulatory assets	29.3	142.5		—	**171.8**
Gas inventories, materials and supplies	25.6	249.7	2[b]	(3.2)	**272.1**
	345.1	671.9		(28.7)	**988.3**
Income tax deposit	5.9	—		—	**5.9**
Deferred charges and other assets	161.9	86.8	2[b]	(31.0)	**223.1**
			2[m]	3.0	
			2[n]	2.4	
Regulatory assets	103.4	49.8		—	**153.2**
Future income taxes	8.0	—	2[f]	8.4	**30.9**
			2[g]	14.5	
Utility capital assets	2,831.3	3,994.8	2[b]	(1,158.4)	**5,667.7**
Income producing properties	418.8	—		—	**418.8**
Investments	170.7	254.5	2[b]	(254.5)	**170.7**
Intangibles, net of amortization	10.9	—		—	**10.9**
Goodwill	550.9	76.4	2[b]	631.6	**1,258.9**
	4,606.9	5,134.2		(812.7)	**8,928.4**
LIABILITIES					
Current					
Short-term borrowings	70.7	524.0		—	**594.7**
Accounts payable and accrued charges	264.2	433.5	2[b]	(85.0)	**625.7**
			2[m]	3.0	
			2[l]	10.0	
Dividends payable	21.1	—		—	**21.1**
Income taxes payable	5.9	20.0	2[b]	2.2	**28.1**
Regulatory liabilities	25.5	—		—	**25.5**
Current installments of long-term debt and capital lease obligations	32.8	41.0		—	**73.8**
	420.2	1,018.5		(69.8)	**1,368.9**
Other long-term liabilities and deferred credits	77.2	176.9	2[b]	(16.8)	**237.3**
Regulatory liabilities	33.6	—		—	**33.6**
Future income taxes	46.9	71.7	2[b]	(63.5)	**55.1**
Long-term debt and capital lease obligations	2,254.0	2,367.0	2[b]	(300.0)	**4,484.3**
			2[e]	139.3	
			2[f]	24.0	
Non-controlling interest	50.4	—		—	**50.4**
Preference shares	319.5	—		—	**319.5**
	3,201.8	3,634.1		(286.8)	**6,549.1**
SHAREHOLDERS' EQUITY					
Common shares (i)	822.5	853.9	2[k]	(853.9)	**1,796.7**
			2[g]	1,001.0	
			2[g]	(26.8)	
Preference shares	122.5	—		—	**122.5**
Contributed surplus	4.3	155.9	2[k]	(155.9)	**4.3**
Equity portion of convertible debentures	1.4	—		—	**1.4**
Foreign currency translation adjustment	(17.8)	0.1	2[k]	(0.1)	**(17.8)**
Retained earnings	472.2	490.2	2[k]	(490.2)	**472.2**
	1,405.1	1,500.1		(525.9)	**2,379.3**
	4,606.9	5,134.2		(812.7)	**8,928.4**

(i) Terasen Inc. common shares are net of $51.0 million of shares held by its wholly owned subsidiary, Terasen Pipelines (Trans Mountain) Inc.

See accompanying notes

Fortis Inc.

PRO FORMA CONSOLIDATED STATEMENT OF EARNINGS
For the year ended December 31, 2005
(Unaudited)
($ millions, except for per share amounts)

	Fortis Inc.	Terasen Inc.	*Pro forma* adjustments Note		*Pro forma* consolidated statement of earnings
Operating revenues	1,430.0	1,952.5	2[d]	(227.8)	**3,154.7**
Equity income	11.4	24.4	2[d]	(21.9)	**13.9**
	1,441.4	1,976.9		(249.7)	**3,168.6**
Expenses					
Energy supply	533.9	1,063.7		—	**1,597.6**
Operating	392.4	421.5	2[d]	(106.9)	**707.0**
Amortization	157.6	142.6	2[d]	(37.6)	**263.2**
			2[m]	0.6	
	1,083.9	1,627.8		(143.9)	**2,567.8**
Operating income	357.5	349.1		(105.8)	**600.8**
Finance charges	153.8	191.4	2[d]	(31.7)	**323.2**
			2[e]	7.3	
			2[o]	(5.8)	
			2[n]	1.0	
			2[p]	7.2	
Gain on settlement of contractual matters	(10.0)	—		—	**(10.0)**
	143.8	191.4		(22.0)	**313.2**
Earnings before income taxes, non-controlling interest and discontinued operations	213.7	157.7		(83.8)	**287.6**
Income taxes	70.4	51.6	2[d]	(9.0)	**111.9**
			2[i]	(1.1)	
Earnings before non-controlling interest and discontinued operations	143.3	106.1		(73.7)	**175.7**
Non-controlling interest	6.2	—		—	**6.2**
Earnings before discontinued operations	137.1	106.1		(73.7)	**169.5**
Loss from discontinued operations	—	4.9		—	**4.9**
Net earnings applicable to common shares	137.1	101.2		(73.7)	**164.6**
Average common shares outstanding (number, in millions)	101.8		2[g]	38.5	**140.3**
Earnings per common share before discontinued operations					
Basic	$ 1.35				**$ 1.21**
Diluted	$ 1.24				**$ 1.15**
Earnings per common share					
Basic	$ 1.35				**$ 1.17**
Diluted	$ 1.24				**$ 1.12**

See accompanying notes

Fortis Inc.

PRO FORMA CONSOLIDATED STATEMENT OF EARNINGS
For the nine-month period ended September 30, 2006
(Unaudited)
($ millions, except for per share amounts)

	Fortis Inc.	Terasen Inc.	*Pro forma* Adjustments Note		*Pro forma* consolidated statement of earnings
Operating revenues	1,071.7	1,406.1	2[d]	(168.2)	**2,309.6**
Equity income	6.9	16.2	2[d]	(16.2)	**6.9**
	1,078.6	1,422.3		(184.4)	**2,316.5**
Expenses					
Energy supply	394.0	767.4		—	**1,161.4**
Operating	290.3	284.2	2[d]	(74.3)	**500.2**
Amortization	130.9	108.7	2[d]	(28.1)	**212.0**
			2[m]	0.5	
	815.2	1,160.3		(101.9)	**1,873.6**
Operating income	263.4	262.0		(82.5)	**442.9**
Finance charges	124.4	134.7	2[d]	(20.1)	**246.2**
			2[e]	5.5	
			2[o]	(4.4)	
			2[n]	0.7	
			2[p]	5.4	
Gain on sale of income producing properties	(2.1)	—		—	**(2.1)**
	122.3	134.7		(12.9)	**244.1**
Earnings before income taxes, non-controlling interest and discontinued operations	141.1	127.3		(69.6)	**198.8**
Income taxes	23.1	45.1	2[d]	(10.3)	**57.1**
			2[i]	(0.8)	
Earnings before non-controlling interest and discontinued operations	118.0	82.2		(58.5)	**141.7**
Non-controlling interest	4.7	—		—	**4.7**
Earnings before discontinued operations	113.3	82.2		(58.5)	**137.0**
Loss from discontinued operations	—	17.0		—	**17.0**
Net earnings applicable to common shares	113.3	65.2		(58.5)	**120.0**
Average common shares outstanding (number, in millions)	103.5		2[g]	38.5	**142.0**
Earnings per common share before discontinued operations					
Basic	$ 1.09				**$ 0.96**
Diluted	$ 1.05				**$ 0.94**
Earnings per common share					
Basic	$ 1.09				**$ 0.85**
Diluted	$ 1.05				**$ 0.84**

See accompanying notes

FORTIS INC.

NOTES TO PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited *pro forma* consolidated financial statements give effect to the acquisition (the ''Acquisition'') of all of the issued and outstanding shares in Terasen Inc. (''Terasen'') as described in the short form prospectus dated March 7, 2007 (the ''Prospectus''). The accompanying unaudited *pro forma* consolidated financial statements have been prepared by management of Fortis Inc. (''Fortis'' or the ''Corporation'') and are derived from the unaudited and audited consolidated financial statements of Fortis as at and for the nine-month period ended September 30, 2006 and for the year ended December 31, 2005, respectively; and the unaudited and audited financial statements of Terasen as at and for the nine-month period ended September 30, 2006, and for the year ended December 31, 2005, respectively.

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

As is standard with similar transactions in regulated utilities, the purchase price is primarily based upon the regulated assets at the point of closing. Based on the purchase price calculation as detailed in the acquisition agreement dated February 26, 2007 (the ''Acquisition Agreement''), the estimated net purchase price of Terasen is $1,099.0 million (refer to Note 2[a]).

The unaudited *pro forma* consolidated balance sheet and unaudited *pro forma* consolidated statements of earnings reflect the acquisition effected on September 30, 2006 and January 1, 2005, respectively. The unaudited *pro forma* consolidated financial statements are not necessarily indicative of the results that actually would have been achieved if the transactions reflected therein had been completed on the dates indicated or the results which may be obtained in the future. For instance, the actual purchase price allocation will reflect the fair value, at the purchase date, of the assets acquired and liabilities assumed based upon the acquirer's evaluation of such assets and liabilities following the closing of the transaction and, accordingly, the final purchase price allocation, as it relates principally to intangible assets, may differ significantly from the preliminary allocation reflected herein.

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

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

2. PRO FORMA ASSUMPTIONS AND ADJUSTMENTS

[a] These *pro forma* consolidated financial statements give effect to the completion of the Acquisition, as if it had occurred on September 30, 2006 in respect of the *pro forma* consolidated balance sheet, and on January 1, 2005 in respect of the *pro forma* consolidated statements of earnings for the year ended December 31, 2005 and for the nine-month period ended September 30, 2006. The Acquisition has been reflected in the *pro forma* consolidated financial statements using the purchase method.

