ANNUAL REPORT 1986

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TransCanada PipeLines

Contents

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This report uses the Imperial System of Units for natural resources operations and the International System of Units (metric) for pipeline operations. Approximate conversions can be calculated using the following table:

from	to	multiply by
kilometres	miles	× 0.62
millimetres	inches	× 0.04
kilowatts	horsepower	× 1.34
gigajoules	million British thermal units	× 0.95
cubic metres	cubic feet	× 35.3
kilopascals	pounds per square inch	× 0.15
cubic metres (liquid measure)	barrels	× 6.29

The Annual Meeting of Shareholders will be held in the Ballroom of the Westin Hotel, 320 Fourth Avenue S.W., Calgary, Alberta on Monday, April 27, 1987, commencing at 10:00 a.m., Calgary time.

Cover

An eerie glow is cast by yard lights at TransCanada's compressor station near Maple, Ontario. Giant exhaust stacks muffle the sound of the huge turbocharged engines that drive the station's compressors.

Highlights

	1986	1985	1984
Financial *(millions of dollars except per common share data)*			
Net income			
Before investment and asset provisions	**175.1**	278.1	265.9
After provisions	**60.6**	162.5	247.9
Net income applicable to common shares			
Before investment and asset provisions	**132.3**	233.3	224.4
After provisions	**17.8**	117.7	206.4
Funds generated from operations	**439.9**	505.5	441.5
Per common share data			
Net income			
Before investment and asset provisions	**$1.20**	$2.40	$2.41
After provisions	**$0.16**	$1.21	$2.22
Funds generated from operations	**$3.99**	$5.21	$4.75
Dividends declared	**$1.12**	$1.12	$1.00
Operating *(millions of dollars except as noted)*			
Pipeline operations			
Gas sales and transportation revenues			
Domestic	**3,337.4**	3,459.4	3,394.0
Export	**569.4**	901.3	796.6
Gas delivered for sales and transportation *(millions of cubic metres)*			
Domestic	**27 340**	26 515	26 183
Export	**5 745**	7 619	6 739
Oil and gas operations			
Revenues before royalties			
Canada	**172.1**	278.0	250.9
United States	**26.9**	41.5	21.2
Indonesia and other foreign	**18.1**	28.2	18.7
Oil and natural gas liquids sales *(thousands of barrels)*	**7,258**	7,404	6,134
Natural gas sales *(billions of cubic feet)*	**33.7**	36.2	31.1

The Business of TransCanada

Since its creation in 1951 TransCanada PipeLines has been a major force in Canada's natural gas industry. It has grown from being the sole transporter of western Canadian gas to markets in the east and is now a diversified energy company with $6 billion in assets and interests in Canada, the United States and around the world.

Moving gas safely and efficiently is still TransCanada's principal business. The company owns and operates a much-expanded version of its original pipeline from Alberta to Quebec, it has investments in other major North American pipeline systems and it is advancing proposals for new transmission systems to meet the changing needs of the industry.

Through its subsidiary, Western Gas Marketing Limited, TransCanada buys and sells more gas than any other Canadian company. The company has under contract the largest pool of natural gas reserves in North America. More than 40 per cent of known reserves in Alberta are contracted to TransCanada.

TransCanada is also engaged in oil and gas exploration, development or production in Canada, the United States, Indonesia, Australia, New Zealand, Italy, and the United Kingdom.

Pipeline Operations

Under a March, 1986 reorganization, all pipeline-related activities are managed by an expanded pipeline group. The group maintains and operates the company's 10 000-kilometre transmission system in Canada, and is responsible for design and construction of all compressor and pipeline facilities. The pipeline group handles the company's extensive dealings with federal regulators concerning the setting of tolls, applications for construction permits, and procedures governing rights-of-way.

A separate unit within the pipeline group oversees TransCanada's investments in other gas transmission facilities as well as new pipeline projects that are not part of the main line in Canada. TransCanada owns 50 per cent of the Great Lakes Gas Transmission system which extends from TransCanada's main line from Manitoba, through the United States to points at the international border near Sault Ste. Marie and Sarnia, Ontario. TransCanada also holds a 50 per cent interest in the Trans Québec & Maritimes pipeline which extends the TransCanada system from Montreal to Quebec City. The company owns 44 per cent of Foothills Pipe Lines (Sask.) Ltd., which moves gas from the Alberta border at Empress to the international border at Monchy, Saskatchewan where it connects with the Northern Border pipeline. TransCanada holds a 30 per cent interest in Northern Border's transmission facilities, which run from Monchy through the U.S. midwest to Ventura, Iowa.

The company is seeking approval in the United States for construction of the Iroquois Gas Transmission System, a partnership with utilities serving the northeastern United States that would transport Canadian gas from a point at the international border near Iroquois, Ontario to Connecticut and Long Island, New York.

Plans are also proceeding to construct, and hold a 40 per cent ownership in, the Ocean State Power project, a gas-fired electrical power plant in Rhode Island that will use Canadian natural gas.

Western Gas Marketing

TransCanada buys and sells gas through its wholly owned subsidiary, Western Gas Marketing Limited. In Canada the company has long-term sales contracts with natural gas distributors east of Alberta. With the advent of deregulation, prices in these contracts are set by negotiation between Western Gas Marketing and its customers. Pricing agreements are now in place that allow Western Gas Marketing to compete with direct sales arrangements between end users of gas and other producers in western Canada.

TransCanada's supply is contracted from more than 700 producers under 2,700 purchase agreements administered by Western Gas Marketing.

Also active in the United States export market, Western Gas Marketing negotiates sales with interstate pipeline companies, local distribution companies and industrial users of natural gas.

Natural Resources

Through wholly owned subsidiaries in its resources group, TransCanada carries on oil and gas exploration, development and production in Canada, the United States and abroad.

Calgary-based TCPL Resources Ltd. oversees Canadian activities as well as operations in Indonesia, Italy, the North Sea, Australia and New Zealand.

Wessely Energy Company, based in Dallas, Texas, oversees all oil and gas exploration and development activities in the United States.

Other Businesses

International PipeLine Engineering Limited, a wholly owned subsidiary, is engaged world-wide in engineering consulting and in the development and marketing of pipeline inspection devices and services. In 1986, TransCanada acquired Kopp AG International Pipeline Services, a West German firm that is a world leader in pipeline inspection service and technology.

TransCanada is a 50 per cent owner of the Empress II extraction plant at Empress, Alberta. The plant removes ethane and natural gas liquids from natural gas.

Cancarb Limited, a wholly owned subsidiary, produces and markets a high quality carbon used in a variety of industrial processes.

G.J. Maier

G.P. Osler

The energy industry in 1986 saw massive changes in both market conditions and the public policy environment, changes that significantly affected TransCanada's performance.

Earnings were down substantially from 1985, largely because of the sharp decline in oil and gas prices. Net income applicable to common shares for 1986, before provisions for the writedown of certain investments and assets, was $132.3 million, a decrease of $101 million compared to 1985. Earnings per share, before provisions, were $1.20 compared to $2.40 in 1985. Funds generated from operations, however, declined by only 13 per cent to $439.9 million compared to $505.5 million in 1985.

Investment and asset provisions of $114.5 million in 1986 were mainly due to sharply lower petroleum prices. On an after-tax basis the provisions were $100.6 million with respect to the book value of the company's oil and gas properties, and $13.9 million for certain energy-related projects in which the company has participated over several years. After provisions, 1986 net income per common share was 16 cents, compared to $1.21 in 1985.

RESTRUCTURING OF THE NATURAL GAS INDUSTRY

The October 1985 Agreement on Natural Gas Markets and Prices initiated a major restructuring of the Canadian natural gas industry. Under the agreement, federal and provincial governments set the scene for market-responsive pricing.

Throughout 1986, TransCanada worked to turn the broad concepts of the agreement into operating realities. Our goal was to guide change, not to follow it. We looked for innovative approaches to protect the company's long-term interests while addressing the concerns of both producers and distributors, all within the framework of government objectives.

Following signing of the agreement, Western Gas Marketing received approval from its gas suppliers to compete with new direct sellers in order to retain major industrial customers. To meet aggressive competition from fuel oil, the company also introduced an incentive program for large commercial and smaller industrial customers.

In addition, Western Gas Marketing renegotiated more than 2,700 producer contracts and gained acceptance by all producers of the netback pricing concept which was contemplated under the agreement. Western Gas Marketing was also successful in renegotiating contracts with its eight domestic distributors to enable market-responsive pricing to be introduced to all segments of the market. Through these initiatives we retained 90 per cent of the company's former share of the Canadian market, despite new intense competition.

By November 1, 1986 – the agreement's target for full implementation of market-responsive pricing – the basic restructuring of natural gas marketing in Canada had been completed, pending certain provincial regulatory approvals. The change from administered pricing within a one-year period was a remarkable achievement for the federal and provincial governments involved, particularly as it was undertaken during a period of great turbulence in the energy industry. This achievement could not have been realized without the hard work and creativity of the employees of TransCanada PipeLines and Western Gas Marketing, and the cooperation of producers and distributors.

The Upstream Petroleum Business

Since 1973 the petroleum industry, particularly its exploration and producing segments, can be described in one word: volatile. The wild swings in oil prices experienced in 1986 put even greater pressure on an already beleaguered industry, especially in North America. In Canada, to the credit of the federal and provincial governments concerned, initiatives were taken to aid the industry. The removal of the petroleum and gas revenue tax, the reduction of royalties, and the provision of various incentive programs helped to stimulate activity.

Along with most other companies, TransCanada's upstream petroleum investments were adversely affected by the sharp drop in oil prices. In addition to the investment and asset provisions noted earlier, the company experienced a reduction in oil and gas operating income from $95.7 million in 1985 to $1.3 million in 1986. The corresponding reduction in funds generated from operating income was from $190.3 million to $102 million.

Fortunately, by year-end crude oil prices had strengthened somewhat, and the OPEC countries appeared to be more determined to maintain price stability. It is hoped that this move towards stability and a gradual firming of prices will prevail. These factors are essential to a sound upstream sector, and a strong producing industry is a very important ingredient of the long-term economic well-being of both Canada and the United States.

Reorganization

TransCanada could not have responded so effectively to external events had we not made significant organizational changes to improve the productivity of our operations. The process began in January when the administration of all our gas purchasing and marketing functions was consolidated under Western Gas Marketing. In 1986 we streamlined the operations of TCPL Resources, which resulted in a 15 per cent reduction in overhead. In the United States, where we formerly had two separate oil and gas companies, we combined our operations under Wessely Energy Company with headquarters in Dallas.

We also have combined several operations to create a single group with responsibility for pipeline investments. This group is separate from the unit responsible for operation and maintenance of the main pipeline. In the corporate area, too, we have brought together related functions and redefined responsibilities.

While we will make further improvements in 1987, the organizational changes already made have resulted in significant productivity gains. They also have enabled us to focus our energies in a positive and creative manner on guiding as well as responding to the changes that dramatically altered our business in 1986.

Business Outlook

TransCanada's corporate strategy to achieve growth and enhance shareholder value is primarily to expand our current businesses and to enter new ventures that are a logical extension of those businesses. The natural resource/energy business is cyclical, and while it demands quick corporate response and flexibility to address current issues, it is fundamentally a long-term enterprise that requires a correspondingly long-term outlook. It is also capital-intensive; but although the number of people required is low, their professional and technical competence must be extremely high.

As one of North America's major gas transmission companies with purchase contracts for approximately 43 per cent of the established gas reserves in Alberta, we must bear in mind our responsibilities not just to our shareholders but to producers and consumers as well. We have, therefore, established two priorities. The first is to expand our sales of gas in new and growing markets in a way that meets the needs of producers and our customers, extending our transportation system as required. Our other priority is to minimize costs and maximize productivity. In the highly competitive business environment of the natural gas industry, this is crucial to our success.

The growth of our existing transmission system in the next few years will come from additions and extensions that are in tune with market needs. In this regard, we see the United States as an important area for market growth and investment. Examples of investments which would complement our transportation and marketing functions include natural gas storage, as well as combined cycle electric power generation and industrial co-generation projects, both using natural gas. Acquisition of a complementary pipeline could also fit in with our plans, but in the past year we have found the systems that are attractive to us to be more than fully priced or otherwise encumbered.

For the longer term, when new gas reserves are required from offshore eastern Canada, the Mackenzie Delta and the Arctic, we will retain a lead position in the consortia that will be needed to provide the technological, operational, and financial strengths to bring that gas to market. Although projects such as Polar Gas and Sable Gas probably are some years away, it is essential that we maintain an up-to-date knowledge base and an overall alertness because of the very long lead times associated with such projects and the volatility of the energy supply-demand-pricing relationship.

With respect to TransCanada's oil and gas investments, our basic exploration strategy is to expand our holdings in areas we consider geologically, politically, and economically attractive. Securing a good position now at moderate initial cost and with minimum work commitments will place us in an advantageous position in the mid-term when the world supply-demand relationship for crude oil becomes more stable. This strategy is also designed to provide a balance between lower risk/smaller reserve prospects and higher risk/larger reserve prospects, some of which will have the potential to make a major impact on the company's petroleum reserve position. An example of this is our participation during 1986 in the Kupe offshore oil and gas condensate discovery in New Zealand.

In this time of low oil prices and great uncertainty, we are being highly selective in making exploration expenditures and are concentrating on exploration and development projects that are economic even at very low prices. We are also taking steps to restructure the arrangement whereby a high percentage of our oil and gas interests are managed by another company. The process may take several years but our ultimate objective is to reduce costs and have a management and technical voice in all operations affecting our investments.

The opportunity to buy extensive holdings of proven oil and gas reserves at low cost, which was expected by investors, has not occurred and probably will not. During the year we evaluated and bid on a number of acquisition targets and concluded a few smaller transactions, but the larger targets were either withdrawn from the market or attracted bids substantially higher than we were prepared to pay. Nevertheless, we will continue to evaluate potential acquisitions and are prepared to act quickly if a satisfactory return on investment can be obtained.

Corporate Changes

During 1986, there were two changes in the membership of the board of directors. Mr. Smiley Raborn, Jr., a director of the company since 1961, did not stand for re-election at the annual meeting as he had reached mandatory retirement age. Dr. Robert J. Richardson resigned as a director on December 31, 1986. We are most grateful for the dedication and strong counsel they provided.

Effective January 27, 1987, Mr. J. V. Raymond Cyr, president of Bell Canada Enterprises, was appointed a director of the company.

