

Consolidated Financial Statements

Pacific Northern Gas Ltd.

December 31, 2005



AUDITORS' REPORT

To the Shareholders of
Pacific Northern Gas Ltd.

We have audited the consolidated balance sheets of **Pacific Northern Gas Ltd.** as at December 31, 2005 and 2004 and the consolidated statements of income, retained earnings and cash flows for each of the years in the three year period ended December 31, 2005. 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 each of the years in the three year period ended December 31, 2005 in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Vancouver, Canada,
February 16, 2006

Pacific Northern Gas Ltd.

CONSOLIDATED BALANCE SHEETS

As at December 31

[\$ in thousands]	2005	2004
ASSETS <i>[notes 7 and 8]</i>		
Current assets		
Accounts receivable <i>[note 3]</i>	28,831	23,304
Income taxes recoverable <i>[note 5]</i>	375	362
Inventories of supplies and natural gas	2,688	1,725
Prepaid expenses	1,800	215
	33,694	25,606
Plant, property and equipment <i>[note 4]</i>	171,351	176,780
Deferred charges <i>[note 2]</i>		
Debt costs	615	754
Rate stabilization adjustment mechanism	2,311	1,788
Pipeline rehabilitation costs	1,011	1,128
Deactivated assets	5,050	—
Other	1,178	1,601
	10,165	5,271
	215,210	207,657
LIABILITIES Commitments, guarantees and contingency <i>[notes 14, and 15]</i>		
Current liabilities		
Bank indebtedness <i>[note 7]</i>	10,159	6,046
Accounts payable and accrued liabilities	21,121	16,046
Gas purchase variance payable <i>[note 2]</i>	881	2,232
Other taxes payable	3,263	2,726
Long term debt due within one year <i>[note 8]</i>	4,880	4,380
	40,304	31,430
Non-current liabilities <i>[note 6]</i>	224	407
Long term debt <i>[note 8]</i>	76,560	81,440
Deferred income taxes <i>[note 5]</i>	15,430	15,430
	92,214	97,277
	132,518	128,707
SHAREHOLDERS' EQUITY		
Preferred shares <i>[note 9]</i>	5,000	5,000
Common shares <i>[notes 10 and 11]</i>	9,065	9,009
Contributed surplus <i>[notes 10 and 11]</i>	2,828	2,567
Retained earnings	65,799	62,374
Common shareholders' equity	77,692	73,950
	82,692	78,950
	215,210	207,657

See accompanying notes

On behalf of the Board:

Director

Director

Pacific Northern Gas Ltd.

**CONSOLIDATED STATEMENTS OF
RETAINED EARNINGS**

Years ended December 31

[\$ in thousands]	2005	2004	2003
Balance, beginning of year	62,374	60,183	57,719
Net income for the year	6,660	5,408	5,668
	69,034	65,591	63,387
Preferred share dividends	337	337	337
Common share dividends	2,898	2,880	2,867
	3,235	3,217	3,204
Balance, end of year	65,799	62,374	60,183

See accompanying notes

Pacific Northern Gas Ltd.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31

[\$ in thousands]	2005	2004	2003
OPERATING ACTIVITIES			
Net income for the year	6,660	5,408	5,668
Add (deduct) items not involving cash:			
Deferred income taxes	1,639	1,474	890
Depreciation and amortization <i>[note 16]</i>	8,905	8,800	8,452
Stock option expense <i>[note 11]</i>	132	93	56
Other	(1,702)	(1,116)	(913)
Operating cash flow	15,634	14,659	14,153
Non-cash working capital changes <i>[note 16]</i>	(3,827)	1,708	(1,941)
Net cash provided by operating activities	11,807	16,367	12,212
INVESTING ACTIVITIES			
Additions to plant, property and equipment <i>[note 4]</i>	(6,753)	(11,276)	(5,406)
Increase in deferred charges <i>[note 2]</i>	(1,737)	(1,096)	(2,519)
Net cash used by investing activities	(8,490)	(12,372)	(7,925)
FINANCING ACTIVITIES			
Increase in bank indebtedness	4,113	3,146	2,900
Repayment of long term debt	(4,380)	(4,380)	(3,880)
Issue of common shares <i>[note 10]</i>	185	143	36
Dividends paid	(3,235)	(3,217)	(13,057)
Net cash used by financing activities	(3,317)	(4,308)	(14,001)
Decrease in cash and cash equivalents during the year	—	(313)	(9,714)
Cash and cash equivalents, beginning of year	—	313	10,027
Cash and cash equivalents, end of year	—	—	313

Supplemental cash flow information *[note 16]*

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

1. SUMMARY OF ACCOUNTING POLICIES

Regulation and related disclosure

Pacific Northern Gas Ltd. and its wholly owned subsidiary, Pacific Northern Gas (N.E.) Ltd., are regulated utilities engaged in the transportation and distribution of natural gas. Their accounting records and practices conform to the requirements of the British Columbia Utilities Commission (the "Commission"). The Commission exercises statutory authority over matters such as rates, including rate of return on equity and capital structure, construction and operation of facilities, accounting practices, tolls, charges and contractual agreements with customers. In order to comply with orders issued by the Commission, the timing of recognition of certain revenues and expenses may differ from that which would otherwise be required under Canadian generally accepted accounting principles for non rate-regulated entities.

Effective December 31, 2005, the Company adopted the new Accounting Guideline AcG-19, *Disclosure by Entities subject to Rate Regulation*, which applies to years ending on or after December 31, 2005. AcG-19 provides guidance about certain aspects of the disclosure and presentation of information of entities providing services or products for which customer rates are established or approved by a regulator. The objective is to ensure that financial statement users are better informed about the existence, nature and effects of all forms of rate regulation. If rate regulation has an impact on the accounting treatment of a transaction, the entity should make mention of it and provide additional information about the impact on its financial statements.

The financial effects of rate regulation relate principally to balances and the accounting policies noted below. Disclosure of the impact of rate regulation on these balances and policies are included in the related notes as referenced:

- Deferred charges and liabilities [note 2]
- Property, plant and equipment and related depreciation rates [note 4]
- Income taxes [note 5]
- Employee future benefit plans for post-retirement non-pension benefits [note 6]
- Hedges, derivatives and other financial instruments [note 14]

Consolidation

The consolidated financial statements include the accounts of Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd. (collectively the "Company") and are prepared in accordance with Canadian generally accepted accounting principles.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

1. SUMMARY OF ACCOUNTING POLICIES (cont'd.)

Use of estimates

The preparation of 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, expenses and disclosure of contingent assets and liabilities.