Estimated Net Purchase Price

	($ millions)
Unadjusted purchase price	1,801.0
Estimated acquisition costs (Note 2[h])	25.0
Estimated net purchase price, before assumed debt	1,826.0
Assumed cash of Terasen in excess of normal working capital	40.0
Assumed short-term notes of Terasen (Note 2[f])	(317.0)
Assumed long-term debt of Terasen (Note 2[f])	(450.0)
Estimated net purchase price	1,099.0

Estimated Net Funding Requirements

	($ millions)
Estimated net purchase price	1,099.0
Assumed short-term notes of Terasen	317.0
Assumed long-term debt of Terasen	450.0
Common share issuance costs (Note 2[g])	41.3
Estimated net funding requirements	1,907.3

Assumed Financing Structure

	($ millions)
Assumed short-term notes of Terasen	317.0
Assumed long-term debt of Terasen	450.0
Common share issuance (Note 2[g])	1,001.0
Incremental long-term debt issuance (Note 2[e])	139.3
	1,907.3

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

The estimated net purchase price has been allocated to the fair values of Terasen net assets and liabilities at September 30, 2006, excluding the net assets and liabilities of the petroleum transportation segment which are not being acquired, in accordance with the purchase method, as follows:

	($ millions)				
	Terasen Inc.	Petroleum Transportation	Note	Fair Value and Other Adjustments	Net Total
Assets acquired:					
Cash and cash equivalents	82.8	—		—	**82.8**
Accounts receivable	188.1	(22.3)		—	**165.8**
Prepaid expenses	8.8	(3.2)		—	**5.6**
Regulatory assets	142.5	—		—	**142.5**
Gas inventories, materials and supplies	249.7	(3.2)		—	**246.5**
Current assets	**671.9**	**(28.7)**		—	**643.2**
Deferred charges and other assets	86.8	(31.0)	2[n]	2.4	**58.2**
Regulatory assets	49.8	—		—	**49.8**
Future income taxes	—	—	2[f]	8.4	**8.4**
Utility capital assets	3,994.8	(1,158.4)		—	**2,836.4**
Investments	254.5	(254.5)		—	**—**
Intangibles	—	—		—	**—**
	5,057.8	**(1,472.6)**		10.8	**3,596.0**
Liabilities assumed:					
Short-term borrowings	524.0	—		—	**524.0**
Accounts payable and accrued charges	433.5	(85.0)	2[l]	10.0	**358.5**
Income taxes payable	20.0	2.2		—	**22.2**
Current installments of long-term debt and capital lease obligations	41.0	—		—	**41.0**
Other long-term liabilities and deferred credits	176.9	(16.8)		—	**160.1**
Future income taxes	71.7	(63.5)		—	**8.2**
Long-term debt and capital lease obligations	2,367.0	(300.0)	2[f]	24.0	**2,091.0**
	3,634.1	**(463.1)**		34.0	**3,205.0**
Net assets at fair value, as at September 30, 2006	1,423.7	(1,009.5)		(23.2)	**391.0**
Net purchase price					**1,099.0**
Goodwill					**708.0**
Goodwill previously recorded by Terasen					**(76.4)**
Additional goodwill					**631.6**

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

[c] Goodwill

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

[d] Results of Petroleum Transportation segment

The acquisition of Terasen does not include the petroleum transportation segment and, as such, the results of this segment for the year ended December 31, 2005 and for the nine months ended September 30, 2006 have been excluded, as follows:

	($ millions)	
	Nine-month period ended Sept 30, 2006	Year ended December 31, 2005
Operating revenues	168.2	227.8
Equity income	16.2	21.9
	184.4	249.7
Expenses		
Operating	74.3	106.9
Amortization	28.1	37.6
Finance charges	20.1	31.7
Income taxes	10.3	9.0
	132.8	185.2

[e] Financing

The Corporation has entered into a bridge financing agreement with its bankers at an assumed rate of 5.10%. This bridge will be refinanced with the issuance of other permanent capital including long-term debt facilities. It is assumed the anticipated debt funding requirement of $139.3 million will be initially financed by the bridge acquisition facility and will be subsequently refinanced at an average rate of 5.25%.

Additional interest expense of the following has been assumed:

	($ millions)	
	Nine-month period ended Sept 30, 2006	Year ended December 31, 2005
Interest on $139.3 million of refinanced incremental debt at 5.25%	5.5	7.3

[f] Assumed debt

Terasen has long-term debt outstanding of $450.0 million, in various series with due dates ranging from 2008 to 2040. The rates range from 5.56% to 8.0%, resulting in the fair market value of the debt exceeding book value by $24.0 million, ($15.6 million, net of future income taxes of $8.4 million), calculated as at September 30, 2006. No adjustment was made to the carrying value of the debt securities of Terasen Gas Inc. and Terasen Gas (Vancouver Island) Inc. This is due to the rate regulated nature of their businesses in which recovery in rates of the costs related to these debt securities is subject to the regulation of the BCUC.

Terasen also has short-term notes of $317.0 million that are being assumed. The remaining short-term notes balance of $207.0 million relates to the BCUC regulated business.

[g] Common share issuance

To fund a portion of the Acquisition purchase price, the Corporation plans to issue approximately 38.5 million common shares on closing resulting in estimated gross proceeds of $1,001.0 million, or net proceeds after common share issuance costs of $974.2 million ($41.3 million common share issuance costs less $14.5 million of future income taxes). The price of $26.00 per share, being the offering price for the issuance of 38.5 million subscription receipts of the Corporation pursuant to the Prospectus dated March 7, 2007, has been used as the issue price per share in the *pro forma* consolidated financial statements.

[h] Acquisition costs

It is assumed Acquisition costs will approximate $25.0 million, and will form part of the investment cost base. These primarily relate to investment banking and legal fees.

[i] Income taxes

Income taxes applicable to the *pro forma* adjustments are tax effected at Fortis' average tax rates of 35.0% and 35.0% for the year ended December 31, 2005 and the nine-month period ended September 30, 2006, respectively.

[j] Earnings per common share

The calculation of the *pro forma* earnings per common share for the year ended December 31, 2005, and for the nine-month period ended September 30, 2006, considers the issuance of 38.5 million common shares as contemplated in the Prospectus dated March 7, 2007, as if the issuance had taken place as at January 1, 2005.

[k] Terasen historical shareholder's equity balances

The historical shareholder's equity, contributed surplus, foreign currency translation and retained earnings balances of Terasen have been eliminated.

[l] Transition costs

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

[m] Long-term debt financing costs

Long-term debt financing costs are assumed to approximate $3.0 million, and will be deferred and amortized over the estimated term of the long-term debt of five years.

[n] Fair value of interest rate swaps and related amortization

The fair value of interest rate swaps of Terasen is an asset of $2.4 million as at September 30, 2006. The fair value adjustment will be amortized over the term of the related debt.

[o] Amortization of fair value debt adjustment

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

[p] Segmentation of short-term interest expense

The $317 million of assumed short-term notes of Terasen includes $110 million which had previously been allocated to the petroleum transportation segment by Terasen. With the acquisition of Terasen and the removal of the petroleum transportation segment, interest on the $110 million of short-term notes has been reallocated back to the remaining business being acquired as follows:

($ millions)	
Nine-month period ended Sept 30, 2006	**Year ended December 31, 2005**
5.4	7.2

INDEX TO MANAGEMENT DISCUSSION AND ANALYSIS

Terasen Inc.

2005 Management Discussion and Analysis
For the Year Ended December 31, 2005
April 10, 2006

This discussion should be read in conjunction with the consolidated financial statements of the Company and related notes for the years ended December 31, 2005 and 2004. In this MD&A, we, us, our, the Company and Terasen mean Terasen Inc., its subsidiaries, joint ventures and investments in significantly influenced companies. Terasen Gas refers to Terasen Gas Inc., TGVI refers to Terasen Gas (Vancouver Island) Inc., Trans Mountain refers to Terasen Pipelines (Trans Mountain) Inc., Corridor refers to Terasen Pipelines (Corridor) Inc., Terasen Pipelines refers to Terasen Pipelines Inc., Express refers to the Express and Platte Pipeline Systems; and Water and Utility Services refers to Terasen Waterworks (Supply) Inc., Terasen Utility Services Inc. and Terasen's 50% interest in Fairbanks Sewer and Water Inc. KMI refers to Kinder Morgan, Inc.

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

About Terasen

On November 30, 2005, all of the shares of the Company were acquired by Kinder Morgan, Inc. (''KMI''), through a subsidiary, pursuant to a Combination Agreement dated as of August 1, 2005. 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 securityholders.

Natural Gas Distribution

Terasen's natural gas distribution operations consist primarily of Terasen Gas and TGVI in addition to several small related utility operations. Terasen Gas is the largest distributor of natural gas in British Columbia, serving more than 804,000 customers in more than 100 communities. Major areas served by Terasen Gas are Greater Vancouver, the Fraser Valley and the Thompson, Okanagan, Kootenay and North Central Interior regions of the province. TGVI serves approximately 85,000 customers on Vancouver Island and the Sunshine Coast area and Terasen Gas (Whistler) serves approximately 2,000 customers in the Whistler region. Terasen Gas and TGVI provide transmission and distribution services to their customers, and obtain natural gas supplies on behalf of residential and commercial customers. Gas supplies are sourced primarily from northeastern British Columbia and, through the Company's Southern Crossing Pipeline, from Alberta.