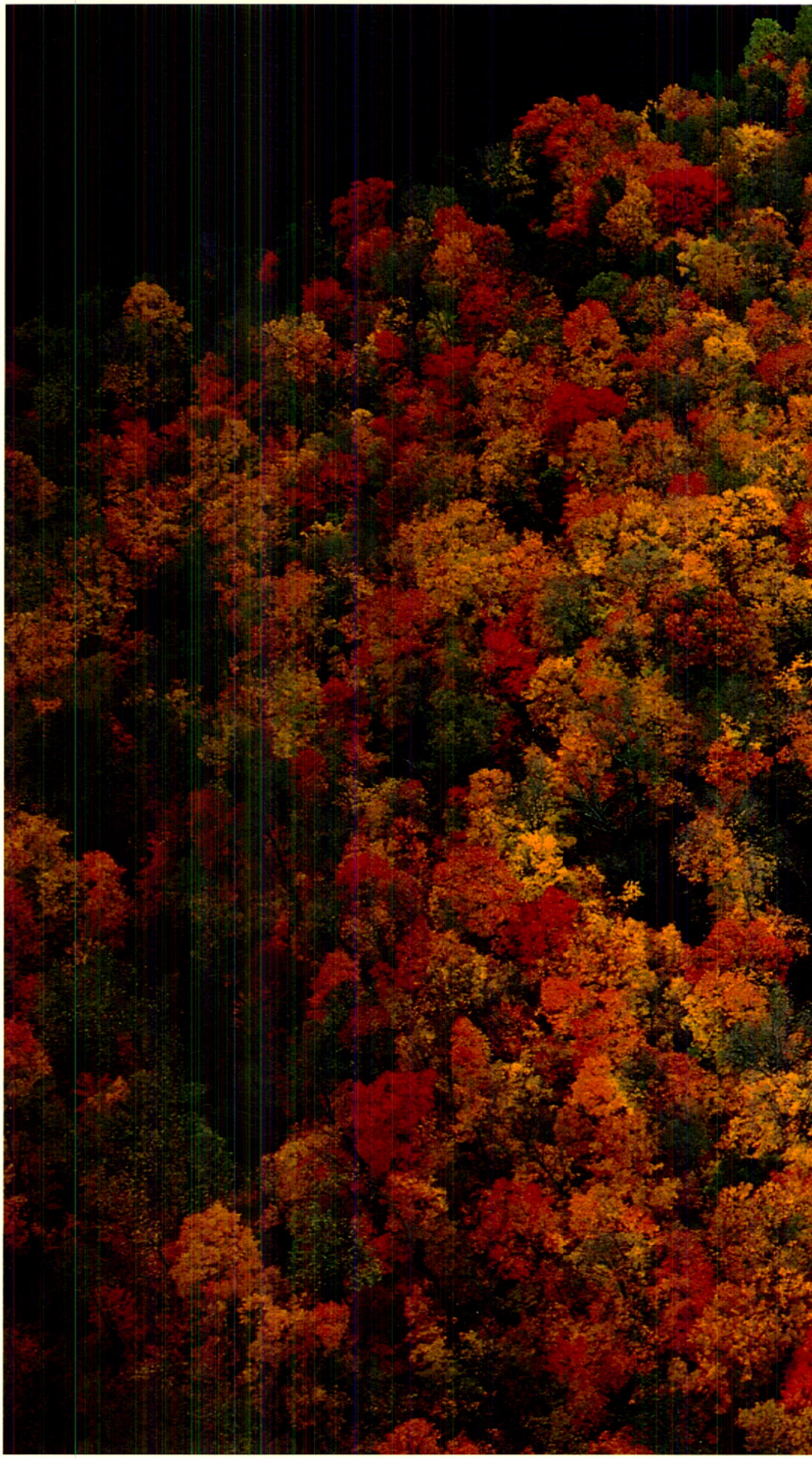
At year-end, George W. Woods retired as TransCanada's vice-chairman, having reached age 65. He has served TransCanada with great distinction since 1959. We thank him on behalf of the board of directors for the outstanding leadership, commitment and foresight that he has provided over the years.

On behalf of the board we also thank all of the employees of TransCanada and its subsidiaries who are continuing to provide the hard work and creativity that is enabling us to adapt effectively to sweeping changes in the business environment. The continued progress and stability of the company would not be possible without their loyalty and support.

On behalf of the board:

G.J. Maier
President and
Chief Executive Officer

G.P. Osler
Chairman



Helicopter pilot Bill Madder flies above the shore of a small lake in Ontario's Muskoka region on his way to compressor station 123 at Bracebridge. Helicopter pilots, stationed at each of TransCanada's five regional offices, carry out aerial patrols along the entire 4 400-km right-of-way at least once a week. A vital part of the pipeline safety program, these patrols help ensure security of the pipeline system and the dependable supply of gas to customers in Canada and the United States.

Pipeline Operations

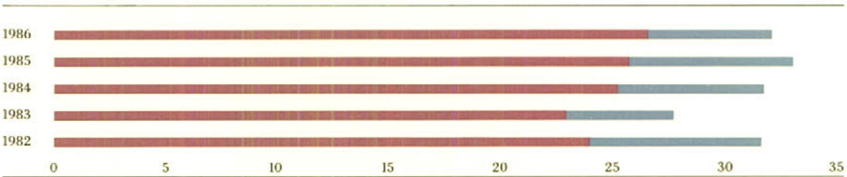
Total deliveries of gas in 1986 were 33 085 million cubic metres, a drop of three per cent from 1985. Maximum daily deliveries reached a peak of 130 million cubic metres in 1986, three per cent greater than in 1985 and just one per cent below the record 131 million cubic metres set in 1984.

For the third consecutive year domestic deliveries set a new record, at 27 340 million cubic metres, up three per cent from 26 515 million cubic metres in 1985. The increase in domestic deliveries was due to improved economic conditions in central Canada and lower natural gas prices – despite unusually warm weather and greater competition from heavy fuel oil caused by the drop in crude oil prices.

Deliveries to the company's traditional United States markets were affected by competition from both natural gas and heavy fuel oil. Total export deliveries in 1986 were 5 745 million cubic metres, down from 7 619 million cubic metres in 1985.

A short-term surplus of natural gas in the United States – the so-called "gas bubble" – continues to restrict demand for Canadian natural gas. At the same time, short-term gas supply purchase decisions and adverse regulatory changes in the United States are also impeding export deliveries.

Despite the overall decline in deliveries to the United States, sales to customers in the northeast region were close to maximum contract levels throughout the year.



Gas Volumes Delivered
(billions of cubic metres)

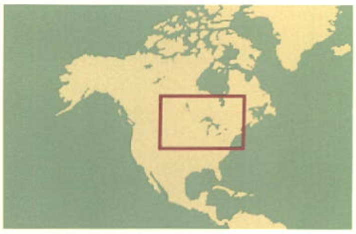
Regulatory Environment

TOLLS HEARING In September 1986, TransCanada began its tolls hearing before the National Energy Board to establish transportation tolls effective January 1, 1987.

A rate of return on common equity of 14.5 per cent on a deemed common equity component of 35 per cent was requested. The company has been on interim tolls since August 1, 1986. These tolls, which were determined by the board in 1985, reflect a 14.5 per cent return on a common equity component of 30 per cent.

In view of the depressed state of the gas producing industry, the company has proposed that any increase in the cost of service be offset by an amortization of deferred income taxes to maintain tolls at their current level.

Because of the length of the tolls hearing and the number of regulatory issues raised, the company does not anticipate a decision from the National Energy Board before the spring of 1987. The interim tolls will remain in effect until then. Under the National Energy Board Act, when new tolls are established the board is empowered to allow recovery by the company of any revenue deficiency incurred in the interim period.



The TransCanada System and Affiliated Pipelines
TransCanada owns and operates the TransCanada pipeline and has interests in the Great Lakes Gas Transmission, Trans Québec & Maritimes, Foothills (Sask.) and Northern Border pipelines and the proposed Iroquois Gas Transmission System.

AVAILABILITY OF TRANSPORTATION SERVICES The Agreement on Natural Gas Markets and Prices, signed in 1985 by the governments of Canada, Alberta, British Columbia and Saskatchewan, aimed at promoting a competitive Canadian natural gas market. It included, as one of its principal tenets, the right of access to TransCanada's pipeline for all buyers and sellers of natural gas.

In May 1986, as a result of the agreement and a public hearing, the National Energy Board extended the company's obligation to provide transportation services to include shippers who displaced volumes previously supplied by the company under existing contracts. The board also decided to implement, on January 1, 1987, a new system of tolls based on the distributors' operating demand volumes, instead of contract demand volumes.

As a result of the agreement and the subsequent regulatory changes, the number of transportation customers using TransCanada's system to serve domestic markets increased to 29 at year-end compared with six a year earlier.

The 5.3 million cubic metres per day being transported for these new customers are largely offset by reduced sales volumes to distribution customers.

During 1986 the company started new firm and interruptible transportation services to the export points at Emerson, Manitoba and Niagara Falls, Ontario.

Construction and Operations

1986 CAPITAL EXPENDITURES Capital expenditures of $72.3 million were made during 1986 to improve the safety, reliability and efficiency of the pipeline system. Many of these expenditures went toward a program for the inspection and testing of a section of the pipeline between Winnipeg and Toronto. This pipeline had experienced three in-service failures over a 12-month period. During 1986, pressure testing of 500 kilometres of this 1 800-kilometre pipeline was completed.

1987 CAPITAL EXPENDITURES Capital expenditures estimated at $107.5 million are planned for 1987. This includes continued inspection and testing of the pipeline between Winnipeg and Toronto, and replacements between Toronto and Montreal which will be made due to increases in population density. Other projects planned include the construction of 6.7 kilometres of a 914-millimetre loop line and the relocation of a 3 200-kilowatt compressor on the Niagara pipeline. These facilities have been approved by the National Energy Board and will permit an additional 1.7 million cubic metres per day of gas to be delivered to the United States at Niagara Falls, Ontario. Construction of these new facilities is scheduled for completion by November 1, 1987.

1988 FACILITIES APPLICATION In January 1987, TransCanada filed an application with the National Energy Board to expand its facilities. This expansion is required to meet the company's projected sales and transportation requirements in existing domestic and export markets and to transport 11.9 million cubic metres per day of incremental gas to the northeastern United States through the proposed Iroquois Gas Transmission System.

The capacity needed to transport this additional gas would be created by a $267 million expansion of the TransCanada system, combined with minor changes to the Great Lakes Gas Transmission system and additions to the Union Gas Limited system. These facilities are scheduled to be in service by November 1, 1988.

TransCanada's previous application to build new export facilities was withdrawn, reflecting the termination of the Niagara Interstate Pipeline System partnership.

Pipeline Investments and Projects

Great Lakes Gas Transmission

Great Lakes Gas Transmission Company, 50 per cent-owned by TransCanada, operates a 2 100-kilometre pipeline extending from the Manitoba border, through Minnesota, Wisconsin and Michigan to Sault Ste. Marie and Sarnia, Ontario. The majority of the natural gas transported by Great Lakes is redelivered to TransCanada at Sault Ste. Marie and Sarnia.

During 1986, natural gas sales of 890 million cubic metres and record transportation volumes of 11 500 million cubic metres were delivered through the Great Lakes system.

Northern Border Pipeline

TransCanada holds a 30 per cent interest in the Northern Border Pipeline Company, a partnership which owns a 1 300-kilometre pipeline running from Monchy, Saskatchewan to Ventura, Iowa. In 1986, Northern Border transported 3 942 million cubic metres of gas, primarily from Alberta, to markets in the midwestern United States.

Foothills Pipe Lines (Sask.)

Foothills Pipe Lines (Sask.) Ltd. owns a 257-kilometre pipeline which runs from the Alberta border, at Empress, through Saskatchewan to connect with the Northern Border pipeline system at Monchy, Saskatchewan. TransCanada is the operator and has a 44 per cent interest in Foothills (Sask.).

Trans Québec & Maritimes Pipeline

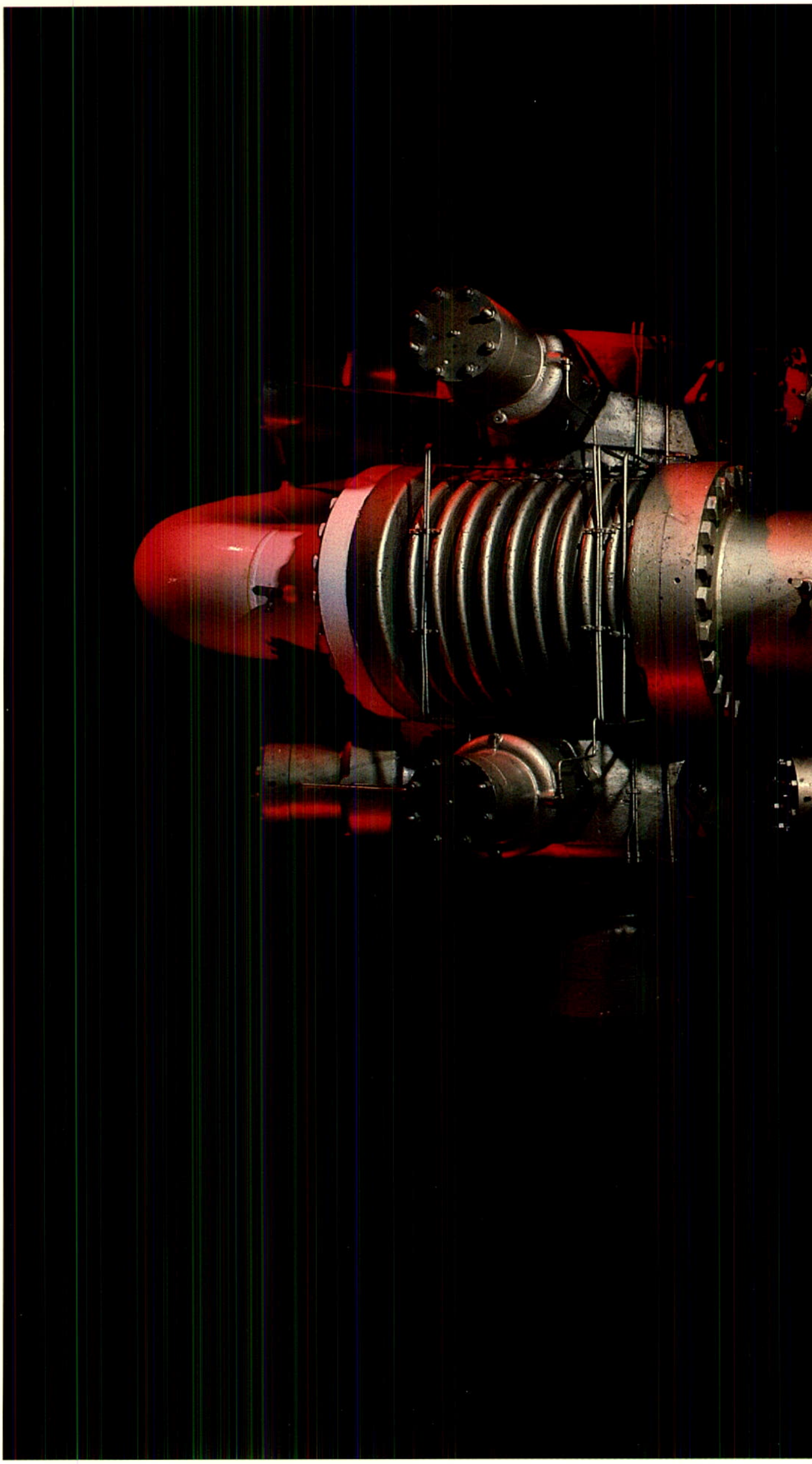
The Trans Québec & Maritimes pipeline is 50 per cent owned by TransCanada and operates a 342-kilometre pipeline which extends from the TransCanada system near Montreal to Quebec City. During 1986, the pipeline's deliveries to Quebec markets increased by 6.9 per cent to a record 2 550 million cubic metres. Peak day deliveries grew by 6.8 per cent from 10.1 million cubic metres to a record 10.7 million cubic metres.