Significant balances impacted by estimates include operating revenues which include estimates of customer usage from the last meter reading date to the end of the reporting period, and accounts receivable which are recorded net of an estimated allowance for doubtful accounts. Actual results could differ from these estimates.

Revenue recognition

The Company's operations are subject to rate-regulation and accordingly there are circumstances where the revenues recognized do not match the amounts billed. Revenue is recognized in a manner that is consistent with the underlying rate-setting mechanism as mandated by the Commission. This may result in the recognition of regulatory assets and liabilities.

Operating revenues include natural gas sales that are recorded on the basis of regular meter readings and estimates of customer usage from the last meter reading date to the end of the year. Operating revenues also include transportation services revenues that are recorded as service is provided, as well as sales of gas surplus to the needs of the Company's sales customers ("off system sales") that are recognized when the gas is delivered.

Cash and cash equivalents

Cash and cash equivalents are held for the purpose of meeting short-term cash commitments and include bank balances and term deposits with maturities of less than 90 days.

Inventories of supplies and natural gas

Inventories of supplies and line-pack natural gas are valued at the lower of cost determined on a first-in, first-out basis and net realizable value. Inventories of natural gas in storage are valued at the lower of average cost and net realizable value.

Included in, or deducted from, inventories of natural gas are amounts for natural gas to be received from, or returned to transportation service customers. This amount represents the

**NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS**

December 31, 2005, 2004 and 2003

difference between natural gas received on behalf of the transportation service customers and natural gas delivered to them.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

1. SUMMARY OF ACCOUNTING POLICIES (cont'd.)

Deferred charges and liabilities

The Company defers certain charges which the Commission or contractual arrangement require or permit to be recovered through future rates. Deferred charges and credits are amortized over various periods as approved by the Commission, depending on the nature of the charges or credits [see note 2].

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

Plant, property and equipment

Plant, property and equipment are recorded at cost less contributions in aid of construction. Cost includes an allowance for funds used during construction calculated at the Company's cost of capital. As directed by the Commission, the cost of depreciable assets retired, together with removal costs, less salvage is charged to accumulated depreciation. Gains or losses on disposal are not taken into income unless the disposal is outside the normal course of business or involves a major item of plant.

Depreciation is provided on a straight-line basis for plant in service at the commencement of each fiscal year at rates approved by the Commission [note 4].

Asset retirement obligations

The fair value of asset retirement obligations associated with the retirement of long-lived assets is recognized in the period when it can be reasonably determined. The fair value, which approximates the cost a third party would charge in performing the tasks necessary to retire such assets, is recognized at the present value of expected future cash flows and is added to the carrying value of the associated asset and depreciated over the asset's useful life. The liability is accreted over time through periodic charges to earnings and is reduced by actual costs of decommissioning and reclamation.

The Company's natural gas transmission and distribution long-lived assets are comprised principally of mains, service lines, compressors, and measuring and regulating equipment. No amount has been recorded for asset retirement obligations relating to the Company's assets as it is not possible to make a reasonable estimate of the fair value of the liability due to the indeterminate timing and scope of the asset retirements. Management expects all retirement costs associated with the regulated assets will be recovered through tolls in future periods and therefore any liability recorded would be offset by an asset.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

1. SUMMARY OF ACCOUNTING POLICIES (cont'd.)

Income taxes

The Company provides for income taxes using the income taxes currently payable method as directed by the Commission, except as described below. Under the income taxes currently payable method, no provisions are made for income taxes deferred as a result of differences in timing between the treatment for income tax and accounting purposes of various income and expenditure items [see note 5].

The Commission has directed that the deferral method of accounting for income taxes be followed for certain transactions within the Company. Under the deferral method of accounting for income taxes, reported earnings are charged with the income taxes related to those earnings. Differences between these taxes and taxes currently payable, arising mainly from differences in the timing of expense deductions, are recorded as deferred income taxes.

Employee future benefit plans

The Company accrues its pension obligations under employee benefit plans and the related costs, net of plan assets. The actuarial determination of the accrued benefit obligation uses the projected benefit method prorated on service (which incorporates management's best estimate of future salary levels, other cost escalations, retirement ages of employees, and other actuarial factors).

For the purpose of calculating the expected return on plan assets, those assets are valued at a market-related value. The market-related value of assets is determined as the average of the fair value of plan assets and four projected values. The projected values are determined by projecting the fair value as at a particular time (1 year, 2 years, 3 years and 4 years prior to the measurement date) to the measurement date using actual non-investment cash flows and an assumed investment return equal to the average market-related value return on three month T-Bills plus 2.5%.

Actuarial gains (losses) arise from the difference between the actual long term rate of return on plan assets for a period and the expected long term rate of return on plan assets for the period, or from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net unamortized cumulative actuarial gain or loss over 10 percent of the greater of the benefit obligation and the fair value of the plan asset at the beginning of the year is amortized over the average remaining service period of the active employees. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment.

The average remaining service period of the active employees covered by the pension plan is 14 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

1. SUMMARY OF ACCOUNTING POLICIES (cont'd.)

For the defined contribution plan maintained by the Company, contributions payable by the Company are expensed as pension costs.

Other retirement benefit plans are non-contributory health care and life insurance plans. Prior to 2004, the Company used the pay-as-you-go method of accounting for non-pension benefits as directed by the Commission. Beginning in 2004, both the current service cost and the benefits paid to retirees are expensed and recovered in customer rates. The accrued benefit obligation is included on the balance sheet in non-current liabilities.

Financial instruments

Derivative and other financial instruments are utilized in connection with management of gas supply and interest rates. The Company enters into forward, future, swap, fixed price and option contracts to manage the impact of market fluctuations on assets, liabilities, or other contractual commitments. The Company defers the impact of changes in the market value of these contracts until such time as the associated transaction is completed.

Credit risk is the risk of loss from non-performance of suppliers, customers or financial counterparties to a contract. The Company maintains credit policies which management believes significantly minimize overall credit risk. These policies include a review of a counterparty's financial condition, measurement of credit exposure and monitoring of concentration of exposure to any one customer or counterparty.

Earnings per common share

Basic earnings per common share are calculated using the weighted average number of common shares outstanding during the year. Diluted earnings per share are calculated using the treasury stock method whereby the weighted average number of common shares outstanding during the year is adjusted to reflect the potential exercise of dilutive share purchase options.

There are 96,000 [2004 – 84,200; 2003 – 71,500] stock options outstanding during the year that could potentially dilute basic earnings per share in the future that were not included in the computation of diluted earnings per share because the options' exercise price were greater than the average market price of the common shares.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

1. SUMMARY OF ACCOUNTING POLICIES (cont'd.)

Stock based compensation

Stock options granted after January 1, 2003 are accounted for under the fair value method. Under this method, compensation expense is measured at fair value at the grant date using the Black-Scholes option pricing model and recognized over the vesting period with a corresponding credit to contributed surplus. Stock options granted prior to January 1, 2003 continue to be accounted for as capital transactions when the options are exercised, which does not give rise to compensation expense.