Petroleum Transportation

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

Other Activities

In addition to Terasen's core businesses of Natural Gas Distribution and Petroleum Transportation, Terasen owns interests in several smaller businesses including a 30% interest in CustomerWorks LP. CustomerWorks provides billing and customer care services to utilities, municipalities and retail energy companies. CustomerWorks has outsourced the provision of its customer care services to an entity owned and operated by Accenture Inc. Prior to the disposition of Terasen's 40.4% ownership interest in Clean Energy on October 31, 2005, the other activities segment also included Clean Energy Fuel Corp. (''Clean Energy''), a provider of natural gas vehicle refueling infrastructure.

In January 2006, Terasen entered into a Purchase and Sale Agreement to dispose of its interest in its water and utility services operations for proceeds of approximately $125 million. The disposition is expected to be completed by the end of April 2006, subject to regulatory approvals. The water and utility services business has accordingly been reclassified as assets and liabilities held for sale and as discontinued operations. The disposition is not expected to give rise to a material gain or loss.

Results of Operations

Net Earnings

	Years ended December 31 2005	2004
	(in millions of dollars)	
Natural gas distribution		
Terasen Gas	**$ 65.3**	$ 69.7
TGVI	**25.5**	26.2
	90.8	95.9
Petroleum transportation		
Trans Mountain	**25.4**	39.4
Corridor	**13.6**	15.6
Express System	**25.5**	15.9
	64.5	70.9
Discontinued operations	**(4.9)**	3.3
Other activities	**(49.2)**	(20.3)
Net earnings	**$101.2**	$149.8

Net earnings for 2005 decreased by $48.6 million compared to 2004. Significant items that impacted net earnings in 2005 were as follows:

Certain items

	($ millions)
KMI transaction costs	$42.9
Inland Pacific Connector costs	3.6
Clean Energy hedging gains and disposition costs	(2.5)
Premium on Trans Mountain debt redemption	7.3
	$51.3

In 2005 the Company has charged to earnings after-tax costs of $42.9 million associated with the acquisition by KMI, 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, and the write-off of approximately $15.3 million of income tax expense related to restricted tax loss carry-forwards.

In the fourth quarter of 2005 Terasen Gas expensed $3.6 million (after-tax) of costs incurred in connection with the Inland Pacific Connector project that were not permitted recovery in rates by the BCUC.

On October 31, 2005, the Company sold its 40.4% ownership in Clean Energy for proceeds of approximately U.S. $35.9 million. The sale, together with equity earnings of Clean Energy for the ten months ended October 31, 2005, has resulted in a gain of approximately $2.5 million, including the recognition of all unrealized gas forward contract gains of Clean Energy in 2005 totalling $10.9 million and the recognition of currency translation losses previously included in Shareholders' Equity totalling $8.4 million.

On November 1, 2005, Trans Mountain exercised its right to redeem the $35 million Series C Debentures. An after-tax charge to earnings of $7.3 million was incurred in connection with the premium that was paid to redeem the debentures.

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

Selected Annual Information

	2005	2004	2003
	Years ended December 31 (in millions of dollars)		
Total revenues[1]	**$1,952.5**	$1,798.1	$1,763.1
Net income before discontinued operations[1]	**106.1**	146.5	130.7
Net income[2]	**101.2**	149.8	132.7
Common dividends paid	**95.1**	86.4	79.4
Total assets (restated)[1]	**5,316.1**	4,981.8	4,933.1
Long-term debt[1,3]	**2,012.9**	2,291.6	2,426.1
Current portion of long-term debt	**398.2**	416.7	51.8

1. Total revenues in 2004 and 2003 have been restated to reflect the reclassification of the water and utility services business as discontinued operations. Net income before discontinued operations and long-term debt for 2004 and 2003 have been restated for the reclassification of the Company's capital securities from equity to long-term debt, and the reclassification of the respective financing costs and income taxes. Total assets for 2004 and 2003 have been restated to reflect the reclassification of deferred charges to other long-term liabilities and deferred credits.
2. Terasen is a wholly-owned subsidiary of KMI and accordingly earnings per share information is not disclosed.
3. Excluding current portion of long-term debt.

Growth in total revenues has been caused mainly by higher natural gas commodity prices, particularly in 2005, which are flowed through in customer rates. Net income, when adjusted for the KMI transaction costs and Trans Mountain Series C redemption costs in 2005, has grown since 2003 mainly as a result of strong earnings growth in petroleum transportation. The completion of the Corridor Pipeline project in April 2003 and the Express System expansion in 2005 and throughput growth on the Trans Mountain system have been the main contributors to earnings growth. The increase in total assets from 2004 to 2005 reflected both capital expenditures and growth in natural gas inventories and accounts receivable as a result of higher natural gas commodity prices.

Results by Business Segment

Natural Gas Distribution

	2005	2004
	Years ended December 31 (in millions of dollars)	
Natural gas distribution revenues	**$1,678.0**	$1,494.1
Natural gas distribution net earnings	**90.8**	95.9

Revenues from natural gas distribution increased in 2005 compared to 2004 mainly as a result of higher market prices for natural gas, which are flowed through in customer rates. Cost of natural gas increased by a corresponding amount.

Earnings from natural gas distribution declined from $95.9 million in 2004 to $90.8 million in 2005 related to the expensing of costs associated with the KMI acquisition and the expensing of costs associated with the Inland Pacific Connector project, as well as a lower allowed return on equity in both Terasen Gas and TGVI and reduced earnings from accretion of the RDDA acquisition discount in TGVI. These factors were partially offset by strong operating performance in both Terasen Gas and TGVI as discussed below.

TERASEN GAS

Earnings from Terasen Gas decreased from $69.7 million to $65.3 million due to the expensing of $6.4 million of costs related to the KMI acquisition primarily from the expiry of loss carryforwards due to the change in control, a lower allowed return on equity in 2005 compared to 2004, and the expensing of $3.6 million (after-tax) of costs incurred in connection with the Inland Pacific Connector project that were not permitted recovery in rates by the BCUC. These factors were partially offset by strong operating performance, including higher transportation revenue, rate base growth and reduced bad debt expense.

Terasen Gas net customer additions during 2005 were 12,613, up from 11,750 customer additions in 2004. Solid economic conditions and continued strength in new housing starts in British Columbia helped drive the net customer additions in 2005. Terasen Gas industrial sales volumes decreased by 755 terajoules while transportation volumes increased by 1,113 terajoules from the previous year. Terasen Gas earns approximately the same margin regardless of whether a customer contracts for sales or transportation service.

Regulation

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

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

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

In 2005, the net balances of the RSAM and CCRA/MCRA accounts decreased to a payable of $9.0 million from a receivable of $14.1 million in 2004. In order to ensure that the balances in the CCRA/MCRA account are recovered on a timely basis, Terasen Gas prepares and files quarterly calculations with the BCUC to determine whether customer rate adjustments are needed to reflect prevailing market prices for natural gas costs.

Short-term and long-term interest rate deferral accounts are also in place to absorb interest rate fluctuations. The interest rate deferral accounts which were in place during 2004 effectively fixed the interest expense on short-term funds attributable to Terasen Gas' regulated assets at 4.00% during 2005, up from 3.25% in 2004. The effective fixed short-term interest rate for 2006 has been set at 4.00%. Any variations from this rate throughout the year are recorded in deferral accounts.

Allowed Return on Equity (ROE) and Capital Structure

Terasen Gas' allowed ROE is determined annually based on a formula that applies a risk premium to a forecast of long-term Government of Canada bond yields. For 2005, the application of the ROE formula set Terasen Gas' allowed ROE at 9.03%, down from 9.15% in 2004. Terasen Gas and TGVI applied to the BCUC in June 2005 to increase their deemed equity components from 33% to 38% and from 35% to 40%, respectively. The same application also requested an increase in allowed ROEs from the levels that would have resulted from the historic formula, which would have been 8.29% for Terasen Gas and 8.79% for TGVI in 2006.

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

2004-2007 Performance Based Rate Plan (PBR)

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

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

Upon expiry of the 2004-2007 PBR, there is no certainty as to whether a new negotiated settlement will be entered into, or what the terms of a new settlement might be.

Municipal Leasing Transactions

Certain municipalities in Terasen Gas' service area have an option to purchase the gas distribution franchise within their municipal boundary. In order to address these purchase options, the Company has developed a leasing arrangement that allows Terasen Gas to continue to operate the gas distribution assets by effectively selling the assets to the municipality and leasing them back for a 17 year period. After 17 years, Terasen Gas has an option to repurchase the assets at depreciated value. At December 31, 2005, Terasen Gas had entered into transactions involving a total value of $152.7 million, and the value of future transactions is not expected to be material.

TGVI

Earnings from TGVI remained steady, decreasing only slightly from $26.2 million to $25.5 million.

TGVI net customer additions during 2005 were 4,354, up from 4,233 customer additions in 2004.