Iroquois Gas Transmission System

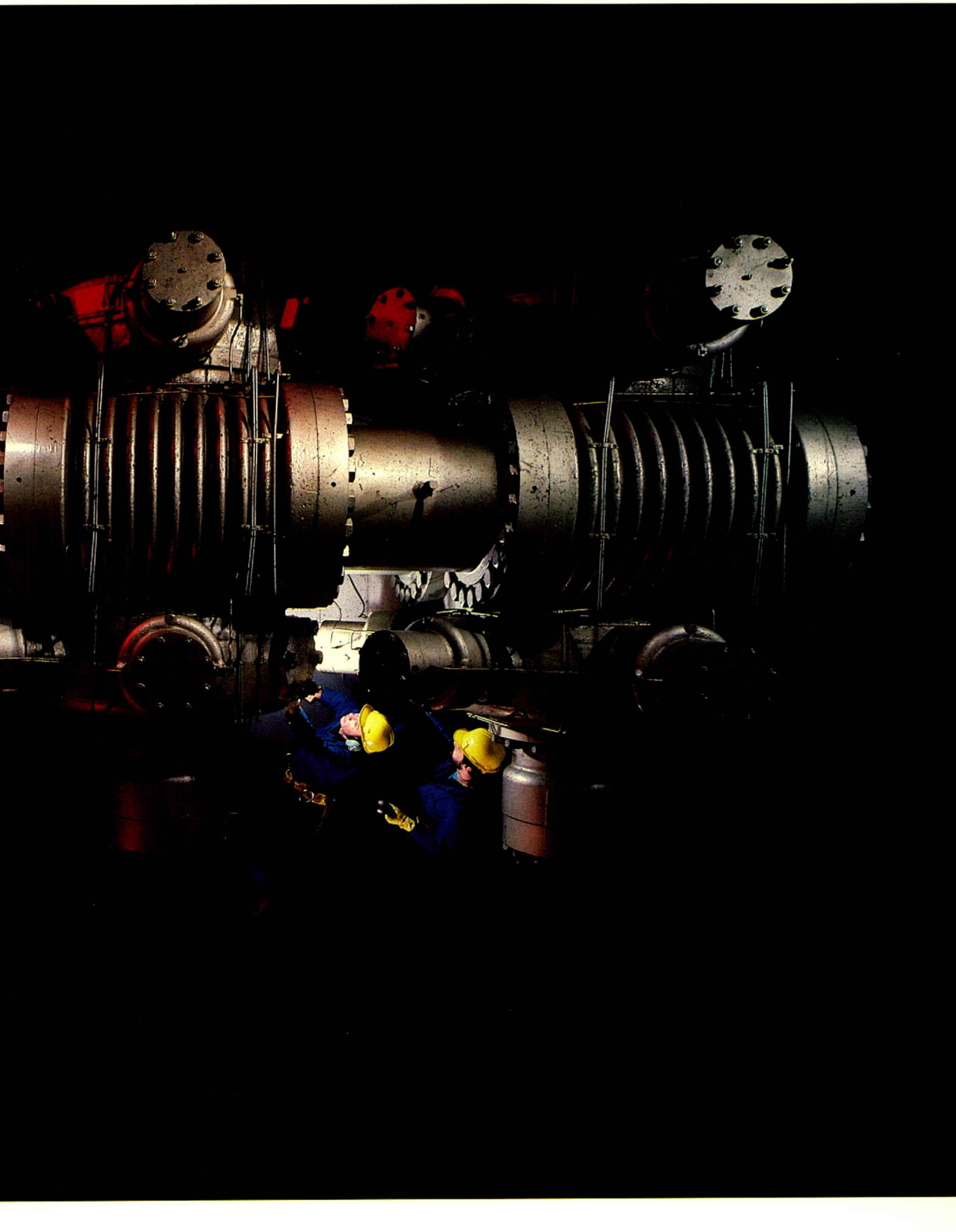
Iroquois Gas Transmission System, a partnership in which TransCanada holds a 50 per cent interest, filed a facilities application with the United States Federal Energy Regulatory Commission in May, 1986.

The (U.S.) $400-million project would allow the delivery of 10 million cubic metres per day of additional western Canadian gas from the TransCanada system east of Lake Ontario to delivery points in New York, Connecticut and New Jersey.

The 605 kilometres of 600-millimetre pipeline would connect with



At TransCanada's Maple compressor station north of Toronto, the massive compressors dwarf a service crew carrying out routine inspection. Fifty-one compressor stations are located along TransCanada's pipeline which stretches eastward from Burstall, Saskatchewan, to Candiac, Quebec. Able to generate a total of more than one million kilowatts of power, the engines at these stations are carefully maintained to ensure maximum efficiency and reliability.



TransCanada's system near Iroquois, Ontario, located midway between Brockville and Cornwall, and cross New York State and Connecticut to Long Island.

Frontier Projects

The Polar Gas Project, managed by TransCanada, has filed with the National Energy Board a proposal to construct a natural gas pipeline from the Mackenzie Delta to connect with existing pipeline systems carrying gas to southern Canadian and United States markets.

Sable Gas Systems, a partnership between TransCanada and provincially owned Nova Scotia Resources Limited, has proposed a pipeline which would transport gas from the Nova Scotia offshore to the United States border.

While considerable development work has been completed in the Polar Gas and Sable Gas projects, their construction is contingent on, among other things, the eventual recovery of world oil prices. As prices rise, frontier projects such as these will begin to be economically feasible. Moreover, as conventional gas supplies in North America begin to decline – probably around the mid 1990s – the oil and gas in the frontiers will require transportation systems to take these new supplies of gas to market. With much of the planning work already in hand, TransCanada will be prepared to proceed with these projects to meet the needs of the marketplace.

Western Gas Marketing

Western Gas Marketing Limited completed its first full year of operation in 1986. A wholly owned subsidiary of TransCanada, Western Gas Marketing was formed to market western Canadian natural gas in Canada and in the United States. Western Gas Marketing administers all of TransCanada's gas purchase contracts with Alberta producers and all gas sales contracts with both domestic and export customers.

The establishment of Western Gas Marketing, which in effect separates TransCanada's gas transportation services from its gas marketing activities, is consistent with and preceded the recommendations contained in the report presented by the Pipeline Review Panel in July, 1986.

The panel, established under the Agreement on Natural Gas Markets and Prices, was responsible for reviewing the role and operations of interprovincial and international pipelines engaged in the buying, selling and transmission of natural gas. While the panel recommended the separation of policy making, management and accounting between the transportation and the marketing activities, it did not view the separation of ownership as a necessary requirement.

Gas Sales Revenue
(billions of Canadian dollars)

DOMESTIC MARKETING

The Agreement on Natural Gas Markets and Prices of October 31, 1985 provided a framework and a timetable for the deregulation of natural gas markets and prices in Canada. As a result, 1986 was a year of transition as the industry prepared for the full implementation of the agreement on November 1, 1986. TransCanada and Western Gas Marketing played a key role in the transformation of the industry as it moved to become increasingly competitive and responsive to market forces.

During 1986, market-responsive pricing agreements were negotiated with TransCanada's eight domestic distributors. Under the agreements, which extend until October 31, 1988, distributors in Ontario and Quebec were able to pass base discounts on to customers commencing in September, 1986. The pricing agreements allow distributors to offer further discounts in vulnerable markets. All necessary federal, Alberta and Quebec approvals have been obtained to implement the agreements for their full term. The Ontario Energy Board has, however, expressed jurisdictional concerns about the agreements and has authorized approval only until October 31, 1987.

Western Gas Marketing and TransCanada are exploring technical and administrative modifications to address the concerns of the Ontario Energy Board so that the agreements will continue for their full terms. The pricing agreements with the Manitoba distributors were the subject of a hearing before the Manitoba Public Utilities Board in February, 1987.

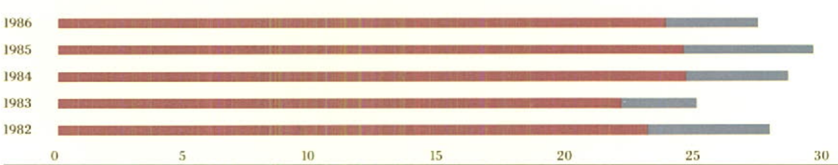
Price negotiations were conducted with virtually all of TransCanada's contracted natural gas producers in 1986. A new netback pricing structure has replaced the government-mandated prices formerly in effect. Under the market-oriented netback pricing arrangement, tolls and other approved charges are deducted from the prices negotiated with distributors to yield a netback price to the producer. This arrangement commenced on November 1, 1986 and will be in effect for two years.

Under this new netback pricing structure, Western Gas Marketing's revenue is earned from an operating, administration and marketing charge. This charge is calculated at 1.5 per cent of a total revenue pool, derived from all domestic and export sales, less the associated transportation costs. Thus, Western Gas Marketing's revenues directly track the producer's revenues and are therefore subject to the influence of both volume and price.

In an effort to protect the company's share of domestic natural gas markets despite severe competition from other gas suppliers and extremely low prices for competing fuels, Western Gas Marketing initiated several new programs in 1986.

Competitive marketing programs, which resulted in the negotiation of market-responsive prices with more than 100 large industrial customers were successfully introduced in 1986. This allowed the company to maintain sales to these industrial buyers at an annual rate totalling 7 770 million cubic metres.

Competition from oil in the large commercial and small industrial sectors also created the need for Western Gas Marketing's Incentive Program on May 1, 1986. This program extended until October 31, 1986 the discount offered under the expired Alberta government Natural Gas Marketing Incentive Plan. The incentive program ensured that 420 large commercial and small industrial customers, using 2 125 million cubic metres of natural gas per year, continued to purchase TransCanada's natural gas.



Gas Sales Volumes
(billions of cubic metres)

Canadian distributors served by the company added approximately 70,000 customers in 1986, increasing the number of customers served in the domestic market to approximately 2.2 million.

Competition from heavy fuel oil and direct sellers of natural gas intensified in industrial markets in 1986. As a consequence, the company's Canadian sales for 1986 were 23 754 million cubic metres, down 2.6 per cent from 24 399 million cubic metres in 1985.

Export Marketing

The regulatory environment in the United States has a strong impact on the company's ability to export gas to American markets. Nineteen eighty-six was an active year for regulatory reform in the United States, characterized by a trend to reduce the amount of regulation and increase competitiveness in natural gas markets.

During 1986, demand for Canadian natural gas exports was also affected by surplus supplies of low-priced natural gas available from American producers and by competition from heavy fuel oil. These market developments resulted in a 16 per cent decline in Canadian natural gas exports during the year.

Western Gas Marketing has an aggressive marketing program in the United States, and is starting to focus on natural gas sales to local distribution companies. Contracts were signed with two distribution companies in the mid-western United States for volumes amounting to 2.1 million cubic metres per day and for terms up to 15 years. Efforts are progressing to obtain firm transportation that directly connects the distribution companies with TransCanada contracted Alberta gas reserves.

Annual Gas Sales and Transportation Volumes

(thousands of cubic metres)	**1986**	1985	1984	1983	1982
CANADIAN					
SALES					
Saskatchewan	**37 071**	40 058	37 163	35 884	57 310
Manitoba	**1 709 677**	1 834 564	1 807 870	1 838 097	1 898 925
Ontario	**17 956 700**	18 341 308	18 865 124	16 860 659	18 352 390
Quebec	**4 051 145**	4 183 401	3 748 793	3 227 584	2 685 537
Total Sales	**23 754 593**	24 399 331	24 458 950	21 962 224	22 994 162
TRANSPORTATION					
Saskatchewan	**627 076**	758 114	764 129	731 234	856 435
Manitoba	**133 099**	99 764	52 538	–	–
Ontario	**1 558 893**	334 766	247 261	171 308	154 943
Quebec	**1 266 523**	923 298	659 985	586 225	476 477
Total Transportation	**3 585 591**	2 115 942	1 723 913	1 488 767	1 496 855
Total Canadian	**27 340 184**	26 515 273	26 182 863	23 450 991	24 491 017
EXPORT					
SALES					
Emerson	**2 643 094**	4 184 215	3 302 727	2 467 892	4 220 956
Niagara Falls	**378 023**	382 248	69 119	–	–
Philipsburg	**145 515**	147 574	141 484	130 590	128 009
Cornwall	**210 424**	227 625	228 063	180 392	157 288
Fort Frances	**110 309**	101 826	155 020	159 652	143 755
Total Sales	**3 487 365**	5 043 488	3 896 413	2 938 526	4 650 008
TRANSPORTATION					
Emerson	**1 825 269**	1 834 399	2 309 125	1 736 423	2 830 115
Niagara Falls	**432 556**	740 784	533 541	450 476	525 508
Total Transportation	**2 257 825**	2 575 183	2 842 666	2 186 899	3 355 623
Total Export	**5 745 190**	7 618 671	6 739 079	5 125 425	8 005 631
Total Deliveries	**33 085 374**	34 133 944	32 921 942	28 576 416	32 496 648

Transportation volumes shown include Storage Transportation Service volumes.

Western Gas Marketing Limited, a subsidiary of TransCanada, is aggressively competing for sales in Canada and the United States. One of the most promising areas for market growth, the American northeast, is served by Boston-based Boundary Gas Inc., a consortium of 15 natural gas distribution companies. Here, Western Gas Marketing's Leo Desjardins (centre) and Tom Sacco of Bay State Gas Company (left) confer with Michael Lucy of Boundary Gas at the steps of Boston's historic Massachussetts State House.

The proposed Iroquois pipeline will connect 19 local distribution companies in the northeastern United States directly to the TransCanada system.

Negotiations are also well advanced for the export of long-term, secure supplies of natural gas to new customers in California and the Pacific northwest.

Gas Supply

Approximately 43 per cent of Alberta's remaining established gas reserves are contracted to TransCanada PipeLines under long-term contracts administered by Western Gas Marketing. In total, the company holds 2,700 gas purchase contracts with 700 active natural gas producers. These contracts encompass 18,600 gas wells which are producing from 724 billion cubic metres of remaining established gas reserves.

The great majority of TransCanada's gas purchase contracts with its producers are reserve-based contracts. They include take-or-pay provisions that assure the producers cash flow while dedicating long-term supplies of gas to the company. Under reserve-based contracts, the company and the producers agree on a minimum rate of production over a specified contract life, based on the total reserves dedicated to the contract.

Some of these contracts allow additional reserves, drilled under dedicated lands, to be developed and added to the contract. Significant reserve development did occur as a result of a high level of drilling activity in the late 1970s and early 1980s.

This increase in the total reserves contracted to TransCanada, combined with the static demand resulting from government-mandated price increases, led to a surplus of supply.

As the contracted supply exceeded market demand, the take-or-pay provision in the contracts became effective and payments were made for the gas that was not taken. TransCanada has made such payments for gas every year since 1977. Since the Topgas program was implemented these payments have been relatively small.

Topgas Program

In 1982 and 1983, banking syndicates advanced $2.7 billion to producers to refinance TransCanada's take-or-pay payments under the Topgas program.

The recovery of these advances began in 1984 and will be completed no later than 1994. On December 31, 1986, there was $2 billion outstanding.

Under the Topgas Program, TransCanada has provided guarantees of up to $360 million to the banking syndicates for any loss that may arise in the event that a producer is unable or fails to deliver prepaid gas.

The significant reduction of gas prices and cash flow to producers in 1986 did not adversely affect the recovery of these take-or-pay advances. Less than $5 million of new take-or-pay debt was incurred in the contract year ending October 31, 1986. Further exposure to take-or-pay debt during the contract years ending October 31, 1987 and 1988 has been eliminated through negotiations in conjunction with the new netback pricing mechanism referred to earlier.

In June 1986, the National Energy Board recommended that Alberta producers who use the TransCanada pipeline system for direct sales be obligated to pay a share of take-or-pay carrying costs. This recommendation was supported by the Alberta government which subsequently enacted the Take-or-Pay Costs Sharing Act.

The act, which is effective from November 1986 to October 1994, benefits producers who have contracts with the company and who have accepted take-or-pay payments in prior years.

Under the act, the Alberta Petroleum Marketing Commission established a levy of 10 cents per gigajoule for a period of 12 months on volumes transported by TransCanada which relate to direct sales contracts entered into after November 1, 1985.

NATURAL RESOURCES

During 1986, the world price for crude oil declined to less than half of what it was in late 1985. This dramatic drop in prices required many companies to rapidly adjust to the new economic environment, resulting in reduced investment in petroleum exploration and development. TransCanada responded to this changed environment by restricting its capital expenditures to higher quality projects, and consolidating its operations to achieve greater efficiencies.

Through its subsidiaries – TCPL Resources, in Canada and internationally, and Wessely Energy Company in the United States – TransCanada's exploration and development expenditures were reduced to $112.1 million, a decline of 35 per cent from 1985. Sales of crude oil and natural gas liquids were 19,900 barrels per day in 1986, a decline of two per cent compared to 1985 levels. Natural gas sales from TransCanada's oil and gas operations also decreased, to 92.4 million cubic feet per day, seven per cent below 1985. The decline in volumes combined with lower prices resulted in total revenue in 1986, after deduction of royalties, dropping by 36 per cent to $180.7 million.