New accounting standards

New accounting standards will be in effect for fiscal years beginning on or after October 31, 2006 for hedge accounting, recognition and measurement of financial instruments and disclosure of comprehensive income. The Company is currently investigating the impact of these new standards.

Comparative figures

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

2. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

General information on rate regulation and its economic effects

The Company and its subsidiary are regulated by the Commission. Customer rates are set under a cost of service methodology that allows revenues to be set to recover the Company's forecast costs and to earn a rate of return on common equity. Applications for changes to rates are made annually and are submitted to the Commission for their review and approval.

Forecast costs include gas commodity and transportation, operation and maintenance, depreciation, property taxes, interest and income taxes. The rate base is the average level of investment in all recoverable assets used in gas transmission and distribution, and an allowance for working capital. Under cost of service regulation, it is the responsibility of the Company to demonstrate to the Commission the prudence of the costs it has incurred. For 2005, the Company's average approved rate of return on the rate base was 8.60 percent after tax, and the average approved rate of return on common equity was 9.63 percent after tax, based on weighting using the respective rate bases of the Company and its subsidiary. The Company's deemed common equity was greater than 36 percent but with no specific figure identified by agreement between the Company and its customers under a negotiated settlement of the 2005 rates. The deemed common equity of its subsidiary was 36 percent in 2005.

Regulatory assets and liabilities

Certain regulatory assets represent future revenues associated with certain costs, incurred in the current period or in prior periods that are expected to be recovered from customers in future periods through the rate-setting process. In the absence of rate regulated accounting, generally accepted accounting principles would not permit deferral of regulatory assets and therefore the earnings impact would be recorded in the period of recovery. Long-term regulatory assets are recorded in deferred charges in the consolidated balance sheets.

Regulatory liabilities represent future reductions or limitations of increase in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The treatment under generally accepted accounting principles of regulatory liabilities and the resulting earnings impact is the same as that under rate regulated accounting because the liabilities represent contractual obligations. Regulatory liabilities are shown on the consolidated balance sheets in current liabilities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

2. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd)

Regulatory risk and uncertainties affecting recovery or settlement

The regulatory assets and liabilities recorded in the financial statements are based upon an expectation of the future actions of the regulator. To the extent that the regulator's future actions are different from the Company's expectations, the timing and amount of recovery or settlement of amounts recorded on the consolidated balance sheets could be significantly different from the timing and amounts that are eventually recovered or settled.

Financial statement effects

In order to recognize the economic effects of the actions or expected actions of the regulator, the timing of recognition of certain revenues and expenses may differ from that otherwise expected under generally accepted accounting principles for non rate-regulated entities.

Accounting for rate-regulated entities has resulted in recording the following regulatory assets and liabilities:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

2. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd)

Deferred charges and liabilities

[\$ in thousands]

Description	Period of Recovery	Income Statement Effect 2005	Carrying Amount 2005	Carrying Amount 2004
<i>Deferrals included in rate base</i>				
Rate Stabilization Adjustment Mechanism ¹	Over three-years, based on forecast customer deliveries	876	2,311	1,788
Pipeline rehabilitation costs²:				
Extraordinary pipeline losses	Straight-line over 10 years, between 2006 and 2014	—	62	70
Pipeline breaks	Straight-line over 10 years, between 2006 and 2014	21	739	809
Stress Corrosion Cracking	Straight-line over 10 years, between 2006 and 2015	42	210	249
Total pipeline rehabilitation costs		63	1,011	1,128
Other rate base deferrals:				
Preliminary surveys and investigations ³	Depreciated over the life of the related asset commencing when placed into service	350	355	13
Property taxes ⁴	1 year, 2006	80	80	225
Industrial customer deliveries ⁵	Straight-line over 3 years, 2006 to 2008	311	696	602
Commission hearing costs ⁶	1 year, 2006	485	409	24
Other	Straight-line over 3 to 10 years	143	252	268
Total other rate base deferrals		1,369	1,792	1,132

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

2. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd)

[\$ in thousands]

Description	Period of Recovery	Income Statement Effect 2005	Carrying Amount 2005	Carrying Amount 2004
<i>Deferrals excluded from rate base</i>				
Deactivated assets ⁷	Straight-line over 10 years, to 2015	5,050	5,050	—
Other deferrals excluded from rate base:				
Depreciation adjustment liability for prior year retirements ⁸	1 year, 2006	(637)	(637)	—
Propane air plant ⁹	Straight-line over 10 years, to 2014	(318)	412	792
Interest ¹⁰	Straight-line over 2 years, 2006 to 2007	(186)	(315)	(248)
Other		(59)	(74)	(75)
Other deferrals excluded from rate base		(1,200)	(614)	469
Total deferred charges		6,158	9,550	4,517
<i>Regulatory liabilities excluded from rate base</i>				
Gas purchase variance payable ¹¹	Based on forecast deliveries over 3 years, to 2008	(283)	(881)	(2,232)

The income statement effect noted in the above table indicates the effect, either increase or (decrease), on 2005 after tax net income as a result of the treatment under rate regulated accounting. The carrying amount for 2005 and 2004 is the cost amount of the deferral, less income taxes and accumulated amortization, at December 31, 2005 and December 31, 2004, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

2. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd)

1. Rate Stabilization Adjustment Mechanism

The Company is authorized by the Commission to maintain a rate stabilization adjustment mechanism ("RSAM") deferral account to mitigate the effect on its earnings of volatility in deliveries to certain customers caused principally by weather and natural gas cost volatility. The RSAM deferral account accumulates the margin impact of variations in the actual versus forecast use for residential and small commercial customers. Balances in the RSAM deferral account are recovered in customer rates over a three year period based on forecast deliveries. During 2005, approximately \$353,000 of the December 31, 2004 RSAM balance was recovered in customer rates [2004 -- \$282,000].

2. Pipeline rehabilitation costs

The cost of carrying out temporary repairs of pipeline breaks as well as the related undepreciated net book value of pipeline assets destroyed as a result of pipeline breaks is recorded in deferral accounts for future recovery from customers. In addition, the cost of investigative work and repair of pipeline assets at risk due to stress corrosion cracking or other material defects is deferred for future recovery in customer rates.