Regulation

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

- TGVI receives, for the benefit of its customers, an annual payment until 2011 from the Province based on the wellhead price of natural gas in B.C. This payment amounted to $46.7 million in 2005, up from $33.2 million in 2004.
- The accumulated revenue deficiency resulting from overall revenues being below the cost of service prior to 2003 had been recorded in a Revenue Deficiency Deferral Account (RDDA). When Terasen acquired TGVI, the amount of the RDDA was $85 million, for which Terasen paid a price of $61 million. The accumulated RDDA recorded on Terasen's consolidated financial statements totaled $35.2 million as at December 31, 2005, corresponding to a balance for TGVI regulatory purposes of $48.3 million. The balance on Terasen's consolidated financial statements is down $10.4 million from December 31, 2004. Terasen is committed to fund these revenue deficiencies by purchasing preferred shares or subordinated debt issued by TGVI. The BCUC was directed to set rates beginning in 2003 that amortize the RDDA balance over the shortest period reasonably possible, having regard for TGVI's competitive position relative to alternative energy sources and the desirability of reasonable rates. The earnings impact of the RDDA discount is discussed under Results — Natural Gas Distribution.
- Any variances in the achieved ROE in a particular year from the allowed ROE (other than variances resulting from operation and maintenance costs) are deferred and recorded in the RDDA. The RDDA accumulated by TGVI is funded by the Company. Recovery of the deficiency through rates charged to customers is dependent upon regulatory approval and must be balanced against maintaining the competitiveness of TGVI's service relative to alternative energy sources. As a result, most risks associated with TGVI's annual financial results (other than operating costs) are, subject to BCUC approval, transferred to customers through the RDDA. The Company began recovery of the deficiency in 2003.

TGVI renewed its regulatory settlement in late 2005 for a two-year period effective January 1, 2006. It provides for a continuation of the operation and maintenance cost incentive arrangements previously in place. The allowed ROE for TGVI was 9.53% for 2005, compared to 9.65% in 2004. As described above, TGVI's ROE for 2006 is 9.50% and TGVI's deemed equity component of its capital structure for 2006 is 40%.

To ensure prompt recovery of the RDDA, the BCUC has approved a rate-setting mechanism for TGVI whereby customer rates are set at levels in excess of TGVI's cost of service, but effectively capped by the price of competitive alternative fuels (electricity or heating oil). This has resulted in significant RDDA amortization in both 2004 and 2005. However, RDDA recovery is sensitive to the relative pricing of natural gas and electricity in TGVI's service area, as well as to margin generated under TGVI's firm transportation agreements discussed below. There is no certainty that TGVI will be able to charge rates that will be sufficient to fully recover the RDDA prior to the expiry of the Provincial royalty payments at the end of 2011.

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

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

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

Petroleum Transportation

	Years ended December 31	
	2005	2004
	(in millions of dollars)	
Petroleum transportation revenues	**$227.8**	$225.5
Petroleum transportation net earnings	**64.5**	70.9

Revenues from petroleum transportation increased by $2.3 million in 2005 compared to 2004 as a result of higher revenues on the Corridor system, which offset lower throughput on the Trans Mountain system in the first quarter of 2005 as discussed below. Corridor revenues were higher in 2005 as a result of the refund in 2004 of deferral account balances to the Corridor shippers.

Earnings from petroleum transportation declined from $70.9 million in 2004 to $64.5 million in 2005 mainly as a result of lower throughput on the Trans Mountain system and a lower allowed return on equity on the Corridor system, offset in part by higher earnings from the Express System as a result of the completion of the Express expansion project. Earnings in 2005 were also impacted by a $7.3 million aftertax charge to earnings associated with the redemption of the Trans Mountain Series C Debentures.

TRANSPORTATION VOLUMES

	Years ended December 31	
	2005	2004
	(barrels per day)	
Trans Mountain Canadian mainline	**220,900**	236,100
Trans Mountain U.S. mainline	**74,600**	91,700
Express System	**213,000**	175,900

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

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

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

TRANS MOUNTAIN

Earnings from Trans Mountain were $25.4 million in 2005, down from $39.4 million in 2004 mainly as a result of the costs of the Trans Mountain Series C Debenture redemption and the reduction in throughput on the Trans Mountain system in the first quarter of 2005.

Regulation

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

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

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

In January 2006, Kinder Morgan Canada entered into a memorandum of understanding with the Canadian Association of Petroleum Producers (CAPP) for a new Incentive Toll Settlement (the 2006-2010 ITS). The 2006-2010 ITS will determine the tolls to be charged on the Trans Mountain system over the five-year term of the agreement, to take effect as of January 1, 2006. The agreement will also govern the financial arrangements for the Pump Station Expansion and Anchor Loop projects. The 2006-2010 ITS is subject to National Energy Board (NEB) approval, and Kinder Morgan Canada and CAPP will work toward a final agreement by the end of June 2006. In addition to tolling and expansion parameters, the formal agreement will allow for new pipeline rules and regulations, capacity allocation procedures for the Westridge Marine Terminal and enhanced service standards.

The toll charged for the U.S. portion of Trans Mountain's pipeline in Washington State falls under the jurisdiction of the Federal Energy Regulatory Commission (FERC). Regulation by FERC is on a complaint basis. There were no complaints in 2005.

Trans Mountain Pump Station Expansion Project

On Nov. 10, 2005, Kinder Morgan Canada received approval from the National Energy Board (NEB) to increase the capacity of the Trans Mountain pipeline system from 225,000 bpd to 260,000 bpd. The $230 million expansion is designed to add 35,000 bpd of heavy crude oil capacity by building new and upgrading existing pump stations along the pipeline system between Edmonton, Alberta, and Burnaby, British Columbia. Construction began in early 2006 and the expansion will be in service in early 2007.

Trans Mountain Anchor Loop Project

Kinder Morgan Canada filed a comprehensive environmental report with the Canadian Environmental Assessment Agency on Nov. 15, 2005, and filed a complete NEB application for the Anchor Loop project on February 17, 2006. The $400 million project involves twinning a 158-kilometre section of the existing Trans Mountain pipeline system between Hinton, Alberta, and Jackman, British Columbia, and the addition of three new pump stations. With construction of the Anchor Loop, the Trans Mountain system's capacity will increase from 260,000 bpd to 300,000 bpd by the end of 2008.

Based on management's expectations for petroleum transportation demand to the West Coast of British Columbia and shipper feedback, Kinder Morgan Canada has decided not to seek long-term contracts with shippers for the Pump

Station Expansion Project or the Anchor Loop Project. As a result, there is no certainty that shipments on the Trans Mountain system will be sufficient to adequately recover the entire capital costs of the Pump Station and Anchor Loop expansions. However, the provisions of the 2006-2010 ITS will mitigate Trans Mountain's financial exposure to throughput shortfalls during that timeframe.

Beyond the Anchor Loop project, Kinder Morgan Canada is actively pursuing TMX 2, an approximately $1 billion project that would loop the Trans Mountain pipeline between Valemont and Kamloops and back to Edmonton, increasing throughput by 100,000 bpd, and TMX 3, a $900 million project that would loop the Trans Mountain pipeline between Kamloops and the Lower Mainland, increasing throughput by 300,000 bpd. Kinder Morgan Canada plans to conduct open seasons for both projects in 2006. Further into the future, Kinder Morgan Canada is considering building a new 400,000 bpd pipeline across northern British Columbia to a new deep-water port facility in Kitimat, British Columbia at a projected cost of $2.0 billion.

Kinder Morgan Canada is no longer pursuing the previously announced Spirit Pipeline due to the termination of arrangements with its project partner.

CORRIDOR

Earnings from the Corridor system were $13.6 million in 2005, down from $15.6 million in 2004 as a result of a lower allowed return on equity caused by lower long Canada bond yields in 2005 compared to 2004. The Firm Service Agreement (FSA) between Corridor and its shippers sets pipeline tolls based on conventional cost of service mechanisms. The FSA is a 25-year agreement, with return on equity linked to prevailing long Canada bond yields. Shell Canada Limited, Chevron Canada Limited and Western Oil Sands L.P. have entered into a long-term ship-or-pay contract with Corridor for 60%, 20% and 20%, respectively, of the available capacity on the Corridor Pipeline.

Corridor Pipeline Expansion

Kinder Morgan Canada has initiated engineering, environmental and consultation activities on its proposed Corridor pipeline expansion project. The $1.0 billion expansion includes building a new 42-inch diluent/bitumen (dilbit) pipeline, a new 20 inch products pipeline, tankage and upgrading existing pump stations along the existing pipeline system from the Muskeg River Mine north of Fort McMurray to the Edmonton region. The Corridor pipeline expansion will add an initial 200,000 bpd of dilbit capacity to accommodate the new bitumen production from the Muskeg River Mine. The current dilbit capacity is approximately 258,000 bpd. It is expected to climb to 278,000 by April 2006 by upgrading existing pump station facilities. By 2009, the dilbit capacity of the Corridor system is expected to be approximately 500,000 bpd. An application for the Corridor Pipeline Expansion Project was filed with the Alberta Energy and Utilities Board on December 22, 2005. Pending regulatory and definitive shipper approval, construction will begin in late 2006.

EXPRESS SYSTEM

Earnings from the Express System were $25.5 million in 2005, up $9.6 million from 2004, as a result of the completion of the Express System capacity expansion in April 2005, and the additional throughput that the Express System was able to transport due to the expansion, and due to the realization of additional tax benefits.

In late 2003 and 2004, Terasen conducted open seasons to obtain long-term commitments for a portion of the Express System's uncommitted capacity and for expansion capacity. Express has 84% of its 280,000 bpd post-expansion total capacity contracted. These contracts expire in 2007, 2012, 2014 and 2015 in amounts of 1%, 40%, 11% and 32% of total capacity, respectively. These contracts provide for committed tolls for transportation on the Express System, which can be increased each year by up to 2%. The remaining capacity is made available to shippers as uncommitted capacity.