CANADIAN OPERATIONS

In Canada, federal and provincial governments are reacting positively to the oil industry crisis caused by the rapid fall in crude oil prices. Removal of the last

PETROLEUM AND NATURAL GAS RIGHTS

as at December 31, 1986. working interest (thousands of acres)	Gross[2]	Net[3]
Canada		
Western Canada[1]		
Alberta	13,751	989
British Columbia	2,802	172
Saskatchewan	2,837	277
Manitoba	1,200	128
Ontario	5	0
	20,595	1,566
Frontier		
Arctic Islands	717	19
Beaufort Sea	914	32
East Coast	64	1
Northwest Territories	2,768	148
	4,463	200
Total Canada	25,058	1,766
U.S.A.	434	177
International		
Australia	24,474	1,613
New Zealand	750	566
Indonesia	17,553	1,785
Italy	1,338	209
North Sea-Netherlands	77	7
North Sea-United Kingdom	28	4
Total International	44,220	4,184
Grand Total	69,712	6,127

[1]In addition to the above working interests, the company holds a royalty interest in 3.4 million acres in Western Canada and frontier lands.
[2]Gross refers to the total number of acres in which the company holds either a working or overriding royalty interest.
[3]Net is determined by multiplying the gross acres by the percentage of working interest held by the company in gross acres. Overriding royalty interests are excluded in calculating net acres.

vestiges of the National Energy Program, including the elimination of the Petroleum and Gas Revenue Tax, has paved the way for a return to a more fair and less complex taxation policy for the industry. Alberta and the other western provinces also responded with various incentive packages.

Regulatory changes, as well as intense competition in the marketplace, have resulted in lower Canadian natural gas prices and volumes.

JOINT EXPLORATION AGREEMENT A majority of TransCanada's oil and gas activities in western Canada are conducted under a joint exploration agreement with Dome Petroleum Limited. During 1986, exploration and development expenditures on these lands amounted to $29.9 million, representing approximately 76 per cent of TCPL Resources' total capital expenditures for Canadian operations.

TransCanada participates in the joint exploration agreement with Dome Petroleum through the MT Partnership in which it is an equal partner with Maligne

Resources Ltd., a subsidiary of Dow Chemical Canada Inc. Under the terms of the agreement, Maligne and TCPL Resources each has the right and obligation to acquire 12.5 per cent of any interest in oil and gas properties that Dome acquires in western Canada. Dome, in turn, has the right to acquire 75 per cent of any oil and gas interest acquired in western Canada by either the MT Partnership or by TCPL Resources or Maligne individually.

A high proportion of TransCanada's Canadian oil and gas interests were acquired through Dome Petroleum when it was a major shareholder of the company and are managed by Dome under the joint exploration agreement.

This situation is unsatisfactory for the long term because it is not cost-efficient and does not give TransCanada adequate involvement in the management of the properties.

The company is exploring ways of changing the existing arrangements with Dome with the ultimate objective of reducing costs and having greater control over operational decisions. Because of the very large number of properties involved and various other complexities, this process may take several years.

In 1986, exploration under the joint exploration agreement led to discoveries in the Cheddarville, Sukunka, Caroline, Romeo and Rainbow areas of Alberta.

ESTIMATED REMAINING RESERVES

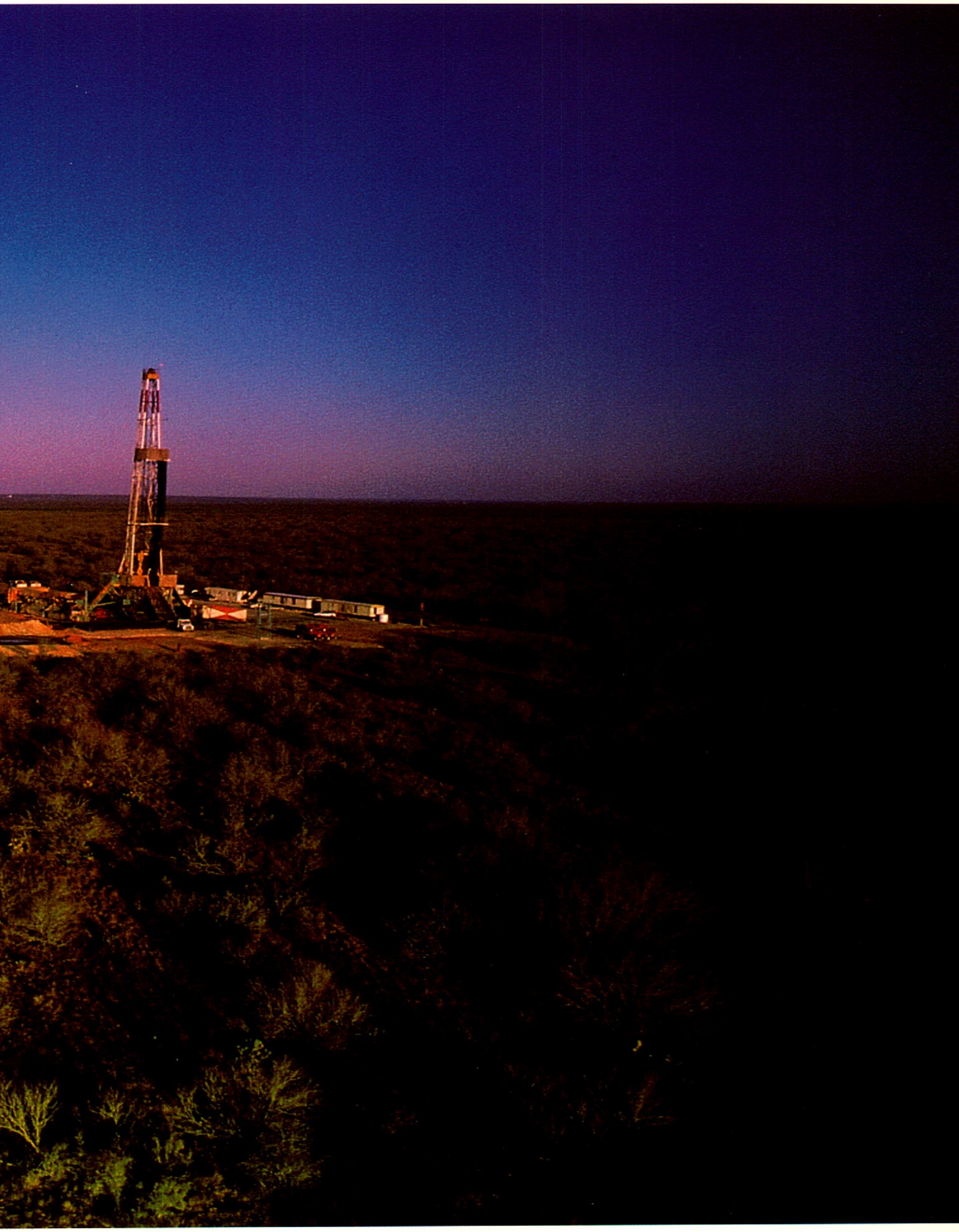
December 31	**1986**	1985
Proved oil and gas reserves[1]		
Crude oil and natural gas liquids *(thousands of barrels)*		
Canada	**62,714**	66,080
United States	**3,618**	6,171
Indonesia and other foreign	**7,616**	5,615
	73,948	77,866
Natural gas *(billions of cubic feet)*		
Canada	**819.4**	858.2
United States	**65.3**	81.1
	884.7	939.3
Synthetic oil[2] *(thousands of barrels)*	**8,880**	9,157
Sulphur *(thousands of tons)*	**700**	665

[1]*Proved reserves in Canada are determined by the deduction of freehold and overriding royalties but before the deduction of provincial royalties. Proved reserves in the United States are net of all royalties. Proved reserves in Indonesia and other foreign jurisdictions are attributable to the company's gross working interest before host government takes.*

[2]*Synthetic oil reserves result from the company's interest in the Syncrude project.*

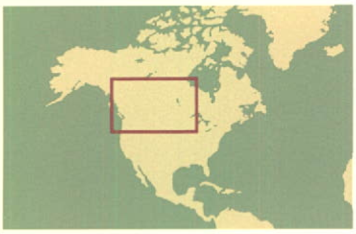
INDEPENDENT EXPLORATION In 1986, TCPL Resources continued to increase its exploration and development activities independent of the joint exploration agreement with Dome Petroleum. Exploration and development expenditures for independent operations amounted to $9.4 million. Step out wells, which successfully extended prior pool discoveries at Rainbow Lake in

In the brush country of south Texas this drilling well is part of an exploration and development program in which wholly owned subsidiary Wessely Energy Company has an interest. While the bulk of its exploration and development activities is in North America, TransCanada also has interests in other parts of the world. Exploration and development expenditures for 1986 were reduced because of the drop in world oil prices, but the company continues to pursue projects that promise good returns.

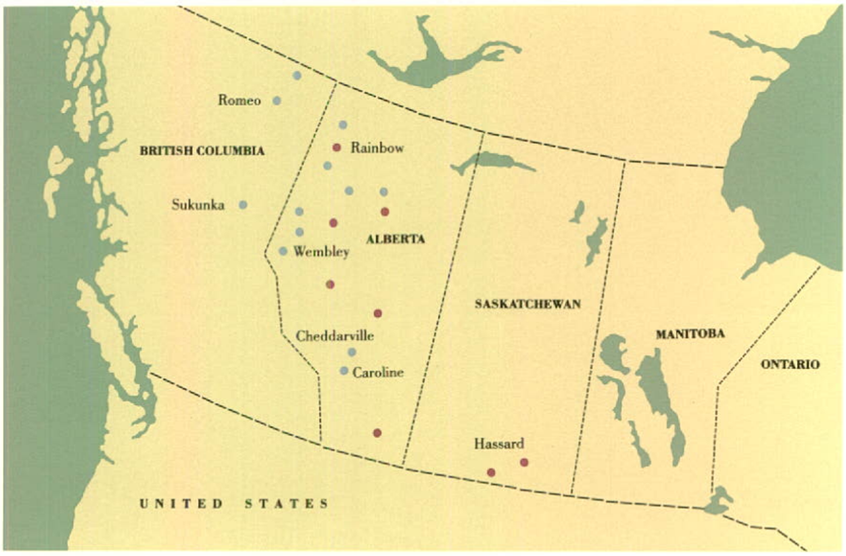


northern Alberta and Hassard Lake in Saskatchewan, highlighted the 1986 independent exploration program in western Canada.

In the Peace River Arch region of Alberta the company has a 90 per cent interest in a new gas and condensate discovery. In addition, TCPL Resources was able to take advantage of lower land values in Alberta and acquired 10,000 net undeveloped acres in promising areas.



Oil and Gas Activity in Canada
Exploration and development activities in Western Canada, carried out independently and under a joint exploration agreement with Dome Petroleum, led to several discoveries in 1986.



PRODUCTION In 1986, sales of crude oil and natural gas liquids in Canada, before royalties, averaged 15,155 barrels per day, compared to 15,056 barrels per day in 1985. This increase reflects a rise in crude oil volumes which offset a decline in natural gas liquids production due to restricted markets. Those volumes include production from Syncrude, in which TransCanada has a minor interest, which was a record 803 barrels per day in 1986.

The Wembley gas cycling plant, located in northwestern Alberta, came on stream in 1986 increasing the company's production of natural gas liquids by approximately 400 barrels per day.

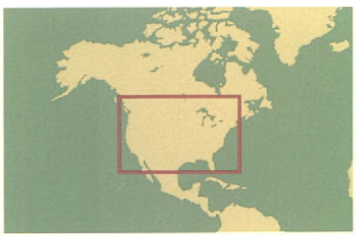
Natural gas sales from oil and gas operations averaged nearly 81 million cubic feet per day in 1986, a seven per cent decrease from 1985. This reduction was primarily attributable to declining export sales since domestic sales were consistent with 1985 levels.

UNITED STATES OPERATIONS

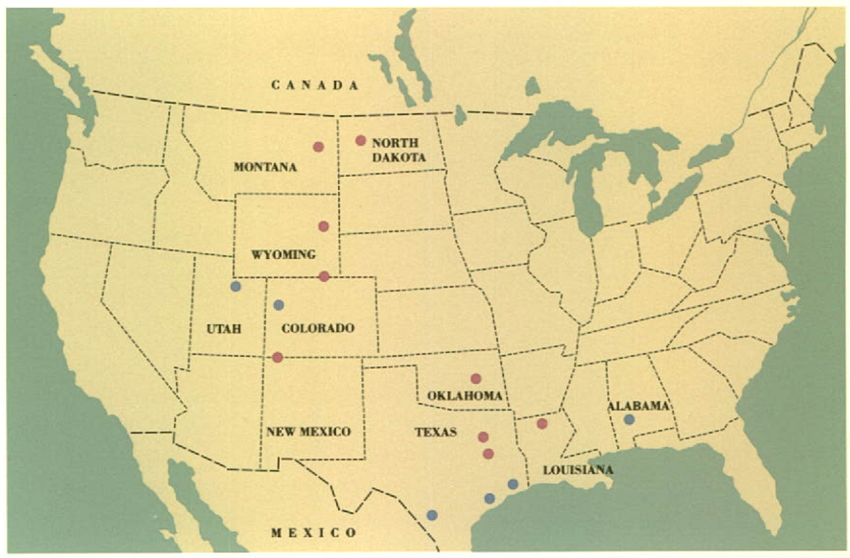
During 1986, TransCanada's operations in the United States, which were previously conducted by Wessely Energy Company and by TCPL Resources U.S.A. were combined in Wessely Energy Company with offices in Dallas and Denver. The accounting and land lease record functions for both offices were consolidated in Dallas.

During 1986, average daily production from properties in the United States amounted to 1,583 barrels of crude oil and natural gas liquids and 11.6 million cubic feet of natural gas. Expenditures for exploration, development and land acquisition programs in 1986 totalled (U.S.) $25.6 million.

Greater emphasis was placed on plays with the potential to add significantly to the company's reserves and cash flow, a policy that will continue in 1987. These plays are South Texas, Southwest Alabama, the Texas Gulf Coast, the Williston Basin located in Montana and North Dakota, and the Powder River Basin of Wyoming.



Oil and Gas Activity in the United States
The company's oil and gas interests in the United States are managed by Wessely Energy Company, a wholly owned subsidiary.



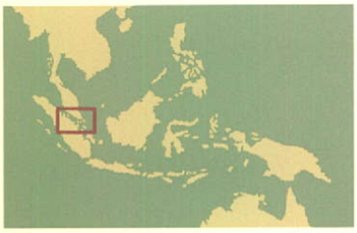
Areas of Significant Activity
- Independent
- Joint Exploration Agreement

INTERNATIONAL OPERATIONS

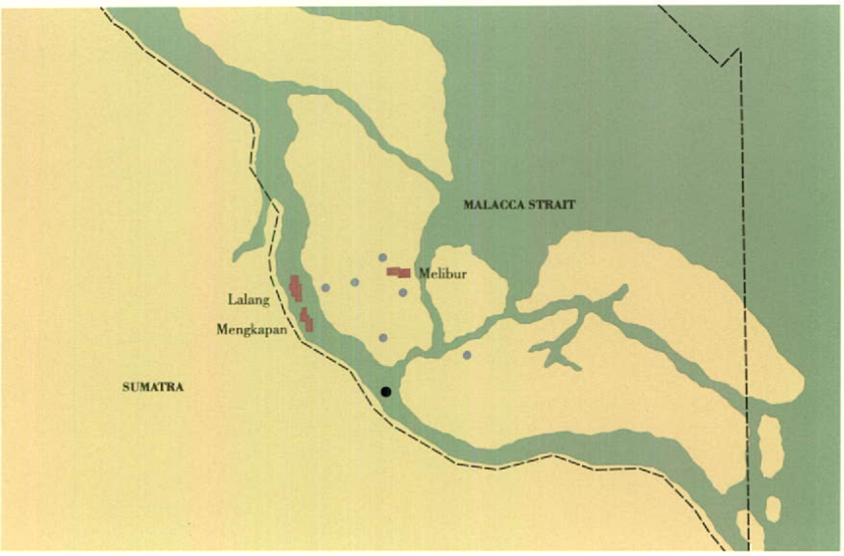
INDONESIA TCPL Resources holds interests, ranging from 1.2 per cent to 14.86 per cent, in five production sharing contracts in Indonesia comprising a total of 1.8 million net acres. Two production sharing contract areas, the Natuna "B" and the Asahan, were relinquished in late 1985 and in September, 1986, respectively.

In 1986, the company's Indonesian production averaged 2,822 barrels of oil per day, all of which was derived from properties in the Southeast Sumatra and Malacca Strait production sharing contract areas. Production rates in 1986 were 17 per cent below 1985 levels because of production declines from existing fields in both contract areas and lower allowable production rates imposed by Pertamina, the Indonesian state oil company.