3. Preliminary surveys and investigations

The Company defers costs associated with the development of new projects that would be beneficial to its customers. In 2005 the Company commenced preliminary study and investigation of a project to loop its main line transmission system from Kitimat to Summit Lake (the "KSL Project"). The KSL Project would be required to provide gas transportation services for liquefied natural gas to be imported and regasified at the proposed Kitimat LNG Inc. terminal to be located on the Douglas Channel approximately 15 kilometers southwest of Kitimat. In 2005 the Company incurred costs of \$0.9 million associated with the KSL Project. Kitimat LNG Inc. is obligated to fund \$0.4 million of this amount under an agreement with the Company. The Company has a contingent obligation to refund all or part of the funding provided by Kitimat LNG Inc. as described in note 15 below. On commencement of construction of the Kitimat LNG Inc. terminal, the deferred costs will be transferred to construction work in progress. In the event the terminal is not constructed, the Company will seek recovery of the deferred costs in future customer rates. The ultimate recovery of this deferred charge is subject to a future decision of the Commission.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

2. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd)

4. Property taxes

As directed by the Commission, a deferral account is used to recover the difference between actual and forecast property taxes, to be recovered from (or refunded to) customers in rates over the following year.

5. Industrial Customer Deliveries

As directed by the Commission, a deferral account is used to recover the lost margin from certain large industrial customers whose deliveries varied from expectations. The amount deferred during the year ended December 31, 2003 is being amortized over three years, commencing in 2004. The credit amount deferred in 2004 was amortized entirely in 2005. Amortization of \$230,000 has been included in net income during 2005 related to these deferred costs. The Company has applied to the Commission for a three-year amortization period for the 2005 deferral, commencing in 2006.

6. Commission hearing costs

The Company's annual revenue requirements application contains a forecast of the costs that the Company will incur relating to the Commission's review of the application. The total actual costs are usually not known by the Company until a few months after the conclusion of the Commission's review process and the implementation of new customer rates. Therefore, customer rates reflect forecast costs of the review process and the Company records in a deferral account the difference between forecast and actual costs for future recovery from or refund to customers.

7. Deactivated assets

In its 2006 Revenue Requirements Application, the Company identified plant, property and equipment assets which would not be required on an ongoing basis to provide service to its customers, having regard to the closure of the Methanex Corporation plant in late 2005 [see note 3]. The Company has requested that compressor facilities, pipeline loops and various other fixed assets with a net book value of \$5.05 million be removed from rate base and transferred to a non-rate base, interest bearing deferral account effective December 31, 2005. The Company has applied for the deferral account to be amortized on a straight-line basis over ten years commencing in 2006. The ultimate recovery of this deferred charge is subject to a future decision of the Commission.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

2. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd)

8. Depreciation adjustment for prior year retirements

As a result of detailed analysis of property, plant and equipment cost and retirement records conducted in 2005, various assets were identified as retired or disposed in prior years, between 1988 and 2001; however, no retirement was recorded at the time. Approximately \$637,000 of accumulated depreciation expense was identified which should not have been recorded in the years 1989 to 2005. The Company has reversed this accumulated depreciation, and transferred the balance to a deferred credit, for refund to customers in 2006. The ultimate realization of this deferred credit is subject to a future decision of the Commission.

9. Propane air plant

In 2004, the net book value of a propane air plant which is no longer in service with an undepreciated value of \$966,000 was removed from fixed assets and transferred to a deferral account for future recovery from customers over a period of twenty years commencing in 2005. As part of the negotiated settlement process for determining 2005 customer rates, the Company agreed to expense \$165,000 of the relocation expenses previously deferred in 2004. This amount has been included in other income deductions in the 2005 consolidated statement of income. In addition, \$242,000 of the amounts deferred in 2004 were returned to rate base and reclassified to plant property and equipment, effective January 1, 2005

10. Interest

As directed by the Commission, the Company has an interest deferral mechanism that mitigates exposure to fluctuations in floating interest rates on both short term and long term debt instruments.

11. Gas purchase variance payable

Gas purchase variance payable amounts arise due to unanticipated commodity cost and demand fluctuations between actual natural gas costs and forecast natural gas costs as recovered in rates. As directed by the Commission, gas purchase variance payable amounts are being refunded to customers on a straight-line basis over three years, based on forecast deliveries. The amount of such credits included in cost of sales in 2005 was \$2,466,000 before income taxes [2004 – \$2,319,000; 2003 – \$1,363,000].

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

2. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd)

Other items affected by rate regulation

Future income taxes

The Company recovers tax expense based on the taxes payable method, as prescribed by the Commission, for ratemaking purposes. Under the income taxes currently payable method, no provisions are made for future or deferred income taxes as a result of differences in timing between the treatment for income tax and accounting purposes of the various income and expenditure items. Therefore, rates do not include the recovery of future income taxes related to temporary differences. Consequently, the Company does not record future income taxes for its regulated activities as the Company expects that all future income taxes will be recovered in rates when they become payable. Generally accepted accounting principles require the recognition of future income tax liabilities and future income tax assets in the absence of rate regulation.

Deferred income tax expenses shown on the consolidated statements of income arise from temporary differences related to the regulatory deferral accounts identified above. The regulatory deferral accounts are recorded on the balance sheet at December 31, 2005 net of deferred income tax liabilities of \$2.0 million. In the absence of rate regulated accounting, regulatory deferrals would not be recorded nor would the associated deferred or future income tax liabilities. However, future income taxes associated with certain assets, primarily property, plant and equipment, would be recorded, in the absence of rate regulated accounting, resulting in the recognition of \$20.2 million [2004 - \$21.3 million] in future income tax liabilities. As a result of these impacts, earnings would increase by \$1.1 million in the year ended December 31, 2005.

From July 1, 1978 until its suspension on November 1, 1986, the deferral method was followed by the Company. Had the liability method of accounting for income taxes been followed continuously since the inception of the Company, the future income tax liabilities and future income tax expense (recovery) would be:

[\$ in thousands]	2005	2004
Deferred income tax liabilities, as reported	15,430	15,430
Adjustment to reflect liability method	(4,783)	(4,783)
Unrecorded future income tax liabilities beginning of year	10,633	10,811
Unrecorded future income tax recovery	(1,098)	(178)
Future income tax liability	20,182	21,280

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

2. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd)

Allowance for funds used during construction (AFUDC) and other capitalized costs

AFUDC is included in the cost of property, plant and equipment and is depreciated over future periods as part of the total cost of the related asset. AFUDC includes both an interest component and a cost of equity component, as approved by the Commission. In the absence of rate regulation, generally accepted accounting principles would permit the capitalization of only the interest component. Therefore, the recording of the equity component as a capitalized asset and the corresponding earnings recognized during the construction phase would not be recognized nor would the subsequent depreciation of the capitalized equity component. It is not possible to make a reasonable estimate of the carrying value of the equity component of AFUDC included in property, plant and equipment. In 2005, the Company capitalized AFUDC amounting to \$258,000 [2004 - \$47,000; 2003 - \$66,000].