Other Activities

	Years ended December 31	
	2005	2004
	(in millions of dollars)	
Other activities revenues	**$46.7**	$78.5
Other activities net (loss)	**(49.2)**	(20.3)

Revenues from other activities declined from $78.5 million in 2004 to $46.7 million in 2005 as a result of the change in accounting treatment for Clean Energy from proportionate consolidation to equity accounting.

The loss from other activities increased from $20.3 million in 2004 to $49.2 million in 2005 primarily as a result of $34.4 million of costs incurred in connection with the acquisition of the Company by KMI.

Discontinued Operations

The water and utility services operations incurred a loss of $4.9 million in 2005, compared to earnings of $3.3 million in 2004. The decline in earnings was due to the expiry of tax loss carryforwards associated with the KMI acquisition and the recognition of a currency translation loss resulting from the pending sale of the business, somewhat offset by strong operating performance in the business.

Summary of Quarterly Results

	For the three months ended				
	Mar-31	Jun-30	Sep-30	Dec-31	Total
			($ millions)		
2005					
Revenues (restated)[1]	$627.5	$354.3	$282.6	$688.1	$1,952.5
Net income before discontinued operations	66.9	27.1	0.9	11.2	106.1
Net income	66.3	29.5	4.0	1.4	101.2
2004					
Revenues (restated)[1]	625.1	321.6	275.6	575.8	1,798.1
Net income before discontinued operations	68.6	16.1	7.6	54.2	146.5
Net income	67.9	17.9	10.1	53.9	149.8

1. Revenues for 2004 and 2005 have been restated to reflect the reclassification of the water and utility services business as a discontinued operation, and to reclassify certain revenues from Clean Energy to equity accounting.

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

Revenues in 2005 were generally higher than in 2004 on a quarterly and annual basis as a result of higher natural gas commodity prices in 2005.

March 2005/2004 — Earnings declined by $1.6 million due to temporary lower petroleum transportation throughput resulting from the decline in production from the Alberta oilsands and maintenance turnarounds at refineries connected to the Trans Mountain pipeline. Strong operating results from the other business units were able to offset the majority of the earnings decline from petroleum transportation.

June 2005/2004 — Earnings increased by $11.6 million, driven by growth in earnings from all areas of operations. Customer growth and operating efficiencies in the quarter were the primary factors in the $2.6 million growth in earnings from natural gas distribution. Higher throughput on the Trans Mountain mainline and the implementation of the Express System expansion resulted in a $4.7 million increase in contribution from petroleum transportation. Growth in earnings from Waterworks and Clean Energy were the key drivers of the improvement in year-over-year earnings contribution from water and utility services and other activities.

September 2005/2004 — Earnings declined by $6.1 million over the prior year third quarter, but include the hedging activities and disposition costs associated with Clean Energy and transaction costs associated with the KMI acquisition. After excluding these items, earnings increased by $4.2 million through a combination of growth in earnings from all three business units, which more than offset increased corporate expenses for the quarter.

December 2005/2004 — Earnings declined by $52.5 million mainly as a result of costs incurred in connection with the acquisition of the Company by KMI of $38.9 million, as well as a charge to earnings associated with the redemption of the Trans Mountain Series C Debentures of $7.3 million.

Liquidity and Capital Resources

Consolidated Cash Flow

	Years ended December 31	
	2005	2004
	(in millions of dollars)	
Cash flow provided by (used for):		
Operating activities	**$195.4**	$335.4
Investing activities	**(212.5)**	(160.2)
Financing activities	**76.5**	(156.7)
Net increase in cash	**$ 59.4**	$ 18.5

CASH FLOW FROM OPERATING ACTIVITIES

Cash flow from operating activities declined from $335.4 million in 2004 to $195.4 million in 2005 due to a number of factors. Net earnings were lower in 2005 as a result of the items disclosed above in the ''Certain Items'' table. The net recovery of rate stabilization accounts in 2005 was $10.1 million compared with $31.0 million in 2004, mainly due to higher rate stabilization account receivable balances at the beginning of 2004. In addition, changes in non-cash working capital were a use of $68.3 million in 2005 compared to a source of $14.7 million in 2004, mainly as a result of the impact of higher gas prices on the value of natural gas inventory and accounts receivable.

INVESTING ACTIVITIES

Proceeds from the sale of natural gas distribution assets in municipal leasing transactions largely offset the acquisition of water and utility services businesses in 2004, whereas expenditures on the water and utility services business in 2005 were largely offset by proceeds from the disposition of the Company's interest in Clean Energy.

Capital expenditures totaled $214.7 million in 2005 compared with $154.4 million in 2004. The increase in capital expenditures was primarily attributable to the acquisition of the Coastal Facilities buildings. Prior to January 2005, the Coastal Facilities synthetic lease agreement had been accounted for as an off-balance sheet item. In 2004, Terasen Gas applied to the BCUC for and received approval to unwind the synthetic lease and include the Coastal Facilities assets in rate base. On January 4, 2005, Terasen Gas paid approximately $49.4 million to BCG Coastal Facilities Trust to unwind the synthetic lease. The Coastal Facilities assets have been included in the Terasen Gas rate base commencing January 2005.

FINANCING ACTIVITIES

In February 2005, Terasen Gas issued $150 million of 30-year medium term note debentures at an interest rate of 5.90%. In October 2005, Terasen Gas issued $150 million of two-year medium term note debentures at a floating rate of interest. In the second quarter of 2004, Terasen Gas issued $150 million of medium term note debentures at an interest rate of 6.50%. Funds generated from the issuance of medium term note debentures were used for general corporate purposes of Terasen Gas and to refinance maturing medium term debentures.

In February 2005, Corridor issued $150 million each of 5-year and 10-year unsecured debentures at rates of 4.24% and 5.033%, respectively. Proceeds were used to repay commercial paper issued by Corridor.

In September 2005, Trans Mountain announced that it had exercised its right to redeem the $35 million principal amount 11.50% Series C Debentures, due June 20, 2010. The redemption took place on November 1, 2005. The total redemption price for the Debentures was $1,353.7615 per $1,000 principal amount, which includes accrued and unpaid interest to the redemption date. The redemption price was determined based on the Canada Yield Price, as defined in the Trust Indenture governing the Debentures.

As at December 31, 2005, the Company and its subsidiaries had lines of credit in place totaling $1,175 million to finance cash requirements. These lines enable the respective companies to borrow directly from their bankers, issue bankers' acceptances and support commercial paper issuance. Bank lines of $375 million were unutilized at the end of 2005. Virtually all short-term cash needs are funded through commercial paper and bankers' acceptances in the

Canadian market at rates generally below bank prime. Terasen does not have, nor does it expect to have, any defaults or arrears.

On January 13, 2006, Terasen Gas (Vancouver Island) Inc. entered into a five-year unsecured, committed, revolving credit facility of $350 million with a syndicate of banks, of which $296 million was drawn against the facility on January 17, 2006. A portion of the facility was used to refinance TGVI's existing term facility of $209.5 million. The facility will also be utilized to finance working capital requirements and general corporate purposes.

Concurrently with executing the above noted 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 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 the Company.

Dividends on common shares totaled $95.1 million in 2005, compared to $86.4 million in 2004. The increase reflects an increase in the dividend rate paid on common shares in 2005.

Financial Position

The following table outlines the significant changes in the consolidated balance sheets as at December 31, 2005 compared to December 31, 2004, other than changes arising from the reclassification of the water and utility services business as a discontinued operation.

Balance Sheet Item	Increase (Decrease) ($ millions)	Explanation
Cash and short-term investments	$ 59.4	Increased as a result of significant cash flow in late 2005 that was used to repay short-term notes subsequent to year end.
Accounts receivable	119.5	Increased mainly as a result of the impact of higher gas prices on accounts receivable for Terasen Gas and TGVI, partially offset by the reclassification of accounts receivable in the water and utilities services segment into assets held for resale.
Goodwill	(51.6)	Declined as a result of the disposition of Clean Energy and the reclassification of water and utility services as long lived assets held for resale.
Short-term notes	433.0	The refinancing of the Corridor bank credit facility resulted in the reclassification of Corridor's remaining commercial paper outstanding from long-term debt to short-term notes. In addition, short-term note balances at the end of 2004 were relatively low as a result of long-term debt issuance in 2004 that pre-funded long-term debt maturities in 2005.
Accounts payable and accrued liabilities	68.1	Increased mainly as a result of the impact of higher gas prices on accounts payable for Terasen Gas and TGVI, offset by the reclassification of accounts payable in the water and utilities services segment into liabilities held for resale.
Long-term debt (including current portion)	(297.2)	The refinancing of the Corridor bank credit facility resulted in the reclassification of Corridor's remaining commercial paper outstanding from long-term debt to short-term notes. In addition, long-term debt maturities in 2005 were partially pre-funded by long-term debt issuance in 2004.

Working Capital

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

Dividend Restrictions

As part of its approval of the acquisition of Terasen by KMI, the BCUC imposed a number of conditions intended to ring-fence Terasen Gas and TGVI from Terasen. These restrictions included a prohibition on the payment of dividends unless Terasen Gas or TGVI has in place at least as much common equity as that deemed by the BCUC for rate-making purposes. As a result of this and the Decision issued by the BCUC on March 2, 2006 Terasen Gas and TGVI must maintain a percentage of common equity to total capital that is at least as much as that determined by the BCUC from time to time for ratemaking purposes. Dividend payments will not be allowed by the regulator if the requisite equity is not in place.

Dividend policies are set to ensure that Terasen Gas and TGVI maintain at least as much common equity as that deemed by the BCUC for rate-making purposes.