Six out of seven exploratory wells discovered oil in a sector of the company's 7.1 per cent-owned Malacca Strait production sharing contract area. On initial testing, oil flowed from the discovery wells at rates between 318 and 9,732 barrels per day. Delineation work on these discoveries is continuing. Development of two prior Malacca Strait discoveries – Mengkapan and Melibur – was nearly complete at the end of the year, and production began in December. At year-end the two new fields were producing nearly 18,000 barrels per day, with capability of over 40,000 barrels per day. The Lalang field, on production since June 1984, is currently capable of producing over 20,000 barrels of oil per day.



Oil and Gas Activity in the Malacca Strait in Indonesia
Oil was discovered in six exploratory wells in a section of the company's 7.1 per cent-owned production sharing contract area in the Malacca Strait, Indonesia.



AUSTRALIA AND NEW ZEALAND TCPL Resources' interests in two offshore and nine onshore blocks in Australia total 1.6 million net acres. During 1986, the company participated in four onshore exploration wells and one appraisal well. This resulted in an oil discovery at Black Stump. The company holds minor interests in several other producing oil fields in Australia, which yield approximately 250 barrels of oil per day (net) to the company.

In 1986 the New Zealand government awarded to TCPL Resources two blocks in the Taranaki Basin offshore the North Island. The company added to its New Zealand acreage by farming into the PPL 38116 exploration license. TCPL Resources now operates and holds a 40 per cent interest in this license where an oil and gas condensate discovery, Kupe South No.1, was drilled in late 1986. The well penetrated 185 feet of hydrocarbon section. The lower part of the section was tested and flowed over 2,000 barrels of oil per day with some water. A test of an upper part of the section flowed gas at the rate of seven million cubic feet per day and condensate at the rate of 1,030 barrels per day. Further evaluation and appraisal of the discovery is planned for 1987.

THE NORTH SEA TCPL Resources holds a nine per cent interest in blocks K4b and K5a in the Netherlands sector of the North Sea. Minor interests in several other offshore blocks were divested during 1986.

In the U.K. sector, TCPL Resources maintains its 15.65 per cent interest in the 22/19 block where a gas and condensate discovery was made in 1984.

ITALY TCPL Resources holds interests ranging from 7.5 to 25 per cent in

DRILLING SUMMARY

for the year ended December 31, 1986 (includes participation and farm-out wells)

	Oil		Gas		D & A*		Total	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Exploratory								
Canada	89	5.29	62	4.97	93	12.14	244	22.40
U.S.A.	6	1.05	4	1.76	16	5.35	26	8.16
Foreign	12	0.71	1	0.17	11	0.83	24	1.71
Total	107	7.05	67	6.90	120	18.32	294	32.27
Development								
Canada	510	16.47	136	3.50	94	4.26	740	24.23
U.S.A.	10	5.11	29	7.67	9	3.67	48	16.45
Foreign	21	1.15	–	–	2	0.12	23	1.27
Total	541	22.73	165	11.17	105	8.05	811	41.95
Exploratory & development								
Total	648	29.78	232	18.07	225	26.37	1,105	74.22

**Dry and abandoned*

DAILY SALES VOLUME SUMMARY

	1986				1985			
	Canada	**U.S.A.**	**Indo-nesia/& Other Foreign**	**Total**	Canada	U.S.A.	Indo-nesia/& Other Foreign	Total
Oil and Natural Gas Liquids *(barrels)*								
Conventional	**11,365**	**1,484**	**3,148**	**15,997**	11,138	1,687	3,500	16,325
Synthetic	**803**	**–**	**–**	**803**	801	–	–	801
Natural Gas Liquids	**2,987**	**99**	**–**	**3,086**	3,117	43	–	3,160
Total Oil and Natural Gas Liquids	**15,155**	**1,583**	**3,148**	**19,886**	15,056	1,730	3,500	20,286
Natural Gas *(millions of cubic feet)*	**80.8**	**11.6**	**–**	**92.4**	87.3	12.0	–	99.3
Sulphur *(long tons)*	**189**	**–**	**–**	**189**	187	–	–	187

Note: Sales volumes for Canada are gross and include all volumes attributable to the company's working interests before the deduction of royalties.
Sales volumes for the United States are net of royalties. Sales volumes for Indonesia are attributable to the company's gross working interest before government takes.
Daily sales volume is calculated by dividing total sales for the respective year by the number of days in that year.

14 permits; they are located in the Adriatic Sea, off the coast of Sicily and onshore in the northern and southern Appennines. During 1986, the company relinquished its interest in two offshore blocks in the Sicily Channel. Seismic programs were completed on 11 other blocks in 1986. Two deep onshore exploratory tests are scheduled for drilling in 1987.

Other Businesses

Cancarb Limited

Cancarb Limited, a wholly owned subsidiary, is a producer of high quality thermal carbon black, a product with markets around the globe. Its Medicine Hat, Alberta plant is the largest facility producing thermal carbon black in the world.

An aggressive marketing program, combined with technical assistance and customer support, allowed Cancarb to increase its market share in 1986 despite heavy discounting of competitive products.

Continuing growth in sales and increases in market share are expected for the coming year, with emphasis to be placed on the development of new markets and new applications for the product.

Ocean State Power Project

TransCanada is participating in a project in the United States to construct, own and operate a 235-megawatt electric power generating plant located at Burrillville, Rhode Island. The project is designed to generate electric power efficiently and economically using natural gas from western Canada. The project is nearing the end of the regulatory phase and construction contracts are expected to be awarded in the last quarter of 1987, with power generation projected for late 1989. TransCanada intends to hold a 40 per cent interest in the plant, subject to United States regulatory approval.

International PipeLine Engineering Limited

International PipeLine Engineering Limited is a wholly owned subsidiary that markets pipeline technology and consulting services both in Canada and internationally. During 1986, IPEL continued to build its markets for in-line inspection and consulting services.

Major contracts during the year include pipeline inspections in Australia, Mexico, Libya, the United States and the Danish sector of the North Sea. IPEL has developed a unique capability to provide a high-quality, comprehensive service to its customers.

Development of the 48-inch magnetic flux inspection tool was completed in 1986, under an agreement with Alyeska, the operators of the Trans-Alaska Pipeline System. The tool successfully passed a comprehensive series of acceptance tests specified by Alyeska. Survey test runs on the Trans-Alaska system are scheduled in early 1987.

Kopp AG International Pipeline Services

In December 1986, TransCanada acquired Kopp AG International Pipeline Services of Lingen, West Germany. In addition to its traditional business areas, including pipeline testing and cleaning, Kopp has developed a sophisticated ultrasonic pipeline inspection tool for liquids pipelines. With the combined marketing and technical strengths of Kopp and IPEL, TransCanada will be strongly positioned to compete for inspection and engineering contracts in the international pipeline industry.

Empress Extraction Plant

The company has a 50 per cent interest in the Empress Extraction Plant which extracts natural gas liquids and ethane from natural gas. The plant is operated on a cost-of-service basis.

Corporate Finance

In July 1986, TransCanada completed a public issue of 9,632,372 units consisting of 9,632,372 common shares and 4,816,186 common share purchase warrants, each of which entitles the holder to purchase one common share at $19.25 until July 13, 1989. Concurrently, the company sold to Bell Canada Enterprises Inc. units consisting of 8,972,278 common shares and 4,486,139 common share purchase warrants which allowed Bell Canada Enterprises to retain its pro rata ownership interest in TransCanada.

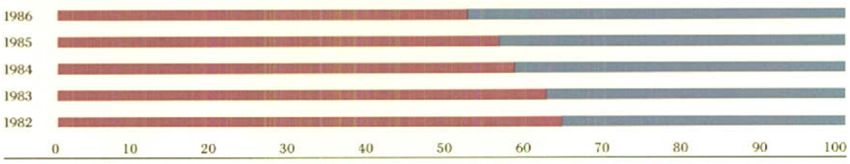
Net proceeds of $304 million from this public offering and sale to Bell Canada Enterprises were used to retire a significant portion of the company's non-recourse oil and gas loans. The balance of these loans was retired by the end of 1986.

In March 1986, TransCanada issued notes for 104 million Swiss francs and swapped the net proceeds for (U.S.) $50 million of fixed rate financing at an attractive spread over United States treasury bond rates for a five-year term. These funds were used to refinance short-term debt related to the non-utility businesses of the company.

In October 1986, TransCanada received $99.8 million as the 80 per cent second installment payment for Series K debentures offered in January 1986. These proceeds were used to redeem the 17¾ per cent (U.S.) $75 million Eurodollar issue, due in 1988. In December 1986, the company also redeemed its 16 per cent (U.S.) $100 million Eurodollar issue, due in 1989. Two other high-coupon debt issues, totalling approximately $26 million were retired during 1986.

In December 1986, TransCanada PipeLines Finance USA Ltd., a United States subsidiary of the company, arranged a (U.S.) $300 million Note Issuance Facility in the Euromarket. Under this Facility, it may issue short-term Euronotes guaranteed by TransCanada from time to time during a seven-year period. This Facility will provide a low-cost financing vehicle in United States dollars.

On January 1, 1987, TransCanada retired (U.S.) $8.2 million 5.60 per cent and $21.3 million 5.85 per cent Subordinated Debentures. These debentures were issued 30 years ago with common shares attached and represented the original public debt and equity issues, which raised $112.5 million towards the initial construction cost of the TransCanada pipeline.

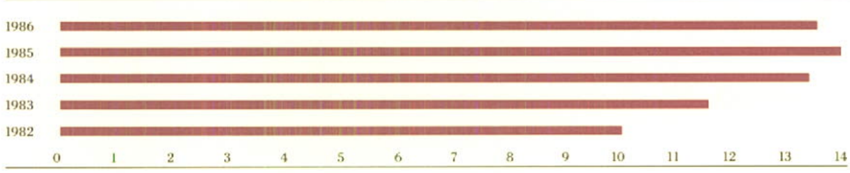


Debt/Equity Ratio
(excluding non-recourse loans) *(percentage)*

Short-term borrowing requirements during 1986 were met principally through the issuance of commercial paper under the company's $400 million program. The average cost of short-term borrowings during the year was 9.1 per cent on average daily Canadian dollar notes outstanding of $177.2 million and 7.25 per cent on average daily United States notes outstanding of (U.S.) $162.4 million.

TransCanada earned 8.96 per cent on average daily Canadian short-term investments of $51.4 million and 6.75 per cent on average daily United States short-term investments of (U.S.) $409.4 million.

The company's Dividend Reinvestment and Share Purchase Plan and Stock Dividend and Share Purchase Plan have been in operation for four years and have over 3,300 common and preferred shareholder participants. The plans raised $85.2 million in common equity during the year at an average price of $16.383 per share. Of this amount, $84.1 million was raised through reinvested or stock dividends and $1.1 million through the optional share purchase features.



Shareholders' Equity per Common Share
(dollars)

The following pages of this annual report contain the REPORT OF MANAGEMENT, the FINANCIAL STATEMENT REVIEW, the CONSOLIDATED FINANCIAL STATEMENTS of the Company, FINANCIAL STATEMENT NARRATIVES, THE NOTES to the CONSOLIDATED FINANCIAL STATEMENTS and SUPPLEMENTARY FINANCIAL and OPERATING DATA, including FIVE-YEAR FINANCIAL and OPERATING HIGHLIGHTS and other CORPORATE INFORMATION.

The FINANCIAL STATEMENT REVIEW is a discussion by management of the financial results of the Company. The bold headings employed throughout the NARRATIVE relate to the specific financial statement captions on each of the referenced statements.

As noted on the bottom of each statement, the accompanying notes to consolidated financial statements are an integral part of these financial statements.

Report of Management

The accompanying consolidated financial statements and all information in the Annual Report are the responsibility of management and have been approved by the Board of Directors of the Company. The consolidated financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada applied on a consistent basis, except for the prospective application in 1986 of the method adopted by the Canadian Institute of Chartered Accountants for computing the limitation of capitalized costs in accounting for oil and gas operations as explained in Note 3(a). These principles also conform in all material respects with International Accounting Standards on an historical cost basis. Financial information contained elsewhere in this Annual Report is consistent with the consolidated financial statements.

The Board of Directors has appointed an Audit Committee consisting solely of directors who are not officers of the Company to review with management and the independent auditors the annual consolidated financial statements of the Company prior to submission to the Board of Directors for final approval. The Audit Committee also meets periodically during the year with management and the internal and external auditors either individually or as a group. Internal and external auditors have free access to the Audit Committee without obtaining prior management approval.

The independent auditors, Peat, Marwick, Mitchell & Co., have been appointed by the shareholders to express an opinion as to whether the consolidated financial statements present fairly the Company's financial position, operating results and changes in financial position in conformity with generally accepted accounting principles.

The report of the independent auditors on page 52 outlines the scope of their examination and their opinion on the consolidated financial statements.

The following discussion has been prepared by management and is a review of the financial results of the Company. Its focus is primarily a comparison of the Company's financial performance between 1986 and 1985 and should be read in conjunction with the consolidated financial statements and accompanying notes. In addition, material changes between 1985 and 1984 are highlighted.

The year 1986 was one of significant change for energy related companies. Not only was there a precipitous drop in world crude oil prices but Canada also faced the challenge of deregulation of natural gas prices. In the 1985 Financial Statement Review, management noted that lower oil and natural gas prices were expected to reduce revenues and income from the Natural resources segment in 1986. Further, it advised that if oil and natural gas prices were significantly lower at the end of 1986 than at the end of 1985, the Company could be faced with further writedowns of its investments in oil and gas properties. Prices in 1986 were in fact dramatically lower than in 1985. For example, the average price received by the Company for Canadian crude oil during December 1986 declined by 52% compared to December 1985. In addition, during December 1986 the average price received by the Company's Natural resources segment for sales of Canadian natural gas was 24% lower than during December 1985.

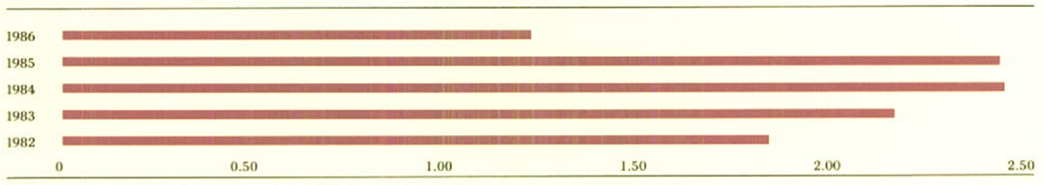
The 1986 adjustment to the carrying value of oil and gas properties was computed in accordance with the Guideline entitled Full Cost Accounting in the Oil and Gas Industry ("CICA Guideline") issued in 1986 by the Canadian Institute of Chartered Accountants. As more fully described in Note 3(a) on page 56, the Company adopted the CICA Guideline on a prospective basis, and consequently, using year end 1986 prices, wrote down its oil and gas properties for accounting purposes by $100.6 million net of related income taxes.

In addition to the reduction in carrying value of oil and gas properties, the Company has also made provisions in its 1986 accounts for investments in certain energy related projects and other minor assets. These provisions total $13.9 million net of related income taxes.

In 1985 the Company made provisions in its accounts for the carrying value of oil and gas properties and other investments and assets totalling $115.6 million. These provisions are also discussed in Note 3 on pages 56 and 57.

Results of Operations The Company's net income in 1986 was $175.1 million before deducting investment and asset provisions compared to net income before provisions of $278.1 million in 1985 and $265.9 million in 1984. This substantial decrease in net income in 1986 is primarily attributable to the effect of reduced oil prices on the Company's Natural resources and other segment. Income from operations of the Company's Pipeline segment in 1986 declined 2% compared to 1985 reflecting, among other things, a lower authorized return on common equity effective August 1, 1985. In addition, the deterioration of the Canadian dollar relative to the Swiss franc and the effect of United States tax reform measures contributed to the profit decrease.