When a fixed asset is retired or otherwise disposed of, the Company does not reflect a gain or loss in income. Entities not subject to rate regulation write off the net book value of the retired asset and include any resulting gain or loss in current operating results. Since the Company does not calculate depreciation expense for individual assets, it cannot identify or quantify gains or losses on the retirement of a fixed asset in any given year.

Interest capitalization

The Company is permitted to earn a short term interest return on deferrals excluded from rate base. For the years 2003 through 2005, interest was capitalized at 6 percent on all regulatory deferrals excluded from rate base. In the absence of rate regulation, generally accepted accounting principles would not permit the capitalization of interest on deferrals. Therefore, the recording of the interest component as a deferred asset or liability and the corresponding earnings adjustment would not be recognized nor would the subsequent amortization of the capitalized interest component. In 2005, this resulted in a charge to income of \$175,000 [2004 – charge of \$135,000; 2003 – credit of \$38,000].

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

2. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd)

Overhead capitalization

With the approval of the Commission, the Company capitalizes a percentage of certain operating, administrative and general costs into the rate base on an ongoing basis. Such treatment is accorded in recognition of the significance of plant, property and equipment constructed by the Company. The Company is authorized to charge depreciation and earn a rate of return on the net book value of such capitalized costs in future years. In the absence of rate regulated accounting, such overhead costs would be charged to the consolidated statement of earnings in the period in which they occurred. In 2005, the Company capitalized \$1.42 million of overhead costs to plant, property and equipment [2004 - \$1.53 million; 2003 - \$1.27 million].

Non-Pension post retirement benefits

The Company provides for post-retirement benefits other than pensions. The cost of providing these benefits are expensed when paid. In addition, since 2004 the Company has expensed the current service cost relating to benefits earned by employees in the current year. Under generally accepted accounting principles, the Company would also expense the annual interest cost and amortize any actuarial gains and losses into income. Had these costs been accrued, earnings in 2005 would have decreased by \$221,000 [2004 - \$315,000; 2003 - \$552,000] [see note 6].

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

3. MAJOR CUSTOMERS

The proportion of energy deliveries and operating revenues attributable to large industrial customers is as follows:

[Percent]	2005		2004		2003	
	Energy	Operating revenues	Energy	Operating revenues	Energy	Operating revenues
Methanex Corporation	62	7	67	9	65	9
West Fraser Mills Ltd., Alcan Inc. and British Columbia Hydro and Power Authority	9	5	8	6	8	8

At December 31, 2005, 7% [2004 – 9%; 2003 – 8%] of accounts receivable was attributable to these four customers. The Company is exposed to credit risk in the event of non-performance by customers, but does not anticipate such non-performance. The Company monitors the credit risk and credit rating of industrial customers on a regular basis. The maximum credit risk is the fair value of the accounts receivable.

On August 30, 2005, Methanex Corporation gave notice of termination of its Firm and Interruptible Gas Transportation Service Agreement with the Company. Under the terms of the agreement, Methanex is required to make a termination payment to the Company of approximately \$23.3 million on February 28, 2006, the effective date of the termination. Under the terms of a negotiated settlement with registered intervenors and approved by the Commission on November 17, 2005, the termination payment will be recorded as an interest bearing credit deferral, and will be amortized into income over the period from March 1, 2006 to October 31, 2009.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

4. PLANT, PROPERTY AND EQUIPMENT

As at December 31, 2005	Average Depreciation Rate (percent)	Cost	Accumulated Depreciation	Net Book Value
[\$ in thousands]				
Transmission plant	2.8	172,212	68,618	103,594
Distribution plant	2.6	86,200	30,784	55,416
General plant	4.3	21,146	9,394	11,752
Processing plant	4.9	745	458	287
Construction in progress	—	302	—	302
	2.8	280,605	109,254	171,351

As at December 31, 2004	Average Depreciation Rate (percent)	Cost	Accumulated Depreciation	Net Book Value
[\$ in thousands]				
Transmission plant	2.7	180,290	74,142	106,148
Distribution plant	2.6	84,330	28,916	55,414
General plant	5.4	21,309	10,928	10,381
Processing plant	4.9	633	375	258
Construction in progress	—	4,579	—	4,579
	2.9	291,141	114,361	176,780

During the year, the Company received contributions in aid of construction of \$278,000 [2004 – \$257,000; 2003 – \$176,000], which have been recorded as a reduction of distribution plant.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

4. PLANT, PROPERTY AND EQUIPMENT (cont'd)

The following table provides information on the changes in the balance of plant, property and equipment cost:

[\$ in thousands]	2005	2004
Cost, beginning of year	291,141	281,789
Capital expenditures, net of contributions in aid of construction	6,847	11,340
Depreciation capitalized	191	212
Plant retirements	(2,235)	(398)
Deactivated assets <i>[note 2]</i>	(15,581)	—
Cost transferred from (to) deferred charges <i>[note 2]</i>	242	(1,802)
Cost, end of year	280,605	291,141

The following table provides information on the changes in the balance of accumulated depreciation:

[\$ in thousands]	2005	2004
Accumulated depreciation, beginning of year	114,361	107,441
Depreciation expense	8,011	7,877
Depreciation capitalized	191	212
Plant retirements	(2,235)	(398)
Salvage on plant retirements	94	65
Deactivated assets <i>[note 2]</i>	(10,531)	—
Accumulated depreciation transferred from (to) deferred charges <i>[note 2]</i>	—	(836)
Depreciation adjustments for prior year retirements <i>[note 2]</i>	(637)	—
Accumulated depreciation, end of year	109,254	114,361

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

5. INCOME TAXES

Significant components of the Company's deferred tax liabilities are as follows:

[\$ in thousands]	2005	2004
Deferred income tax liabilities		
Capital cost allowance claimed for income tax purposes in excess of depreciation and amortization	14,462	14,462
Other	968	968
Deferred income tax liabilities	15,430	15,430

Income tax expense varies from the amount that would be expected if current rates were applied to income before income taxes for the following reasons:

[Percent]	2005	2004	2003
Combined Canadian federal and provincial statutory income tax rates, including surtaxes	34.9	35.6	37.6
Increase (decrease) in income taxes resulting from:			
Large corporations tax	2.2	3.1	4.5
Depreciation in excess of capital cost allowance	5.4	7.0	6.6
Amortization of intangibles	2.5	3.1	1.8
Capitalized overhead deducted for tax purposes	(3.8)	(4.9)	(3.9)
Other items	(1.5)	(0.7)	(1.0)
Effective rate of income taxes	39.7	43.2	45.6

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

6. EMPLOYEE FUTURE BENEFIT PLANS

The Company and its subsidiary have a number of funded and unfunded defined benefit plans, as well as defined contribution plans, that provide pension, other retirement and post-employment health and life insurance benefits for most employees. Benefits earned under the defined benefit plans are principally based on years of service and average earnings.