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

In 2005, none of these restrictions constrained the distribution of subsidiary earnings not otherwise needed for reinvestment.

Credit Ratings

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

The table below summarizes the ratings assigned to the Company's various securities at December 31, 2005.

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

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

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

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

After reassessing its relationship with Standard & Poor's Ratings Services, a division of the McGraw-Hill Companies (Canada) Corporation (S&P), Terasen decided early in 2004 to discontinue the engagement of S&P to provide credit ratings on the debt of Terasen and Terasen Gas. Terasen believes the credit ratings issued by Moody's and DBRS will be sufficient to service the requirements of creditors and maintain the Company's access to capital. S&P continues to provide an unsolicited rating on Terasen's outstanding debt based on publicly available information. As of December 31, 2005, Terasen's unsecured long-term debt was rated BBB– by S&P.

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

Projected Capital Expenditures

Terasen has estimated total 2006 consolidated capital expenditures of $501 million. Major capital expenditures in 2006 include construction on the Trans Mountain Pump Station Expansion project ($168 million), initial expenditures on the Corridor Pipeline Expansion ($95 million) and upgrades to the Trans Mountain U.S. mainline in Washington State to support future expansion ($31 million).

The Company expects to finance capital expenditures in 2006 with a combination of proceeds from the refinancing of TGVI's credit facility and shareholder advances, short-term borrowings and internally generated funds. The Company does not expect to pay common dividends to its shareholder in 2006, instead retaining its earnings for reinvestment in growth opportunities.

Off-Balance Sheet Arrangements

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

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

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

Transactions with Related Parties

The Company has not had any significant transactions with related parties outside of the consolidated group in 2005.

Changes in Accounting Policies

Liabilities and Equity

In accordance with recent changes to the CICA Handbook Section 3861 ''Financial Instruments — Disclosures and Presentation'', the Company's $125 million 8% Capital Securities have been reclassified from shareholders' equity to liabilities because the Capital Securities can be settled by issuing equity at a variable price dependent upon the market value of the Company's common shares at the settlement date. As a result of the change, distributions associated with the Capital Securities are now recorded as financing costs and the related income-tax benefits are recorded within income tax expense. Previously, the distributions were recorded on an after-tax basis as a deduction from net earnings to determine earnings applicable to common shares. There is no impact to earnings applicable to common shares or earnings per share. The changes have been applied retroactively and have increased long-term debt and decreased shareholders' equity, both by $125.0 million, compared to the amounts previously reported as at December 31, 2004. The restatement has also increased financing costs by $10.0 million, decreased income tax expense by $3.4 million and capital securities distributions by $6.6 million compared to the amounts previously reported for the year ended December 31, 2004.

Variable Interest Entities

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

Rate Regulated Entities

The Canadian Institute of Chartered Accountants have undertaken a project to review and change how rate regulated enterprises recognize and measure regulated assets and liabilities. The results of this project could introduce significant volatility into the earnings of such businesses, which may include the elimination of regulatory deferral accounts. The project could also require rate regulated enterprises to include future income taxes payable on their balance sheets. There is very real risk that this could negatively affect debt covenant compliance and impact utilities' ability to attract financing and equity capital. The industry has actively intervened in this process over the past two years, and an exposure draft on this matter is anticipated in late 2006.

Disclosure Controls and Procedures

The President and the Chief Financial Officer evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Multilateral Instrument 52-109) and concluded that the company's disclosure controls and procedures were effective as of December 31, 2005.

Financial Instruments

Fair Value Estimates

The fair value of the Company's long-term debt, calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues at December 31, 2005, or by using available quoted market prices, is estimated at $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. As approved by the regulator, derivatives are used to manage natural gas price risk in the natural gas distribution operations. The majority of the natural gas supply contracts have floating, rather than fixed prices. The Company uses natural gas price swap contracts to fix the effective purchase price. Any differences between the effective cost of natural gas purchased and the price of natural gas included in rates are recorded in a deferral account (MCRA and CCRA), and subject to regulatory approval, are passed through in future rates to customers.

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

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

			December 31, 2005		December 31, 2004	
Asset (Liability)	**Number of swaps and options**	**Term to maturity (years)**	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
			(in millions)			
Interest Rate Swaps[1]						
Terasen Inc.	3	1 - 9	$ —	$ 3.6	$ —	$5.4
TGI	3	2	—	(1.6)	—	—
TGVI	4	1 - 4	—	(0.6)	—	(3.2)
Corridor	2	5 - 10	—	0.3	—	—
Natural Gas Commodity Swaps and Options						
Terasen Gas and TGVI[2]	161	Up to 3	21.2	105.6	—	(8.3)
Clean Energy[3]	—	—	—	—	6.5	6.5
Foreign Currency Swaps						
Terasen Inc.[4]	—	—	—	—	(0.6)	(0.6)

1 The interest rate derivatives entered into by Terasen Inc. resulted in lower interest expense of $4.8 million in 2005, compared with a $3.6 million interest expense reduction in 2004. The derivatives entered into by TGI and TGVI relate to regulated operations and any resulting gains or losses are recorded in deferral accounts, subject to regulatory approval, and passed through to customers in future rates. The gains and losses associated with derivatives entered into by Corridor are similarly passed through to shippers in future rates.

2 The natural gas derivatives fair value reflects only the value of the natural gas derivatives and not the offsetting change in value of the underlying future purchases of natural gas. These fair values reflect the estimated amounts the Company would receive or pay to terminate the contracts at the stated dates. Included in the carrying value of the natural gas derivatives is $22.2 million of unrealized fair value gains associated with derivative instruments which were deemed to be ineffective at December 31, 2005, and $1.0 million of derivative instruments which did not qualify for hedge accounting that are in a liability position. The gains and losses associated with natural gas derivatives are recorded in deferral accounts, subject to regulatory approval, and passed through to customers in future rates.

3 Clean Energy entered into natural gas commodity derivatives to manage its exposure to the cost of natural gas. These transactions resulted in a $10.9 million contribution to earnings in 2005, compared with a $3.3 million contribution in 2004. The carrying and fair value of Clean Energy's natural gas commodity swaps at December 31, 2004 reflected Terasen's 45.0% ownership interest at that time. Terasen disposed of its interest in Clean Energy on October 31, 2005.

4 The change in fair value of the derivatives of $1.6 million in 2005 and $0.7 million in 2004 has been included in the earnings contribution from the Express System for the respective periods.

Outstanding Share Data

December 31, 2005

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

Terasen is an indirect wholly-owned subsidiary of Kinder Morgan, Inc. At December 31, 2005 all of the common shares of the Company are owned by Kinder Morgan, Inc.

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

Forward Looking Statement
When used in this report, the words ‘‘anticipate’’, ‘‘expect’’, ‘‘project’’, ‘‘believe’’, ‘‘estimate’’, ‘‘forecast’’ and similar expressions are intended to identify forward looking statements, which include statements relating to pending and proposed projects or possible acquisitions. Such statements are subject to certain risks, uncertainties and assumptions pertaining to operating performance, regulatory parameters, economic conditions and, in the case of pending and proposed projects, risks relating to design and construction, regulatory processes, obtaining financing and performance of other parties, including partners, contractors and suppliers and in the case of possible acquisitions, obtaining financing, acquiring assets or companies at an appropriate price and the ability to effect synergies in a timely and cost-effective manner.

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

Terasen Inc.

Interim Management's Discussion and Analysis
For the three and nine Months Ended September 30, 2006
Dated November 27, 2006

The following discussion of the financial condition and the results of operations of Terasen Inc. (Terasen or the Company) should be read in conjunction with the Company's December 31, 2005 annual audited consolidated financial statements and related notes together with Management's Discussion and Analysis and the unaudited interim consolidated financial statements and related notes for the periods ended September 30, 2006.

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

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

THIRD QUARTER 2006 FINANCIAL RESULTS

Result of Operations

NET EARNINGS	Three months ended September 30 2006	Three months ended September 30 2005	Nine months ended September 30 2006	Nine months ended September 30 2005
	In millions of dollars			
Natural gas distribution	**$(6.8)**	$(3.6)	**$48.3**	$59.8
Petroleum transportation	**17.4**	17.2	**51.6**	50.8
Discontinued operations[1]	**(4.1)**	3.1	**(17.0)**	4.9
Other activities	**(4.0)**	(12.7)	**(17.7)**	(15.7)
Net earnings	**$ 2.5**	$ 4.0	**$65.2**	$99.8

1 In January 2006, Terasen entered into a Purchase and Sale Agreement to dispose of its interest in its water and utility services operations for proceeds of approximately $132 million. The disposition was completed on May 19, 2006 with the proceeds from the sale being used to reduce debt. The disposition gave rise to a $17.0 million loss which has been fully recorded.

Terasen reported earnings of $2.5 million for the three months ended September 30, 2006 compared with earnings of $4.0 million in the corresponding quarter of 2005. For the nine months ended September 30, 2006, earnings were $65.2 million compared to $99.8 million in the nine months of 2005. The decrease in earnings for the nine months is mainly due to a provision of $14.5 million made for retroactive tax amending legislation that was introduced in a provincial legislature, a loss of $17.0 million recorded on the sale of water and utility services operations and the $2.2 million loss of earnings from Clean Energy operations which was disposed on October 31, 2005.