Net income applicable to common shares, after investment and asset provisions and after provision for preferred dividends, amounted to $17.8 million in 1986, compared to $117.7 million in 1985 and $206.4 million in 1984. On a per common share basis, prior to investment and asset provisions, earnings were $1.20 in 1986 compared to $2.40 in 1985 and $2.41 in 1984 . After these provisions, earnings per share were $0.16 in 1986, $1.21 in 1985 and $2.22 in 1984. Earnings per share are calculated based upon weighted average common shares outstanding of 110.2 million in 1986, 97.0 million in 1985 and 93.0 million in 1984. The increase in the 1986 weighted average number of shares includes the issue in July 1986 of 18.6 million additional common shares.

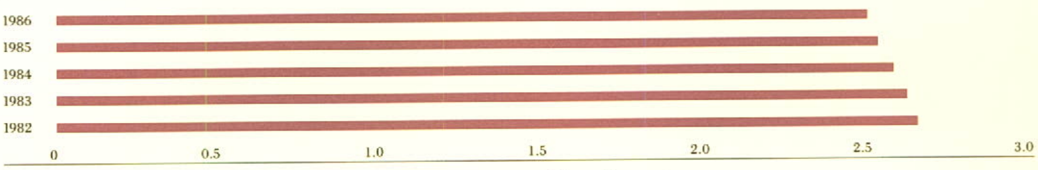


Net Income per Common Share
(dollars before investment and asset provisions)

The Company's Pipeline segment, together with investments in other pipelines, continue to provide the most significant contribution to consolidated net income. These operations are subject to the jurisdiction of various regulatory bodies with respect to matters such as tolls, construction, operations and accounting.

The Pipeline segment tolls are set by the National Energy Board ("NEB") to permit the Company the opportunity to recover projected costs of transporting natural gas and to provide a fair and reasonable return on its investment. Tolls are based on a number of factors including estimates of the level of the Pipeline segment's rate base, operating costs and financing costs.

Rate base is essentially the net book value of the Pipeline segment's plant, property and equipment plus an allowance for working capital. The plant, property and equipment component of rate base has decreased over the past three years as depreciation expense has exceeded capital expenditures. If, in the period during which tolls are effective, variations occur between the actual and estimated amounts of certain operating costs, the Company may earn more or less than the approved return on its rate base. Changes in authorized rate base also impact the contribution to net income by this segment. As discussed further in Note 13 on page 68, the Company has been operating under interim tolls since August 1, 1986.



Plant, Property and Equipment
Pipeline
(billions of dollars)

The impact of inflation on the Company is, to a large extent, minimized by the regulatory process. The Company believes that to present financial statements in any form other than historical cost would be misleading in that such statements would not depict the economics of its regulated operations.

In December 1985 TransCanada formed Western Gas Marketing Limited, a wholly owned subsidiary, to administer all of TransCanada's gas purchase contracts with Alberta producers and all gas sales contracts with domestic and export customers. This action, in effect, separates the Company's transportation services from its marketing activities.

Western Gas Marketing's mandate is to expand market demand for Western Canadian natural gas in Canada and the United States.

Ninety per cent of the Company's total revenues in 1986 result from sales of natural gas. These revenues are based upon approved tolls and prices in effect at the time of the sale and are influenced by the amount of natural gas sold and the geographic location of the sale.

The two tables following set out the changes in the gas sales and transportation revenues and related volumes for 1986 compared to 1985 and 1985 compared to 1984, respectively. It should be noted that, as a result of the regulatory process, variations in sales and transportation volumes by themselves do not impact net income.

Year Ended December 31	Increase/(Decrease) in Gas Sales and Transportation 1986 over 1985		
	Domestic	Export	Total
Revenues *(millions of dollars)*			
Gas sales	**(195.4)**	**(325.8)**	**(521.2)**
Gas transportation	**73.4**	**(6.1)**	**67.3**
	(122.0)	**(331.9)**	**(453.9)**
Volumes *(millions of cubic metres)*			
Gas sales	**(645)**	**(1 556)**	**(2 201)**
Gas transportation	**1 470**	**(318)**	**1 152**
	825	**(1 874)**	**(1 049)**

Year Ended December 31	Increase/(Decrease) in Gas Sales and Transportation 1985 over 1984		
	Domestic	Export	Total
Revenues *(millions of dollars)*			
Gas sales	56.7	99.8	156.5
Gas transportation	8.7	4.9	13.6
	65.4	104.7	170.1
Volumes *(millions of cubic metres)*			
Gas sales	(60)	1 148	1 088
Gas transportation	392	(268)	124
	332	880	1 212

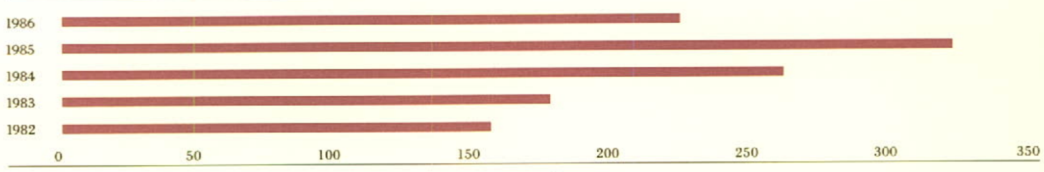
The impact of deregulation of natural gas prices on revenues and volumes is quite apparent when comparing these tables. The first table shows that in 1986 domestic gas sales volumes decreased by 645 million cubic metres or 2.6% while domestic transportation volumes increased by 1 470 million cubic metres or 69.5%. This shift has resulted from a decision by the NEB in 1986 to extend the Company's obligation to provide transportation services to shippers who displace volumes previously sold by the Company. Domestic gas sales revenues in 1986 decreased by $195.4 million or 5.7% from 1985 while domestic transportation revenues increased by $73.4 million or 192.1%. The overall reduction in domestic gas sales and transportation revenues in 1986 over 1985 is caused by including the cost of purchasing the gas as well as transportation tolls in gas sales revenues, whereas transportation revenues include only the transportation tolls.

Export gas sales volumes in 1986 fell by 1 556 million cubic metres or 30.8% from 1985 while export transportation volumes decreased by 318 million cubic metres or 12.3%. Revenues from export sales decreased by $325.8 million or 39.4% while revenues from export transportation were down $6.1 million or 8.2%. Export sales prices have decreased significantly during 1986 in response to competitive market forces. In addition, in the United States markets currently served by the Company, there is a short-term surplus of natural gas which has reduced the export of Canadian natural gas to those markets.

The second table above sets out changes between 1985 and 1984 for sales and transportation revenues and volumes. In total, the increase in gas sales and transportation revenues in 1985 when compared to 1984 was a result of higher volumes and toll increases effective August 1, 1984 and November 1, 1985. The effect on revenues of increased export volumes was partially offset by lower export gas prices in 1985 compared to 1984.

Revenues
Pipeline
(billions of dollars)

Natural resources revenues represent the revenues, net of royalties, received from the sale of crude oil, natural gas and natural gas liquids. Reflecting the significant decline in world oil and gas prices, the Natural resources segment's revenues after royalties for 1986 fell by 36% to $180.7 million compared to $281.9 million in 1985. Crude oil and natural gas liquids production in 1986 approximated 1985 production while natural gas volumes declined by approximately 7%. In 1985, net revenues had increased by $53.8 million or 23.6% over 1984, principally as a result of higher production in all areas.



Revenues
Natural resources
and other
(millions of dollars)

The most significant component of Costs and Expenses is the Pipeline segment's operating costs. Included therein are cost of gas sold and transmission, operating and general expenses. The decrease in the Pipeline segment's operating costs between 1986 and 1985 of $452.1 million is principally a result of a decrease in cost of gas sold, reflecting the decline in sales volumes mentioned above and reduced gas prices paid to producers. Cost of gas sold increased in 1985 from 1984 as a result of higher sales volumes and higher prices paid to producers in 1985.

The Natural resources and other segment operating costs decreased by $9.3 million in 1986 due principally to the cancellation of the Canadian government's Petroleum and Gas Revenue Tax effective October 1, 1986.

Income from Investments – Pipelines increased by $7.4 million in 1986 compared to 1985 as a result of improved earnings from the Company's two United States pipeline investments, Great Lakes Gas Transmission Company and Northern Border Pipeline Company ("Northern Border"). The decrease in 1985 compared to 1984 was principally a result of lower earnings of Northern Border reflecting, among other things, a decision by Northern Border to improve its competitive position by temporarily reducing transportation tolls through deferral of a portion of its allowed return on equity.

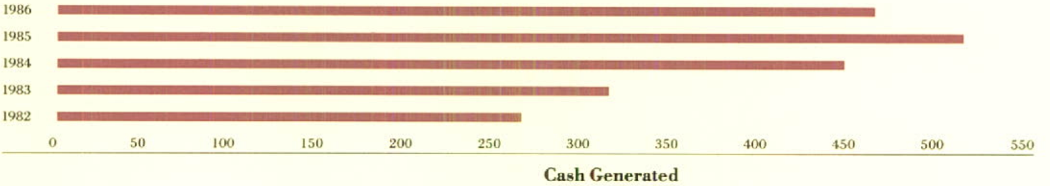
The reductions in income from interest-bearing deposits reflect lower cash balances on deposit and lower short-term interest rates.

Financial charges increased from $357.1 million in 1985 to $394.9 million in 1986, principally as a result of amortizing unrealized foreign exchange losses resulting from the strengthening of the Swiss franc against the Canadian dollar during 1986. As can be seen from the table in Note 18 on page 70, foreign exchange losses with respect to principal amounts of foreign currency denominated debt totalled $33.8 million in 1986 compared to a net gain of $18.1 million in 1985 for a total difference of $51.9 million. The Company has a significant amount of debt denominated in Swiss francs borrowed at an average exchange rate of approximately 59.4 cents per Swiss franc. The Swiss franc has strengthened to a level of approximately 85.6 cents per Swiss franc as at December 31, 1986 from 67.9 cents per Swiss franc at the end of December 1985. In accordance with Canadian generally accepted accounting principles, the Company amortizes these unrealized exchange losses against income over the remaining lives of the respective debt issues. As at December 31, 1986 and based upon the Swiss franc exchange rate at that date, approximately $190 million remains to be amortized. The exchange gain of $18.1 million in 1985 is principally due to the retirement in that year of debt denominated in Dutch guilders.

Income taxes decreased by $40.9 million in 1986, primarily reflecting lower pre-tax earnings in 1986. This reduction in income taxes would have been greater except for the impact of certain United States tax reform measures as set out in Note 9(e) on page 64 which increased income tax expense by $13.4 million. The increase in income taxes of $63.2 million in 1985 was principally due to additional income taxes in the Pipeline segment which are recovered through the tollmaking process.

Liquidity and Capital Resources In 1986, cash generated internally amounted to $460 million and financing activities provided additional funds of $671.6 million. These funds, totalling approximately $1.1 billion, together with a minor reduction of cash on hand, were sufficient to meet capital expenditure requirements for both the Pipeline and Natural resources segments, to retire the Company's non-recourse loans, to reduce long-term debt and to pay dividends on preferred and common shares.

Cash generated internally was $51 million lower than in 1985 due in part to the reduction in income before provisions of $103 million and the requirement to pay approximately $114 million of income taxes previously deferred. These reductions were partially offset by dividends received by the Company in excess of the earnings of certain pipeline investments, which provided additional funds of approximately $32 million in 1986 as compared to 1985. The amortization of previously deferred costs, the majority of which are recovered in Pipeline segment revenues, also provided $106.8 million in additional funds. Changes in other components of cash generated internally made up the balance.

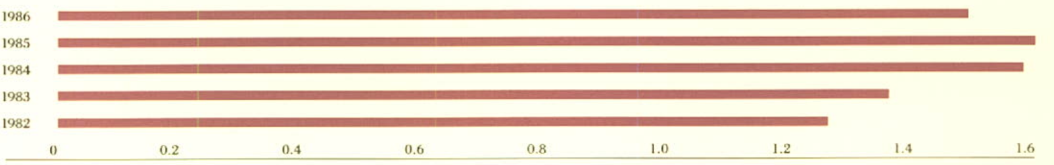


Cash Generated Internally
(millions of dollars)

Investment activities include capital expenditures which were lower overall in 1986 compared to 1985. The lower capital spending level in the Natural resources segment more than offset increased capital expenditures in the Pipeline segment. Included in 1985 investment activities is the repayment by an affiliate of a loan. Activities in 1984 included the acquisition by the Natural resources segment of the assets of Wessely Energy Corporation.

Financing activities in 1986 were $460.1 million higher than in 1985 principally because of a new equity issue, the proceeds of which were used to retire a significant portion of non-recourse loans. Financing activities in 1985 were $498.3 million lower than those of 1984.

Capital expenditures in 1987 are budgeted to be $248.3 million including $107.5 million for the Pipeline segment and $140.8 million for the Natural resources and other segment. In addition, scheduled retirement of long-term debt will require additional funds of $143.9 million. Such cash requirements are expected to be met by way of internally generated funds and external financing.



Plant, Property and Equipment
Natural resources and other
(billions of dollars)

The current oversupply of natural gas in Canada and the United States, together with the deregulation of natural gas prices in Canada and the significant decline in world oil prices, has resulted in intense competition for markets and lower natural gas prices. The Company is competing effectively for market share in this environment and is particularly conscious of the level of its costs in each of its business segments. Although natural gas prices have been deregulated, the Pipeline segment will continue to be regulated by the NEB and, as a regulated enterprise, will continue to have the opportunity to earn a fair and reasonable return on its rate base.

Consolidated Income

Year Ended December 31 *(stated in millions of dollars except per share amounts)*	**1986**	1985	1984
Revenues			
Pipeline	**3,923.9**	4,382.5	4,214.3
Natural resources and other	**221.4**	319.0	258.2
	4,145.3	4,701.5	4,472.5
Costs and Expenses			
Operating			
Pipeline	**3,279.7**	3,731.8	3,597.3
Natural resources and other	**119.4**	128.7	115.8
Depreciation and depletion			
Pipeline	**95.6**	89.1	92.7
Natural resources and other	**100.7**	94.6	80.5
	3,595.4	4,044.2	3,886.3
Income from Operations	**549.9**	657.3	586.2
Income from Investments			
Pipelines *(Note 5)*	**87.6**	80.2	98.7
Interest-bearing deposits	**30.6**	34.1	41.9
	118.2	114.3	140.6
Other Income	**16.0**	18.6	18.4
Income before the Undernoted Items	**684.1**	790.2	745.2
Financial Charges *(Note 18)*	**394.9**	357.1	387.5
Income before Income Taxes	**289.2**	433.1	357.7
Income Taxes *(Note 9)*	**114.1**	155.0	91.8
Income before Provisions	**175.1**	278.1	265.9
Investment and Asset Provisions *(Note 3)*	**114.5**	115.6	18.0
Net Income for the Year	**60.6**	162.5	247.9
Net Income per Common Share *(Note 11)*			
Before provisions	**$1.20**	$2.40	$2.41
After provisions	**$0.16**	$1.21	$2.22

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

The Statements of Consolidated Income summarize revenues and expenses for the last three years.

• **Revenues** represent principally the sale of natural gas from the Pipeline segment. Also included in revenues are the sales from the Natural resources segment net of royalties paid to provincial, state and federal governments as well as others.

• **Costs and Expenses** include the costs of the natural gas sold by the Pipeline segment and the costs of producing the crude oil, natural gas and related products sold by the Natural resources segment. In addition, costs and expenses include the transmission costs incurred in transporting natural gas through the transmission system and operating and general expenses related to the Pipeline segment and other operations of the Company.

• **Income from Investments** includes the Company's proportionate share of income from investments in regulated pipelines and also earnings from interest-bearing deposits.

• **Other Income** includes the Company's miscellaneous income as well as an allowance for funds used during construction of pipeline facilities.

• **Financial Charges** represent the costs of borrowing long-term and short-term funds as well as the related costs of obtaining those funds. Reference should be made to Note 18 on page 70 for further detail.

• **Income Taxes** represent taxes which the Company incurred based upon the earnings of the respective years as explained in more detail in Note 9 on pages 63 and 64.