The measurement dates of the funded plans, as well as the effective dates of the most recent actuarial valuations and the next required actuarial valuations for the purpose of funding the funded plans are as follows:

	2005	2004
Measurement date of the plan assets and accrued benefit obligation	September 30, 2005	September 30, 2004
Effective date of the most recent actuarial valuation report for funding purposes	December 31, 2003	December 31, 2003
Effective date of the next required actuarial valuation report for funding purposes	December 31, 2006	December 31, 2006

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

6. EMPLOYEE FUTURE BENEFIT PLANS (cont'd.)

[a] Information about the defined benefit pension plans is as follows:

[\$ in thousands]	2005	2004	2003
Accrued benefit obligations			
Balance, beginning of year	19,235	17,224	15,323
Current service cost	682	595	419
Employees' contributions	7	8	4
Interest cost	1,148	1,028	987
Benefits paid	(889)	(777)	(680)
Actuarial losses	2,394	1,157	1,171
Balance, as at measurement date	22,577	19,235	17,224
Plan assets			
Fair value, beginning of year	14,038	12,720	11,601
Actual return on plan assets	1,785	1,590	1,426
Employer contributions	1,165	497	369
Employees' contributions	7	8	4
Benefits paid	(889)	(777)	(680)
Fair value, as at measurement date	16,106	14,038	12,720
Funded status - plan deficit	(6,471)	(5,197)	(4,504)
Unamortized net actuarial losses	6,216	4,749	4,456
Unamortized past service costs	—	—	1
Unamortized transitional asset	(28)	(26)	(24)
Accrued benefit obligation as at measurement date	(283)	(474)	(71)
Employer contribution between measurement date and year end	237	593	109
Accrued benefit assets (liability) end of year	(46)	119	38

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

6. EMPLOYEE FUTURE BENEFIT PLANS (cont'd.)

The following is a summary of the significant actuarial assumptions used in measuring the Company's accrued pension benefit obligations:

[Percent]	2005	2004	2003
Accrued benefit obligation as of December 31, with a measurement date of September 30:			
Discount rate	5.25	6.00	6.00
Rate of compensation increase	3.25	3.25	3.25
Benefit costs for years ended December 31, with a measurement date of September 30:			
Discount rate	6.00	6.00	6.50
Expected long-term rate of return on plan assets	7.50	7.50	7.75
Rate of compensation increase	3.25	3.25	3.25

The following table shows the allocation of the pension plan assets at the measurement dates:

[Percent]	2005	2004
Asset category:		
Cash and short-term notes	5.2	4.2
Canadian bonds	35.0	38.4
Canadian equities	32.0	33.8
Foreign equities	27.8	23.6
	100.0	100.0

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

6. EMPLOYEE FUTURE BENEFIT PLANS (cont'd.)

The Company's pension plan expense is as follows:

[\$ in thousands]	2005	2004	2003
Current service cost	682	595	419
Interest cost	1,148	1,028	987
Expected return on plan assets	(1,069)	(930)	(1,116)
Amortization of past service costs	—	1	2
Amortization of net actuarial loss	211	214	40
Amortization of transitional asset	2	2	2
Net defined benefit pension plan expense	974	910	334
Defined contribution pension plan expense	58	46	49
Total pension expense	1,032	956	383

[b] Information about the non-pension post-retirement benefit obligation is as follows:

[\$ in thousands]	2005	2004	2003
Balance, beginning of year	4,162	4,739	4,167
Current service cost	115	180	160
Interest cost	247	284	273
Benefits paid	(199)	(192)	(101)
Actuarial loss (gain)	758	(849)	240
Balance, as at measurement date	5,083	4,162	4,739
Funded status - plan deficit	(5,083)	(4,162)	(4,739)
Unamortized net actuarial losses	4,788	3,982	4,739
Accrued benefit obligation as at measurement date	(295)	(180)	—
Employer contribution between measurement date and year end	295	—	—
Accrued benefit obligation, end of year	—	(180)	—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

6. EMPLOYEE FUTURE BENEFIT PLANS (cont'd.)

Effective January 1, 2004, the Company changed the method of expensing non-pension post-retirement benefits on a prospective basis [note 1]. Prior to that date, only benefits paid were expensed. Beginning in 2004, both the current service cost and the benefits paid are expensed and recovered in customer rates. The accrued benefit obligation at December 31, 2004 is included on the balance sheet in non-current liabilities. Commencing in 2005, the amounts expensed in 2004 and 2005 have been funded through contributions to a retirement compensation arrangement, as directed by the Commission.

The assumed extended health care cost trend used for measurement purpose is 10.0% per annum, grading down over 5 years to 5.0% and remaining at that level thereafter. The assumed dental premium trend used for measurement purposes is 7.0% per annum for the first 10 years and 6.0% per annum thereafter.

The Company's non-pension post-retirement benefit expense is as follows:

[\$ in thousands]	2005	2004	2003
Current service cost	115	180	—
Benefits paid	199	192	101
Non-pension post-retirement benefit expense, as reported	314	372	101
Current service cost	—	—	160
Interest cost	247	284	273
Amortization of transitional obligation	123	123	123
Amortization of net actuarial loss	50	100	97
Less benefits paid, expensed above	(199)	(192)	(101)
Non-pension post-retirement benefit plan expense, accrual method	535	687	653

Total cash payments for employee future benefits are \$1,489,000 in 2005 [2004 – \$1,153,000; 2006 – \$628,000], consisting of cash contributed to funded pension plans, cash payments in respect of non-pension post-retirement benefits, and cash contributed to defined contribution pension and non-pension post retirement benefit plans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

7. BANK INDEBTEDNESS

[\$ in thousands]	2005	2004
Bank overdraft	10,159	946
Bank demand operating line of credit	—	5,100
Bank indebtedness	10,159	6,046