Results by Business Segment

Natural Gas Distribution

	Three months ended September 30 2006	Three months ended September 30 2005	Nine months ended September 30 2006	Nine months ended September 30 2005
	In millions of dollars			
Revenues	**$217.0**	$213.7	**$1,204.6**	$1,065.8
Net earnings	**$ (6.8)**	$ (3.6)	**$ 48.3**	$ 59.8

For the three and nine months ending September 30, 2006, revenues from natural gas distribution increased by $3.3 million and $138.8 million, respectively, compared to the corresponding periods in 2005. Cost of natural gas, on a year-over-year basis, decreased $1.0 million in the third quarter and increased $130.2 million for the nine months ended September 30, 2006. Higher revenues and cost of natural gas reflected mainly the higher commodity cost of gas charged to customers due to higher market prices and some customer growth in the quarter. Changes in both consumption levels and the commodity cost of natural gas do not materially impact earnings as a result of regulatory deferral accounts.

As noted in the Company's annual 2005 Management's Discussion and Analysis, the allowed Return on Equity (''ROE'') for 2006 for Terasen Gas has been set at 8.80% (9.03% in 2005) and at 9.50% for TGVI (9.53% in 2005), In addition, the deemed equity components for Terasen Gas and TGVI, with the approval of the British Columbia Utilities Commission (''BCUC'') were increased to 35% and 40% respectively in 2006 compared to 33% and 35% in 2005.

For the three months ended September 30, 2006, Terasen Gas and TGVI net customer additions were 1,102 and 1,150 respectively, bringing the total number of utility customers to 896,488 at September 30, 2006. Although the net increase of 6,126 customers for the first three quarters of 2006 is lower than the 8,446 net new customers reported in the same period of 2005, favorable economic conditions and housing activity in British Columbia continue to drive customer growth in the region.

Although the above items result in higher earnings for both Terasen Gas and TGVI, overall loss for the gas distribution segment have increased by $3.2 million in the third quarter of 2006, mainly due to higher non-recurring bad debt expenses related to the unbilled basic charge revenues in the current quarter compared to the same quarter in the prior year. Earnings for the first nine months of 2006 were $48.3 million compared to $59.8 million in 2005. The decline in the earnings in 2006 compared to 2005 is mainly due to a tax provision made in the second quarter related to the retroactive tax amending legislation in the Province of Quebec. The remaining difference is a result of TGVI's operations and maintenance (''O&M'') expenses which were rebased as part of its 2006-2007 rate settlement and reduced the contribution of incentive earnings in 2006. In addition, Terasen Gas has changed the timing of its recognition of earnings sharing obligation related to its forecast O&M and capital expenditures incentives to coincide with the timing of revenues received. Previously, these obligations were recognized on a straight line basis. This change affects the timing of revenues and net earnings for each quarter but is not a material amount.

Petroleum Transportation

	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
	In millions of dollars			
Revenues	**$60.4**	$57.3	**$168.2**	$163.0
Net earnings	**$17.4**	$17.2	**$ 51.6**	$ 50.8

Transportation volumes	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
	(barrels per day)			
Trans Mountain Canadian mainline	**236,700**	229,100	**230,700**	213,900
Trans Mountain U.S. mainline	**103,000**	84,900	**97,800**	68,200
Express System	**249,200**	224,600	**230,700**	205,200

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

Revenues from petroleum transportation were $60.4 million in the third quarter of 2006, up $3.1 million from the same quarter of 2005 mainly due to higher throughput in the third quarter of 2006 offset partially by lower tolls. For the first three quarters of 2006, revenues were $168.2 million as compared to $163.0 million in the same period of 2005. Year-to-date revenues were slightly higher than the previous year's nine months as the first quarter of 2005 was negatively impacted by temporary production outages and turnarounds at refineries, the impact of which is shown in the throughput figures.

Earnings from petroleum transportation were $17.4 million in the third quarter of 2006, up $0.2 million from the previous year's third quarter mainly due to higher revenues, as described above, offset by higher power and O&M expenses. Earnings increased to $51.6 million in the first nine months of 2006 compared to $50.8 million in the corresponding period of 2005, mainly due higher earnings in TransMountain due to the increase in revenues described above.

Other activities

	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
	In millions of dollars			
Revenues	**$10.9**	$ 11.6	**$ 33.3**	$ 35.6
Net loss before discontinued operations	**$ (4.0)**	$ (12.7)	**$ (17.7)**	$ (15.7)

During the third quarter of 2006, revenues from other activities decreased by $0.7 million on a year-over-year basis as a result of a decrease in international operations revenues and a slight decrease in revenues from CustomerWorks LP due to some lower rates from contracts renegotiated in 2006. The loss from other activities decreased from $12.7 million in the third quarter of 2005 to $4.0 million in the third quarter of 2006. On a year to date basis, the loss increased to $17.7 million from a loss $15.7 million in the first nine months of 2005. The year over year change is primarily due to the inclusion of earnings and gains from hedging activities from Clean Energy in 2005, which Terasen disposed of on October 31, 2005, a tax provision of $3.5 million made in the second quarter of 2006 for retroactive tax amending legislation that was introduced in a provincial legislature and higher operating expenses due to management fees to KMI and $4.0 million of non-recurring charges in 2005 related to the acquisition of Terasen by Kinder Morgan.

Discontinued Operations

The water and utility operations incurred an incremental loss of $4.1 million in the third quarter of 2006 compared to $3.1 million of income in the corresponding period of 2005. The total loss recorded on the disposition of these operations amounted to $17.0 million.

QUARTERLY FINANCIAL INFORMATION

	2006			**2005**				**2004**
	Sept.	**June**	**Mar.**	**Dec.**	**Sept.**	**June**	**Mar.**	**Dec.**
Revenues	$288.3	$367.3	$750.5	$688.1	$282.6	$354.3	$627.5	$575.8
Net earnings before discontinued operations	$ 6.6	$ 6.1	$ 69.5	$ 11.2	$ 0.9	$ 27.1	$ 66.9	$ 54.2
Net (loss) earnings	$ 2.5	$ (1.6)	$ 64.3	$ 1.4	$ 4.0	$ 29.5	$ 66.3	$ 53.9

December 2005/2004 — Earnings declined by $52.5 million mainly as a result of costs incurred in connection with the acquisition of the Company by KMI of $38.9 million, as well as a charge to earnings associated with the redemption of the Trans Mountain Series C Debentures of $7.3 million.

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

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

September 2006/2005 — Earnings decreased by $1.5 million due to a loss on disposal of the water business offset by lower costs in 2006 due to 2005 one time transaction costs of $4.1 million on the sale of Clean Energy and $4.0 million of transaction costs associated with the Kinder Morgan acquisition incurred in 2005.

SEASONALITY

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

LIQUIDITY AND CAPITAL RESOURCES

Terasen expects to generate sufficient cash from operations to meet its working capital needs and to maintain its financial capacity and flexibility. The Company's liquidity and capacity to access capital markets to maintain operations and fund growth remain substantially unchanged since December 31, 2005.

CONSOLIDATED CASH FLOW

	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
	In millions of dollars			
Cash flow provided by (used for):				
Operating activities	**$ (52.6)**	$ (17.0)	**$ 223.0**	$ 160.7
Investing activities	**$ (78.0)**	$ (53.1)	**$ (65.5)**	$ (182.9)
Financing activities	**$176.5**	$ 11.7	**$ (154.1)**	$ 35.4
Net increase in cash	**$ 45.9**	$ (58.4)	**$ 3.4**	$ 13.2

CASH FLOW FROM OPERATING ACTIVITIES

Cash from operations refers to cash generated before the impact of working capital and rate-stabilization deferral account changes. Cash from operations for the three months ended September 30, 2006 was $21.3 million, compared to $47.8 million in the corresponding period of 2005. Cash flow from for operating activities, which includes the impact of changes in working capital and deferral accounts, was $223.0 million in the first nine months of 2006 compared with $160.7 million in the corresponding period of 2005.

Between December 31, 2005 and September 30, 2006, accounts receivable, accounts payable and accrued liabilities declined while gas in storage inventory increased as a result of the typical seasonal increase in natural gas consumption during the period. These changes in working capital accounts and rate stabilization accounts generated increased cash flow from operating activities compared to 2005.

INVESTING ACTIVITIES

Capital expenditures totaled $84.1 million in the third quarter of 2006 compared to $43.4 million in the corresponding period in 2005. Year to date capital expenditures were $194.2 million in 2006 compared to $170.3 million in the first nine months of 2005. The increase in the third quarter is mainly due to expenditures incurred in the pipeline operations as construction of the first phase of the expansion of the Trans Mountain system West Coast pipeline expansion (''TMX'') is underway. The increase in capital expenditures on a year to date basis was primarily attributable to the TMX expansion which is currently underway. The decrease in the overall investing activities is due to the proceeds from the sale of the water and utility services business.

There have been no material changes to Terasen's planned capital expenditures from those reported in the Company's Annual 2005 Management's Discussion and Analysis.

FINANCING ACTIVITIES

On January 13, 2006, TGVI entered into a five-year unsecured, committed, revolving credit facility of $350 million with a syndicate of banks, of which $296 million was drawn against the facility on January 17, 2006. A portion of the facility was used to refinance TGVI's existing term facility of $209.5 million. The facility will also be utilized to finance working capital requirements and general corporate purposes.

Concurrently with executing the above noted 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 TGVI may be required to make on non-interest bearing government contributions. The terms and conditions are primarily the same as those for the aforementioned TGVI facility except this facility ranks junior to repayment of TGVI's Class B subordinated debt which is held by the Company. Borrowings outstanding under this facility were $3.7 million as of September 30th, 2006.