• **Investment and Asset Provisions** are explained in detail in Note 3 on pages 56 and 57.

CONSOLIDATED CHANGES IN FINANCIAL POSITION

Year Ended December 31 (stated in millions of dollars)	**1986**	1985	1984
Cash Generated Internally			
Income before provisions	**175.1**	278.1	265.9
Depreciation and depletion	**196.3**	183.7	173.2
Deferred income taxes	**(31.8)**	83.1	85.3
Equity income from investments net of dividends received	**19.0**	(13.9)	(25.1)
Amortization of deferred charges and other assets	**81.3**	(25.5)	(57.8)
Funds generated from operations	**439.9**	505.5	441.5
Decrease in operating working capital *(Note 19)*	**20.1**	5.5	1.6
	460.0	511.0	443.1
Investment Activities			
Capital expenditures	**184.4**	217.5	351.8
Pipeline investments (repayments)	**–**	(68.4)	1.2
Deferred charges and other	**40.0**	67.9	26.3
	224.4	217.0	379.3
Reduction of Long-Term Debt and Non-Recourse Loans	**802.3**	383.2	166.0
Dividends Paid	**160.7**	153.1	128.5
Financing Activities			
Long-term debt – new financing	**214.0**	194.7	220.3
Common shares and common share warrants issued	**400.3**	85.4	66.7
Preferred shares issued	**–**	157.1	98.9
Preferred shares redeemed	**–**	(157.0)	–
Increase/(decrease) in notes payable	**57.3**	(68.7)	323.9
	671.6	211.5	709.8
(Decrease)/Increase in Cash and Short-Term Investments	**(55.8)**	(30.8)	479.1
Cash and Short-Term Investments – at beginning of year	**672.1**	702.9	223.8
Cash and Short-Term Investments – at end of year	**616.3**	672.1	702.9

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

The Statements of Consolidated Changes in Financial Position provide a reconciliation of the Company's position with respect to cash and short-term investments for 1986, 1985 and 1984.

This statement links the Statements of Consolidated Income and Consolidated Financial Position. It details the components of cash generated internally, the investment expenditures made by the Company, the amount by which long-term debt and non-recourse loans were reduced, the dividends paid by the Company to its preferred and common shareholders and the financing activities of the Company.

• **Cash Generated Internally** represents cash generated from operations of the Company's business segments adjusted for changes in operating working capital as set out in Note 19 on page 70. It is greater than net income in the respective periods principally due to items included in net income which do not require current cash outlays such as investment and asset provisions, depreciation and depletion and amortization of deferred amounts.

• **Investment Activities** represent the capital outlays which the Company has made during the respective fiscal years.

• **Reduction of Long-Term Debt and Non-Recourse Loans** reflects the repayment during 1986 of all of the non-recourse loans and certain term loans as well as the scheduled reduction of other long-term debt.

• **Dividends Paid** include $125 million paid to common shareholders in 1986. On a per share basis common dividends paid were $1.12 in 1986 and 1985 and $1.00 in 1984.

• **Financing Activities** set out the various external sources of cash that the Company has utilized including issuance of long-term debt, common and preferred shares, as well as short-term borrowings.

• **The Decrease or Increase in Cash and Short-Term Investments** in the respective years is the net result of all of the above.

CONSOLIDATED FINANCIAL POSITION

December 31 (stated in millions of dollars)	**1986**	1985
Assets		
Current Assets		
Cash and short-term investments	**616.3**	672.1
Accounts receivable	**414.3**	626.8
Inventories – Line pack gas and gas stored underground	**73.9**	87.9
– Materials and supplies	**41.3**	37.0
Total current assets	**1,145.8**	1,423.8
Payments on Future Gas Supply *(Note 12)*	**44.4**	81.7
Investments in Pipelines *(Note 5)*	**376.3**	401.7
Plant, Property and Equipment		
Pipeline *(Notes 4 and 6)*	**2,493.7**	2,515.7
Natural resources and other *(Notes 3, 4 and 7)*	**1,494.1**	1,597.2
	3,987.8	4,112.9
Deferred Charges and Other Assets *(Notes 3 and 13)*	**415.0**	302.1
	5,969.3	6,322.2
Liabilities and Shareholders' Equity		
Current Liabilities		
Notes payable *(Note 8)*	**598.0**	540.7
Accounts payable	**339.5**	533.6
Interest accrued	**119.4**	127.4
Dividends payable	**45.9**	38.8
Long-term debt and non-recourse loans due within one year *(Notes 6 and 7)*	**143.9**	168.3
Total current liabilities	**1,246.7**	1,408.8
Deferred Revenues	**53.4**	26.8
Long-Term Debt *(Note 6)*	**2,173.8**	2,215.0
Non-Recourse Loans *(Note 7)*	**–**	398.0
Deferred Income Taxes *(Note 9)*	**393.1**	455.1
Shareholders' Equity		
Preferred shares *(Note 10)*	**444.4**	445.0
Common shares *(Note 11)*	**662.8**	274.1
Contributed surplus	**285.1**	273.3
Retained earnings	**624.5**	731.7
Foreign exchange adjustment *(Note 20)*	**85.5**	94.4
	2,102.3	1,818.5
Commitments and Contingencies *(Note 21)*		
	5,969.3	6,322.2

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

On behalf of the Board:

, Director   , Director

The Statements of Consolidated Financial Position present the Company's assets, liabilities and shareholders' equity at the end of the last two years.

Assets are captioned principally in order of liquidity (the ease of converting the assets into cash).

• **Current Assets** include cash and short-term investments.

• **Payments on Future Gas Supply** represent amounts advanced to producers as explained in Note 12 on page 67.

• **Investments,** as detailed in Note 5 on pages 58, 59 and 60 include the Company's investments in related pipeline systems.

• **Plant, Property and Equipment** of the Pipeline segment is the primary asset upon which that segment earns its regulated return. The Natural resources segment plant, property and equipment is primarily oil and gas properties. Reference should be made to Note 4 on page 57 for more detail.

• **Deferred Charges and Other Assets** represent costs and expenditures set aside in the Company's accounts for amortization to the Statement of Consolidated Income or reclassification to other balance sheet accounts at later dates. Note 13 on page 68 summarizes these amounts.

Liabilities are set out in the order that they are expected to be discharged.

• **Current Liabilities** include notes payable. The Company maintains short-term lines of credit with several banks and has issued commercial paper to finance short-term cash requirements.

• **Long-Term Debt** represents the amounts borrowed by the Company to finance long-term investments. The amount outstanding at the end of any particular period can be affected by new borrowings and repayments as well as exchange rates applicable to foreign currency borrowings.

• **Non-Recourse Loans** were retired by the Company during 1986 mainly from the proceeds of a common share issue.

• **Deferred Revenues** represent payments received by a subsidiary of the Company subject to delivery of certain natural gas volumes in the future. Also included in deferred revenues are funds received by that subsidiary in exchange for the assignment of future net revenues of certain oil and gas properties.

• **Deferred Income Taxes** represent the provision for income taxes payable in the future.

Shareholders' Equity represents the investment that preferred and common shareholders have in the Company and in total represents the sum of total assets less liabilities. Of this amount, preferred shareholders have contributed $444.4 million and the balance of $1,657.9 million is attributable to common shareholders as at December 31, 1986.

Contributed Surplus is presented in a separate financial statement and represents the excess of amounts paid by shareholders of the Company over and above any stated value of the shares sold plus or minus any gains realized on shares reacquired by the Company and the costs of certain past share issues. Also included in Contributed Surplus are the proceeds from the sale of common share warrants described more fully in Note 11 on pages 66 and 67.

Retained Earnings is presented in a separate financial statement and represents the cumulative net income of the Company less dividends on preferred and common shares. Retained Earnings are reinvested in the Company.

Consolidated Contributed Surplus and Retained Earnings

Year Ended December 31 (stated in millions of dollars)	**1986**	1985	1984
Contributed Surplus			
Balance at beginning of year	**273.3**	276.3	275.9
Redemption of preferred and cancellation of common shares (net)	**0.2**	(3.0)	0.4
Common share warrants issued *(Note 11)*	**11.6**	–	–
Balance at end of year	**285.1**	273.3	276.3
Retained Earnings			
Balance at beginning of year	**731.7**	739.3	627.1
Other *(Note 17)*	**–**	(16.5)	–
Net income for the year	**60.6**	162.5	247.9
	792.3	885.3	875.0
Dividends declared			
Preferred	**42.8**	44.6	42.2
Common	**125.0**	109.0	93.5
	167.8	153.6	135.7
Balance at end of year *(Note 16)*	**624.5**	731.7	739.3

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

Auditors' Report

PEAT MARWICK

To the Shareholders of TransCanada PipeLines Limited

We have examined the statement of consolidated financial position of TransCanada PipeLines Limited as at December 31, 1986 and December 31, 1985 and the statements of consolidated income, retained earnings, contributed surplus and changes in financial position for each of the years in the three-year period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements which appear on pages 46, 48, 50 and 52 present fairly the financial position of the Company as at December 31, 1986 and December 31, 1985 and the results of its operations and the changes in its financial position for each of the years in the three-year period ended December 31, 1986 in accordance with generally accepted accounting principles which, except for the prospective application in 1986, with which we concur, of the method adopted by the Canadian Institute of Chartered Accountants for computing the limitation of capitalized costs in accounting for oil and gas operations as explained in Note 3(a), were applied on a consistent basis.

Toronto, Canada
January 27, 1987

Peat, Marwick, Mitchell & Co.
Chartered Accountants

Notes to Consolidated Financial Statements

NOTE 1.
ACCOUNTING POLICIES

The consolidated financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada. These principles also conform in all material respects with International Accounting Standards on an historical cost basis. The significant accounting policies of the Company are summarized below:

Principles of consolidation The consolidated financial statements include the accounts of the Company, its subsidiaries and the proportionate share of the assets, liabilities, revenues and expenses of its oil and gas joint ventures, including the extraction plant at Empress, Alberta.

Effective January 1, 1985, the Company changed on a retroactive basis its method of accounting for its investment in oil and gas joint ventures from the equity method to the proportionate consolidation method. This method more appropriately reflects the increasing significance of the Company's oil and gas operations.

Regulation The Company is subject to the authority of certain regulatory bodies with respect to the determination of tolls and related accounting for the natural gas transmission system (the "Pipeline segment") as further described in Notes 2 and 13. In order to achieve a proper matching of revenues and expenses, the timing of recognition of certain expenses may therefore differ from that otherwise expected under generally accepted accounting principles applicable to non-regulated companies.

Investments The Company uses the equity method of accounting for its pipeline investments. Under this accounting method these investments are carried at cost plus the related equity in earnings reduced by dividends received.

Plant, property and equipment

PIPELINE Plant, property and equipment of the Pipeline segment is carried at cost.

Depreciation is calculated on a straight-line basis using rates approved by the National Energy Board ("NEB"). Effective August 1, 1984, the NEB approved the following depreciation rates – 2.5% for pipelines, 3.5% for compressor stations and other transmission plant and various rates for general plant and equipment. Previously, an approved rate of 2.75% was used to calculate depreciation for pipelines.

NATURAL RESOURCES The Company uses the full cost method of accounting for its oil and gas operations whereby all costs of exploring for and developing oil and gas and related reserves are capitalized in cost centres established on a country-by-country basis. Capitalized costs include all acquisition, exploration and development costs, including interest and other carrying charges of non-producing properties and costs of drilling both productive and non-productive wells. Such costs are generally limited to the value of future net revenues from estimated production of proved reserves at current prices and costs and the costs of unproven properties. Future net revenues are calculated after deducting general and administrative expenses, financing costs and income taxes. Reference should be made to Note 3(a) for the changes in the method of determining the limitation of capitalized costs.

In 1985, the Company reverted to the unit-of-production method to calculate depletion. For the purpose of calculating depletion, natural gas production and reserves (computed on a before royalties basis for all cost centres with the exception of the United States cost centre which is computed after deducting royalties) are converted to equivalent units of crude oil based on the relative energy content of each commodity. Previously, during the period of regulated oil and gas prices in Canada, the Company calculated depletion using the revenue method.

Costs of unusually significant acquisitions of non-producing properties are initially not depleted but are brought into the applicable cost centre for depletion purposes on a straight-line basis over the anticipated period that exploration of those properties will be undertaken.

Interest is capitalized on the costs of acquiring and evaluating unusually significant acquisitions of unproven oil and gas properties and major development projects until such time as development activities have proceeded to the point where proved reserves are capable of being produced or it is determined that there are no economically proved reserves associated with the properties.

NOTE 1.
ACCOUNTING POLICIES (CONTINUED)

Translation of foreign currency Transactions and accounts in a currency other than a domestic currency are translated into the domestic currency using the temporal method. Certain debt payable in foreign currencies is exchanged through swap agreements into other currencies. Such debt is accounted for using exchange rates applicable to the currencies into which they have been swapped. Foreign exchange gains and losses on Pipeline segment related debt are included in income as they are dealt with in the tollmaking process. Other foreign exchange gains and losses are included in income in the current period except for unrealized gains and losses related to non-hedged monetary assets and liabilities with a fixed or ascertainable life extending beyond one year. These unrealized gains and losses are deferred and amortized to income over the remaining life of such assets or liabilities.

The accounts of self-sustaining foreign operations are translated into Canadian dollars using the current rate method. The resulting translation adjustments are reflected in a separate component of shareholders' equity.

Income taxes The Company follows the taxes payable method of accounting for income taxes related to the regulated operations of the Pipeline segment. This method is prescribed by the NEB for tollmaking purposes. Since there is reasonable expectation that all such taxes will be included in future costs of service and recovered in revenues at such time, this method is being followed for accounting purposes. For all other operations the Company follows the deferral method of tax allocation accounting.

Inventories Inventories include line pack gas and gas stored underground which are valued and charged to operations in accordance with the regulatory process. Materials and supplies are valued at actual cost and charged to operations at average cost.

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

NOTE 2.
SEGMENTED AND OTHER INFORMATION

The Company operates principally in three segments of the energy industry:

(i) **Pipeline segment**
The Company owns and operates a natural gas transmission system which extends from Alberta into Quebec. The Pipeline segment purchases, transports and sells natural gas to regional gas distribution and transmission companies in Canada and the United States. In addition, the Pipeline segment transports gas for industrial users who purchase natural gas directly from producers.

Matters such as tolls, construction, operations and accounting in connection with the Pipeline segment are subject to the jurisdiction of certain regulatory bodies. Pipeline tolls are determined by the NEB on a net plant rate base, rate of return and cost of service basis.

(ii) **Marketing segment**
Western Gas Marketing, a subsidiary of the Company, administers the Pipeline segment's existing contracts to buy and sell gas and co-ordinates all TransCanada's natural gas marketing efforts in Canada and the United States. Western Gas Marketing commenced financial operations on November 1, 1986, the date deregulation became effective. Because the contribution of Western Gas Marketing to consolidated operating income since that date is not material, its financial results have not been separately segmented.

(iii) **Natural resources and other segment**
The Company is engaged in exploration, development and production of oil, natural gas and natural gas liquids in western Canada, offshore areas of Canada and in the United States, Indonesia, Australia, New Zealand, Italy, and the United Kingdom (the "Natural resources segment"). Other operations include the extraction of natural gas liquids and ethane from natural gas, the sale of sulphur and the manufacture and sale of thermal carbon black.