The Company has lines of credit that provide for a bank operating facility and hedge line of credit totalling \$ 35 million [2004 - \$25 million]. The lines of credit have a term of 18 months, expiring June 24, 2006. The amount available under the operating facility is subject to borrowing base requirements. The lines of credit are collateralized by the pledge of a \$40 million debenture and a charge on certain accounts receivable and inventories. The operating facility bears interest at prime rate or bankers' acceptance rates [December 31, 2005 – 5.0%; December 31, 2004 – 4.25%] and provides funds for general corporate and working capital requirements. At December 31, 2005, the amount available under the facility was approximately \$18.5 million, \$10.2 million of which had been drawn.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

8. LONG TERM DEBT

[\$ in thousands]	2005	2004
Secured Debentures [a]		
RoyNat Debenture due January 15, 2011, bearing interest at a floating rate [December 31, 2005 – 6.342%], payable in monthly instalments of \$110,000, with a final instalment of \$120,000 at maturity.	6,720	8,040
RoyNat Debenture due December 15, 2012, bearing interest at a floating rate [December 31, 2005 – 6.842%], payable in monthly instalments of \$105,000, with a final instalment of \$2,505,000 at maturity.	11,220	12,480
2011 Series Debenture, 10.75% due December 13, 2011, payable in annual instalments of \$700,050, and \$800,000 in each of years 2009 and 2010 with a final instalment of \$5,000,000 at maturity.	8,700	9,400
2018 Series Debenture, 8.75% due November 15, 2018, payable in annual instalments of \$600,000, commencing November 15, 1999 and \$1,000,000 in each of the years 2014 to 2017, with a final instalment of \$7,000,000 at maturity.	15,800	16,400
2025 Series Debenture, 9.30% due July 18, 2025, payable in annual instalments of \$500,000, commencing July 18, 2004 with a final instalment of \$9,500,000 at maturity.	19,000	19,500
2027 Series Debenture, 6.90% due December 2, 2027, payable in annual instalments of \$500,000, commencing December 2, 2006 with a final instalment of \$9,500,000 at maturity.	20,000	20,000
	81,440	85,820
Long term debt due within one year [b]	4,880	4,380
	76,560	81,440

[a] Collateral for the Secured Debentures consists of a specific first mortgage on substantially all of the Company's plant, property and equipment and gas purchases and gas sales contracts, and a first floating charge on other property, assets and undertakings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

8. LONG TERM DEBT (cont'd.)

[b] Payments required to meet sinking fund and retirement provisions of long term debt during the next five years and thereafter are as follows:

<u>[\$ in thousands]</u>	
2006	4,880
2007	4,880
2008	4,880
2009	4,980
2010	4,980
Thereafter	56,840
	<u>81,440</u>

9. PREFERRED SHARES

<u>[\$ in thousands]</u>	<u>2005</u>	<u>2004</u>
Authorized		
1,400,000 cumulative redeemable junior preferred shares with a par value of \$10		
200,000 6.75% cumulative redeemable preferred shares with a par value of \$25 each		
Issued		
200,000 6.75% preferred shares	5,000	5,000

The 6.75% preferred shares are redeemable at the option of the Company at \$26 per share plus any accrued and unpaid dividends at the date of redemption.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

10. COMMON SHARES

[\$ in thousands]	2005	2004
Authorized		
6,020,000 Voting common shares with a par value of \$2.50 each		
Issued		
3,626,180 Common shares [2004 – 3,603,580]	9,065	9,009

During 2005, the Company issued 22,600 common shares [2004 – 19,700] for cash consideration of \$185,000 [2004 – \$143,000] upon the exercise of employee options. Of this amount, \$129,000 [2004 – \$94,000] has been credited to contributed surplus, representing the excess of the issue price over the par value of the shares.

11. STOCK OPTION PLAN

The Company has a stock option incentive plan under which share options are granted to certain of its employees. Share options are granted at an exercise price equal to the fair market value of the Company's common shares on the date of the grant.

Share options generally vest in five equal stages with the first stage vesting on the date of the grant, and the remainder in four equal annual stages commencing on the first anniversary of the date of the grant. The maximum term of options awarded is ten years.

As of December 31, 2005, there are 307,980 [2004 – 330,580] shares reserved for issuance pursuant to options that may be granted under the stock option incentive plan.

In 2005, 31,200 options were issued at an exercise price of \$19.70.

Since January 1, 2003, the Company has accounted for its grants under this plan in accordance with the fair value based method of accounting for stock-based compensation [note 1]. The compensation cost that has been charged against income (and credited to contributed surplus) in 2005 is \$132,000 [2004 - \$93,000; 2003 - \$56,000].

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

11. STOCK OPTION PLAN (cont'd.)

	2005	2004	2003
Dividend yield	4%	4%	4%
Expected volatility (annualized)	29%	44%	44%
Risk free interest rate	3.7%	3.0%	3.0%
Expected years of option life (average)	7.5	7.5	7.5

A summary of the changes to of the Company's stock option plan during the years ended December 31, 2005, 2004 and 2003 is as follows:

	2005		2004		2003	
	Number of shares	Weighted- average exercise price \$	Number of shares	Weighted- average exercise price \$	Number of shares	Weighted- average exercise price \$
Outstanding at beginning of year	278,400	15.61	272,200	14.52	247,000	14.45
Granted	31,200	19.70	25,900	20.80	34,600	14.15
Exercised	(22,600)	8.20	(19,700)	7.28	(4,800)	7.52
Expired	(19,400)	20.00	—	—	(4,600)	14.13
Outstanding at end of year	267,600	16.40	278,400	15.61	272,200	14.52
Options exercisable at end of year	206,560	15.91	212,600	15.78	197,260	15.38
Weighted average remaining contractual life	5.8 years		5.9 years		6.6 years	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

11. STOCK OPTION PLAN (cont'd.)

The following table summarizes information about the stock options outstanding and exercisable as at December 31, 2005:

Expiry Date	Options Outstanding	Options Exercisable	Exercise Price \$
March 14, 2006	13,200	13,200	18.75
March 14, 2007	12,700	12,700	20.75
March 24, 2008	11,500	11,500	30.50
March 11, 2009	14,700	14,700	24.50
March 16, 2010	25,200	25,200	15.50
March 21, 2011	20,600	20,600	7.85
April 27, 2011	11,700	11,700	6.50
March 15, 2012	32,200	25,500	13.50
July 4, 2012	35,000	35,000	13.50
March 13, 2013	33,700	19,860	14.15
March 2, 2014	25,900	10,360	20.80
August 5, 2015	31,200	6,240	19.70
	267,600	206,560	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

12. RELATED PARTY TRANSACTIONS

The Company's transactions with related parties are as follows:

[\$ in thousands]	2005	2004	2003
Westcoast Energy Inc., parent company until December 18, 2003			
Transportation services received	—	—	876
Materials purchases and services received	—	—	463
Westcoast Energy Risk Inc., a company related through common control until December 18, 2003			
Services received	—	—	2,253
Duke Energy Marketing LP, an entity related through common control from March 14, 2002 to December 18, 2003			
Natural gas purchases	—	—	19,385
Engage Energy Canada, L.P., an entity related through common control until December 18, 2003			
Natural gas purchases and services received	—	—	197
Natural gas sales	—	—	23,121

The transactions listed above were in the normal course of operations and were recorded at amounts established and agreed between the related parties, which approximate fair market value.