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

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

In September 2006, Terasen Gas issued $120 million of 30-year medium term note debentures at an interest rate of 5.55%. Funds generated from the issuance of medium term note debentures were used to repay $100 million which matured in the quarter with the remainder available to fund the retirement of a $20 million debenture which is due to mature in the fourth quarter.

As at September 30, 2006, the Company and its subsidiaries had lines of credit in place totaling $1,175 million to finance cash requirements. These lines enable the respective companies to borrow directly from their bankers, issue bankers' acceptances and support commercial paper issuance. Bank lines of $534 million were unutilized at September 30, 2006. Utilized lines are used for short term borrowings and letters of credit. Virtually all short-term cash needs are funded through commercial paper and bankers' acceptances in the Canadian market at rates generally below bank prime. Terasen does not have, nor does it expect to have, any defaults or arrears. The company has thirty eight letters of credit outstanding totaling $117 million.

In addition to the above lines of credit, TGVI on its $350 million credit facility had borrowings outstanding at September 30, 2006 of $284 million. While the borrowings are short-term bankers acceptances, the underlying credit facility on which the advances are provided is committed through to January 2011 and the borrowings are primarily to support the longer term rate base assets of TGVI. Accordingly, a portion of the borrowings have been classified as long term debt in the consolidated balance sheet.

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

No dividends were declared in the first nine months of 2006 compared to $23.8 million in the third quarter of 2005 and $71.2 million in the first nine months of 2005.

FINANCIAL POSITION

The following table outlines the significant changes in the consolidated balance sheets as at September 30, 2006 compared to December 31, 2005, other than changes arising from the reclassification of the water and utility services business as a discontinued operation.

Balance Sheet Item	Increase (Decrease) ($ millions)	Explanation
Accounts receivable	$(280.0)	Decrease is mainly due to lower sales of gas in the summer months compared to winter.
Rate stabilization accounts (including current and long term)	163.5	The increase in the net asset position of rate stabilization accounts is mainly due to the fair value mark to market for the gas derivatives. The derivatives are ''out of the money'' and any losses are passed through to customers.
Short-term notes	(157.0)	Decrease is due to the repayment of short-term notes from the refinancing of TGVI and due to the lower debt requirements in the utility operations as a result of the higher equity requirements as rendered by the BCUC decision.
Inventories of gas in storage and supplies	44.0	Increase is mainly due a build up in supply in anticipation for usage in the cooler winter months.

WORKING CAPITAL

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

LETTERS OF CREDIT

$117 million of letters of credit were outstanding at September 30, 2006 primarily related to unfunded pension plans and guarantees to third parties for power purchases and on behalf of co-investors in the Express System to fund the Debt Service Account.

CREDIT RATINGS

Following the Kinder Morgan Inc management buyout offer announced in May 2006, both DBRS and Moody's have placed Terasen Inc.'s credit ratings under review with negative implications and possible downgrades. There have been no other changes to the Company's credit ratings from those reported in the annual 2005 Management's Discussion and Analysis.

TRANSACTIONS WITH RELATED PARTIES

The Company estimates that its parent company, Kinder Morgan Inc., provided corporate management services it receives totaling approximately $1.2 million for the three-months ended September 30, 2006. Year to date corporate management service fees were $8.5 million.

FINANCIAL AND OTHER INSTRUMENTS

The Company hedges its exposure to fluctuations in natural gas prices and interest rates through the use of derivative instruments. The table below indicates the valuation of the derivative instruments as at September 30, 2006. For more information on Terasen's derivatives please refer to Terasen's 2005 Annual Management's Discussion and Analysis.

			September 30, 2006		December 31,2005	
Asset (Liability)	**Number of swaps**	**Term to maturity (years)**	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
				(in millions)		
Interest Rate Swaps						
Terasen Inc.	2	2 - 9	$	$ 1.6	$ —	$ 3.6
Terasen Gas[1]	3	2	—	(1.1)	—	(1.6)
TGVI[1]	2	3	—	(0.5)	—	(0.6)
Corridor[1]	2	4 - 9		(0.4)	—	(0.3)
Natural Gas Commodity Swaps Terasen Gas and TGVI[1,2]	263	Up to 3	(162.8)	(176.5)	21.2	105.6

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

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

BUSINESS DEVELOPMENT

The following is an update on Terasen's business development activities during the first nine months of 2006. More information on the Company's business development activities is provided in Terasen's 2005 annual Management's Discussion and Analysis.

TERASEN GAS (WHISTLER) (''TGW'') AND TERASEN GAS VANCOUVER ISLAND (''TGVI'')

On June 28, 2006, TGW and TGVI received final approval from the BCUC to extend natural gas service to Whistler. Under the proposed arrangements, TGVI will extend its transmission system to serve TGW by the construction of a 50 kilometre pipeline lateral from Squamish to Whistler and TGW will convert its current piped propane system to natural gas. The pipeline construction is expected to commence in the fall of 2006 and will be co-ordinated with the current Sea to Sky Highway upgrade project. Gas service is expected to be available by November 2008.

CORRIDOR EXPANSION

We have initiated engineering, environmental, consultation and procurement activities on the proposed Corridor pipeline expansion project, as authorized and supported by shipper resolutions and the underlying firm service agreement. The proposed C$1.6 billion expansion includes building a new 42-inch diameter diluent/bitumen (''dilbit'') pipeline, a new 20-inch diameter products pipeline, tankage and upgrading existing pump stations along the existing pipeline system from the Muskeg River Mine north of Fort McMurray to the Edmonton region. The Corridor pipeline expansion would add an initial 180,000 bpd of dilbit capacity to accommodate the new bitumen production from the Muskeg River Mine. An expansion of the Corridor pipeline system has been completed in 2006 increasing the dilbit capacity to 278,000 barrels per day (''bpd'') by upgrading existing pump station facilities. By 2009, the dilbit capacity of the Corridor system is expected to be approximately 460,000 bpd. An application for the Corridor pipeline expansion project was filed with the Alberta Energy Utilities Board and Alberta Environment on December 22, 2005, and approval was received in August 2006. Construction of the Corridor pipeline expansion is expected to begin in November 2006 as the shippers have received definitive approval of their Muskeg River Mine expansion.

TMX

On February 17, 2006, Kinder Morgan Canada filed a complete National Energy Board (''NEB'') application for the Anchor Loop project. On November 15, 2005, Kinder Morgan Canada filed a comprehensive environmental report with the Canadian Environmental Assessment Agency regarding the project. The C$435 million project involves looping a 98-mile section of the existing Trans Mountain pipeline system between Hinton, Alberta, and Jackman, British Columbia, and the addition of three new pump stations. With construction of the Anchor Loop, the Trans Mountain system's capacity will increase from 260,000 bpd to 300,000 bpd by the end of 2008. The public hearing of the application was held the week of August 8, 2006. On October 26, 2006, the NEB released its favorable decision on the application.

RISK ASSESSMENT

The risk profile of Terasen remains substantially unchanged from the profile outlined in Terasen's 2005 Annual Management's Discussion and Analysis.

FORWARD LOOKING STATEMENT

When used in this report, the words ''anticipate'', ''expect'', ''project'', ''believe'', ''estimate'', ''forecast'' and similar expressions are intended to identify forward looking statements, which include statements relating to pending and proposed projects or possible acquisitions. Such statements are subject to certain risks, uncertainties and assumptions pertaining to operating performance, regulatory parameters, economic conditions and, in the case of pending and proposed projects, risks relating to design and construction, regulatory processes, obtaining financing and performance of other parties, including partners, contractors and suppliers and in the case of possible acquisitions, obtaining financing, acquiring assets or companies at an appropriate price and the ability to effect synergies in a timely and cost-effective manner.

ADDITIONAL INFORMATION

Additional information relating to Terasen including its Annual Information Form is available on SEDAR at www.sedar.com.

CERTIFICATE OF FORTIS INC.

Dated: March 7, 2007

This short form prospectus, together with the documents incorporated herein by reference, constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by the securities legislation of each of the provinces of Canada. For the purpose of the Province of Québec, this simplified prospectus, together with documents incorporated herein by reference and as supplemented by the permanent information record, contains no misrepresentation that is likely to affect the value or the market price of the securities to be distributed.

(Signed) H. STANLEY MARSHALL President and Chief Executive Officer	(Signed) BARRY V. PERRY Vice-President, Finance and Chief Financial Officer

On behalf of the Board of Directors

(Signed) BRUCE CHAFE Director	(Signed) DAVID G. NORRIS Director

CERTIFICATE OF THE UNDERWRITERS

Dated: March 7, 2007

To the best of our knowledge, information and belief, this short form prospectus, together with the documents incorporated herein by reference, constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by the securities legislation of each of the provinces of Canada. For the purpose of the Province of Québec, to our knowledge, this simplified prospectus, together with the documents incorporated herein by reference and as supplemented by the permanent information record, contains no misrepresentation that is likely to affect the value or the market price of the securities to be distributed.

CIBC World Markets Inc.	Scotia Capital Inc.	TD Securities Inc.
(Signed) David H. Williams	(Signed) John Matovich	(Signed) Harold R. Holloway

BMO Nesbitt Burns Inc.	RBC Dominion Securities Inc.
(Signed) James A. Tower	(Signed) David Dal Bello

National Bank Financial Inc.

(Signed) Robert B. Wonnacott

Canaccord Capital Corporation

(Signed) Ronald A. Rimer

Beacon Securities Limited	HSBC Securities (Canada) Inc.
(Signed) Lonsdale W. Holland	(Signed) Jeffrey B. Allsop

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