On December 18, 2003, all of the common shares of the Company held by Westcoast Energy Inc. were acquired by Tricor Acquisition (STP) Inc. ("Tricor").

On March 11, 2005, the Company filed a prospectus for the public offering of 1,338,477 common shares of the Company owned by Tricor, at a price of \$19.40 per common share, for gross proceeds of approximately \$26 million. The common shares offered by Tricor represented 37 percent of the Company's outstanding common shares and 100 percent of Tricor's interest in the Company. The transaction was subsequently completed on April 12, 2005. The Company did not sell any newly issued common shares as part of this offering and did not receive any of the proceeds from the sale of the common shares by the selling shareholder.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

13. FAIR VALUES OF FINANCIAL INSTRUMENTS

The fair values of debt instruments included in the consolidated balance sheets are as follows:

[\$ in thousands]	Carrying value		Fair value	
	2005	2004	2005	2004
Long term debt	81,440	85,820	90,566	96,401

The fair value of the Company's long-term debt is estimated by reference to quoted market prices for similar instruments.

The fair values of other financial instruments included in the consolidated balance sheets, including accounts receivable, bank indebtedness, and accounts payable and accrued liabilities approximate their carrying values due to their short term nature.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

14. NATURAL GAS CONTRACTS

The Company's tolls are set using a forecasted price for gas. However, some of the Company's gas supply contracts contain pricing mechanisms that reflect monthly variations in the price of gas, rather than fixed prices.

The Company had outstanding fixed price contracts, natural gas swap and collar contracts, and call options relating to natural gas supply as follows:

As at December 31, 2005

Financial Instrument	Notional Quantity (GJ's)	Percent of Annual Gas Purchases	Delivery Period	Price Range (per GJ)	Estimated Fair Value Receivable (Payable) [\$ in thousands]
Fixed price contracts	450 000	4.6	Jan.- Mar. 2006	\$5.83 to \$10.00	(167)
Natural gas swap contracts	1 193 000	12.1	Jan. – Oct. 2006	\$7.85 to \$10.60	1,670
Call options	1 219 500	12.3	Jan.- Mar. 2006	Caps from \$10.00 to \$15.00	633
Total	2 862 500	29.0			2,136

As at December 31, 2004

Financial Instrument	Notional Quantity (GJ's)	Percent of Annual Gas Purchases	Delivery Period	Price Range (per GJ)	Estimated Fair Value (Payable) [\$ in thousands]
Fixed price contracts	3 219 000	22.8	Jan.- Oct. 2005	\$6.27 to \$9.87	(3,855)
Natural gas price collar contracts	716 850	5.0	Jan. - Feb. 2005	\$8.22 to \$10.25	(1,406)
Total	3 935 850	27.8			(5,261)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

The difference between the price of gas used for toll purposes and the actual cost of gas purchased is deferred and refunded to or recovered from customers as directed by the Commission.

14. NATURAL GAS CONTRACTS (cont'd)

The fair values reflect the estimated amounts that the Company would receive or pay at December 31 to terminate the call options, fixed price, swap or collar contracts, based on the estimated future net cash flows under the terms of each contract.

These estimated fair market values have no impact on earnings due to the regulated nature of the Company's operations. Based on the current regulatory process, any gains or losses arising from utility related financial instruments would be treated as part of the cost of service.

In the absence of rate regulation, the Company would have had to choose whether to adopt hedge accounting as outlined in Accounting Guideline 13, "Hedging Relationships". In the event that the Company chose not to adopt hedge accounting, changes in the fair value of its hedging instruments would have been recorded in the statements of income and certain financial instruments would be recorded at their fair value in the balance sheet.

The Company's purchase commitments at December 31, 2005 under various gas supply contracts expiring through 2010 were as follows:

[\$ in thousands]

2006	45,451
2007	1,093
2008	991
2009	941
2010	50
Thereafter	—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

15. COMMITMENTS AND GUARANTEES

Under the terms of its gas transportation and supply agreements with certain customers, the Company has provided an indemnity for all damages, claims or actions arising from any act or accident in connection with the installation, presence, maintenance and operations of the Company's property and equipment, or in connection with the presence of gas deemed to be in the possession and control of the Company, and carries insurance to cover losses in the event of any claims under these provisions. The Company has also provided an environmental indemnity to certain secured debenture holders for any losses arising from non-compliance by the Company with applicable environmental laws.

Under the terms of its funding agreement with Kitimat LNG Inc., which covers a portion of certain costs incurred in the preliminary development of the KSL Project, the Company is required to repay all of the funding provided by Kitimat LNG Inc. after the commencement of construction of Kitimat LNG Inc.'s proposed liquefied natural gas import and regasification terminal. In the event construction does not proceed and the Company is permitted to recover any deferred KSL preliminary development costs in future customer rates, the recovery of costs will be shared on a pro rata basis with Kitimat LNG Inc. in proportion to the funding provided by each party.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

16. SUPPLEMENTAL CASH FLOW INFORMATION

[\$ in thousands]	2005	2004	2003
Depreciation and amortization:			
Depreciation, per income statement	8,011	7,877	7,873
Amortization of deferred charges, per income statement	755	763	503
Amortization of debt issue costs, included in long term interest expense	139	160	76
Total depreciation and amortization	8,905	8,800	8,452
Non-cash working capital changes:			
(Increase) decrease in:			
Accounts receivable	(5,527)	1,796	(3,864)
Income taxes recoverable	(13)	(362)	—
Inventories of supplies and natural gas	(963)	490	(850)
Prepaid expenses	(1,585)	(82)	67
Increase (decrease) in:			
Accounts payable and accrued liabilities	5,075	924	1,213
Gas purchase variance payable	(1,351)	(1,047)	601
Income and other taxes payable	537	(11)	892
Attributable to operating activities	(3,827)	1,708	(1,941)
Interest and tax payments:			
Income taxes paid	2,765	2,993	3,690
Interest paid	7,181	7,269	7,877

17. SEGMENTED INFORMATION

The Company operates in one industry and geographic segment, the transmission and distribution of natural gas within Canada. The consolidated financial statements have therefore not been segmented.