NOTE 2.
SEGMENTED
AND OTHER
INFORMATION
(CONTINUED)

The Company's financial data by business segment is as follows:

(a) **Business Segments**

Year Ended December 31 (millions of dollars)	**1986**	1985	1984
Pipeline segment			
Gas sales – domestic	**3,225.8**	3,421.2	3,364.5
– export	**501.1**	826.9	727.1
Gas transportation and other	**197.0**	134.4	122.7
	3,923.9	4,382.5	4,214.3
Costs and expenses			
Operating	**3,279.7**	3,731.8	3,597.3
Depreciation	**95.6**	89.1	92.7
	3,375.3	3,820.9	3,690.0
Pipeline segment operating income	**548.6**	561.6	524.3
Natural resources and other segment			
Oil and natural gas liquids	**126.6**	232.8	192.0
Natural gas	**78.5**	102.2	90.9
Other products	**12.0**	12.7	7.9
Less: Royalties	**(36.4)**	(65.8)	(62.7)
	180.7	281.9	228.1
Other operations	**40.7**	37.1	30.1
	221.4	319.0	258.2
Costs and expenses			
Operating	**119.4**	128.7	115.8
Depletion and depreciation	**100.7**	94.6	80.5
	220.1	223.3	196.3
Natural resources and other segment operating income	**1.3**	95.7	61.9
Income from operations	**549.9**	657.3	586.2
Capital expenditures			
Pipeline	**72.3**	44.2	53.7
Natural resources and other	**112.1**	173.3	298.1
	184.4	217.5	351.8

December 31 (millions of dollars)	**1986**	1985	1984
Business segment assets			
Pipeline	**3,181.0**	3,397.1	3,365.3
Natural resources and other	**1,792.4**	1,851.6	1,767.3
	4,973.4	5,248.7	5,132.6
Investments	**376.3**	401.7	450.6
Other	**619.6**	671.8	708.5
	5,969.3	6,322.2	6,291.7

As at December 31, 1986, over 90% of the Company's assets identifiable with its business segments were located in Canada.

NOTE 2.
SEGMENTED AND OTHER INFORMATION (CONTINUED)

(b) **Principal Customers**

The following table sets forth the Company's revenues generated by the Pipeline segment from natural gas sales under long-term contracts and transportation services to its five principal customers:

Year Ended December 31 (millions of dollars)	**1986**	1985	1984
The Consumers' Gas Company Ltd.	**1,195.0**	1,206.2	1,244.7
Union Gas Limited	**885.7**	958.8	958.3
Gaz Metropolitain, inc.	**482.1**	506.7	463.9
ICG (Ontario) Ltd.	**391.3**	438.9	421.1
Great Lakes Gas Transmission Company	**214.1**	245.2	243.0

NOTE 3.
INVESTMENT AND ASSET PROVISIONS

The following provisions were made in the accounts of the Company:

Year Ended December 31 (millions of dollars)	**1986**	1985	1984	1983 and prior
a) Carrying value of oil and gas properties	**100.6**	43.7	4.6	31.5
b) Carrying value of certain investments and other assets	**13.9**	71.9	13.4	–
Total investment and asset provisions	**114.5**	115.6	18.0	31.5

(a) **Carrying Value of Oil and Gas Properties**

In September 1986, the Canadian Institute of Chartered Accountants issued a guideline entitled Full Cost Accounting in the Oil and Gas Industry ("CICA Guideline"). The Company has adopted the CICA Guideline on a prospective basis.

The Company's Natural resources accounting policies with respect to full cost accounting in effect at the time of the change were in conformity in all material respects with the CICA Guideline, except that the CICA Guideline introduced a new methodology in computing the limitation of capitalized costs ("ceiling test"). Under the new CICA Guideline, future net revenues are not discounted but are calculated after deducting general and administrative expenses, financing costs and income taxes on a global basis. Previously, the Company applied a discounting factor when calculating future net revenues for each individual cost centre in the ceiling test computation.

The adoption of the CICA Guideline along with the significant decline in world energy prices has required the Company to reduce the carrying value of its oil and gas properties at December 31, 1986 by $100.6 million net of related income taxes of $7.8 million. The 1986 provision has been computed based upon prices prevailing at December 31, 1986. Under the previous ceiling test method, an additional provision in 1986 of $61.2 million net of related income taxes would have resulted.

The ceiling test is not intended to provide an estimate of the fair market value of oil and gas properties but is a cost recovery test at a point in time.

Prior to 1985, all costs of exploring for and developing oil and gas and related reserves were capitalized in a single cost centre. In 1985, the Company determined that it was more appropriate to account for these costs on a country-by-country basis with two cost centres in Canada – Western Canada and Frontier. This change in accounting resulted in (i) a provision in 1985 of $20.8 million net of related income taxes of $5.4 million in respect to Frontier properties which effectively eliminated all costs of such properties, and (ii) provisions totalling $59.0 million, net of related income taxes of $28.9 million, in respect to the carrying value of properties in the United States and Indonesia, including a provision of $22.9 million in 1985 and prior period adjustments amounting to $4.6 million for 1984 and $31.5 million for 1983 and prior years.

NOTE 3.
INVESTMENT AND ASSET PROVISIONS (CONTINUED)

(b) Carrying Value of Certain Investments and Other Assets
In 1986, the Company made provisions in its accounts for investments in certain energy related projects and other minor assets. These provisions total $13.9 million net of related income taxes of $14.5 million.

In 1985, the Company made a provision for the carrying value of certain investments and other assets in the amount of $71.9 million net of related income taxes of $13.5 million. This provision related to mining assets, undeveloped oil sands properties and costs of certain deferred or terminated projects. In 1984, the Company made a provision for its investment in the Alaskan Northwest Natural Gas Transportation Company of $13.4 million net of related income taxes of $11.8 million.

NOTE 4.
PLANT, PROPERTY AND EQUIPMENT

December 31 (millions of dollars)	**1986**			1985		
	Cost	**Accumulated Depreciation and Depletion**	**Net**	Cost	Accumulated Depreciation and Depletion	Net
Pipeline						
Gas transmission plant	**3,452.2**	**958.5**	**2,493.7**	3,387.2	871.5	2,515.7
Natural resources and other						
Oil and gas properties	**1,922.2**	**545.0**	**1,377.2**	1,823.2	348.7	1,474.5
Other assets	**144.0**	**27.1**	**116.9**	142.6	19.9	122.7
	2,066.2	**572.1**	**1,494.1**	1,965.8	368.6	1,597.2
	5,518.4	**1,530.6**	**3,987.8**	5,353.0	1,240.1	4,112.9

Oil and gas properties include capitalized administrative costs of $8.2 million in 1986 ($7.6 million – 1985 and $3.3 million – 1984). The Company also capitalized certain interest costs, as disclosed in Note 18.

Costs of oil and gas properties which are currently excluded from the depletion calculation amounted to $42.5 million at December 31, 1986 and $124.0 million at December 31, 1985.

The following table sets forth the ageing of such costs as at December 31, 1986:

Year of Expenditure (millions of dollars)	**Total**	1986	1985	1984	Prior to 1984
Acquisition costs	**32.3**	16.5	2.3	–	13.5
Capitalized interest	**10.2**	2.4	2.1	2.2	3.5
	42.5	18.9	4.4	2.2	17.0

These oil and gas properties are currently under various stages of exploration and development and it is anticipated that approximately 93% of these costs will be included in the depletion calculation in 1987. The remainder of these costs will be either included in the depletion calculation or amortized not later than 1993.

Depletion per dollar of net revenue from production for the years ended December 31, 1986, 1985 and 1984 was $0.4985, $0.3174 and $0.3246 respectively.

NOTE 5.
INVESTMENTS–PIPELINES

The Company's pipeline investments at December 31, 1986, 1985 and 1984 and its share of the earnings from those investments for the years then ended are:

	1986		1985		1984	
(millions of dollars)	**Investment**	**Equity Earnings**	Investment	Equity Earnings	Investment	Equity Earnings
Great Lakes Gas Transmission Company						
Shares	**84.3**	**20.0**	111.9	16.4	89.7	17.0
Loan	**–**	**–**	–	–	66.1	–
Northern Border Pipeline Company	**216.0**	**56.2**	209.5	50.5	192.4	64.2
Foothills Pipe Lines (Sask.) Ltd.	**27.0**	**5.1**	29.9	5.8	34.5	5.7
Trans Québec & Maritimes Pipeline Inc.	**49.0**	**6.3**	50.4	7.5	67.9	11.8
	376.3	**87.6**	401.7	80.2	450.6	98.7

Investments in Northern Border Pipeline Company and Trans Québec & Maritimes Pipeline Inc. are held through partnerships and reflect the Company's proportionate share of income on a pre-tax basis. Dividends received from pipeline investments amounted to $106.0 million in 1986, $66.4 million in 1985 and $73.6 million in 1984. Consolidated retained earnings at December 31, 1986, includes $96.1 million which represents undistributed earnings of investments accounted for by the equity method.

Great Lakes Gas Transmission Company
The Company owns 50% of Great Lakes Gas Transmission Company ("Great Lakes") which operates a pipeline system extending from the Canada/United States border near Emerson, Manitoba through the United States to the vicinity of Sarnia, Ontario. Great Lakes purchases gas from the Company for resale to United States customers and transports gas for the Company to eastern Canada.

The following sets out summarized financial information for Great Lakes:

December 31 (millions of U.S. dollars)	**1986**	1985
Natural gas transmission plant	**290.2**	299.1
Current assets	**73.5**	73.6
Current liabilities	**(65.1)**	(55.5)
Deferred credits	**(85.1)**	(82.2)
Long-term debt	**(88.6)**	(70.4)
Shareholders' equity	**124.9**	164.6

Year Ended December 31 (millions of U.S. dollars)	**1986**	1985	1984
Operating revenues	**282.0**	286.6	294.4
Operating expenses	**(214.6)**	(232.1)	(227.5)
Interest	**(8.8)**	(9.2)	(15.4)
Income taxes	**(28.3)**	(20.1)	(23.9)
Net income	**30.3**	25.2	27.6

NOTE 5.
INVESTMENTS –
PIPELINES
(CONTINUED)

Northern Border Pipeline Company
The Company owns a 30% interest in the Northern Border Pipeline Company, a partnership which owns a natural gas pipeline extending from the Canada/United States border near Monchy, Saskatchewan to a point near Ventura, Iowa.

The following sets out summarized financial information for Northern Border Pipeline Company:

December 31 (millions of U.S. dollars)	**1986**	1985
Natural gas transmission plant	**1,080.2**	1,114.3
Current assets	**55.5**	74.5
Current liabilities	**(65.1)**	(87.7)
Deferred credits	**(199.3)**	(156.1)
Long-term debt	**(552.4)**	(602.8)
Partners' equity	**318.9**	342.2

Year Ended December 31 (millions of U.S. dollars)	**1986**	1985	1984
Operating revenues	**247.7**	243.7	306.8
Operating expenses	**(68.1)**	(60.1)	(84.0)
Interest	**(52.5)**	(68.0)	(88.5)
Income before income taxes	**127.1**	115.6	134.3

Foothills Pipe Lines (Sask.) Ltd.
The Company owns 44% of Foothills Pipe Lines (Sask.) Ltd. ("Foothills (Sask.)") which owns a pipeline extending from the Alberta/Saskatchewan border near Empress, Alberta to the Canada/United States border near Monchy, Saskatchewan which connects with the Northern Border pipeline.

The following sets out summarized financial information for Foothills (Sask.):

December 31 (millions of dollars)	**1986**	1985
Natural gas transmission plant	**302.7**	316.8
Current assets	**12.4**	13.5
Current liabilities	**(7.2)**	(4.1)
Deferred credits	**(59.7)**	(46.8)
Long-term debt	**(178.4)**	(202.4)
Shareholders' equity	**69.8**	77.0

Year Ended December 31 (millions of dollars)	**1986**	1985	1984
Operating revenues	**71.2**	76.7	81.5
Operating expenses	**(24.2)**	(23.9)	(22.6)
Interest expense	**(20.7)**	(24.1)	(31.6)
Income taxes	**(14.8)**	(15.5)	(14.1)
Net income	**11.5**	13.2	13.2

NOTE 5.
INVESTMENTS – PIPELINES (CONTINUED)

Trans Québec & Maritimes Pipeline Inc.
The Company owns 50% of the issued shares of Trans Québec & Maritimes Pipeline Inc. ("TQM"). TQM is the agent of a partnership, in which the Company is an equal partner, formed to operate a natural gas transmission system extending from the vicinity of Montreal to Quebec City, Quebec.

The following sets out summarized financial information for TQM:

December 31 (millions of dollars)	**1986**	1985
Natural gas transmission plant	**427.7**	446.7
Current assets	**13.6**	18.0
Deferred charges	**4.0**	7.4
Current liabilities	**(10.2)**	(16.8)
Bank loans	**(38.3)**	(55.0)
First Mortgage Bonds	**(285.0)**	(285.0)
Partners' equity	**111.8**	115.3

Year Ended December 31 (millions of dollars)	**1986**	1985	1984
Operating revenues	**148.1**	135.9	124.2
Operating expenses	**(95.1)**	(82.5)	(59.4)
Interest	**(41.2)**	(38.7)	(41.2)
Income before income taxes	**11.8**	14.7	23.6

NOTE 6.

LONG-TERM DEBT

Classification*(2)*	Repayment Dates	**1986** **Outstanding December 31 *(2)***	**Average Interest Rate*(3)***	1985 Outstanding December 31 *(2)*	Average Interest Rate*(3)*
UTILITY *(1)*					
First Mortgage Pipe Line Bonds					
Denominated in Canadian dollars	1992 to 1993	**70.9**	**9.1%**	81.8	9.1%
Denominated in United States dollars (1986 U.S. $467.6; 1985 U.S. $503.7)	1987 to 1997	**645.5**	**16.0%**	704.0	15.9%
Denominated in Pounds Sterling (1986 £25.0; 1985 £25.0)	2007	**51.2**	**16.5%**	50.5	16.5%
Debentures (Series A to H, J and K)					
Denominated in Canadian dollars	1990 to 2005	**469.7**	**11.5%**	377.6	11.6%
Notes					
Denominated in United States dollars (1986 U.S. $97.8; 1985 U.S. $271.9)	1992	**135.0**	**16.0%**	380.0	16.5%
Subordinated Debentures					
Denominated in Canadian dollars	1987	**21.3**	**5.9%**	23.4	5.9%
Denominated in United States dollars (1986 U.S. $8.2; 1985 U.S. $8.7)	1987	**11.3**	**5.6%**	12.1	5.6%
		1,404.9		1,629.4	
Less: Exchange differential recoverable through the tollmaking process		**80.4**		136.6	
		1,324.5		1,492.8	
NON-UTILITY					
Debentures (Series I)					
Denominated in Canadian dollars	1993	**100.0**	**11.7%**	100.0	11.7%
Notes					
Denominated in Canadian dollars	1989 and 1994	**96.9**	**12.6%**	76.2	12.6%
Denominated in Swiss francs (1986 SFr. 804.0; 1985 SFr. 750.0) *(4)*	1991 to 1995	**668.1**	**6.3%**	509.0	6.0%
Denominated in Australian dollars (1986 A. $40.0; 1985 A. $40.0) *(5)*	1990	**38.3**	**5.8%**	38.7	8.2%
Term Loans					
Denominated in Canadian dollars *(6)*	1996 and 1999	**55.4**	**8.3%**	29.9	10.1%
Denominated in United States dollars (1986–nil; 1985 U.S. $22.0)	–	–	–	30.8	8.5%
Term Promissory Notes					
Denominated in Canadian dollars	–	–	–	5.0	15.5%
Denominated in United States dollars (1986 U.S. $25.0; 1985 U.S. $40.0)	1987	**34.5**	**17.4%**	55.9	16.7%
		993.2		845.5	
		2,317.7		2,338.3	
Less: Due Within One Year		**143.9**		123.3	
		2,173.8		2,215.0	

(1) Utility long-term debt of the Company finances the Pipeline segment.
(2) Amounts outstanding are stated in millions of Canadian dollars; amounts denominated in other than Canadian dollars are stated in millions.
(3) Weighted average interest rates are stated as at the respective outstanding dates and include, where applicable, effective interest rates arising from swaps.
(4) An amount of 104 million Swiss francs was exchanged through a swap agreement into U.S. $50 million.
(5) The amount denominated in Australian dollars was exchanged through a swap agreement into U.S. $27.7 million. Interest is payable at floating rates approximating the six month London Interbank Offered Rate.
(6) Interest is payable at floating rates approximating Canadian chartered bank prime rates.

NOTE 6.
LONG-TERM DEBT
(CONTINUED)

First Mortgage Pipe Line Bonds
The Deed of Trust and Mortgage securing the Company's first mortgage pipe line bonds provides for a first charge on all real and immovable property and rights of the Company and on substantially all of the Company's Pipeline segment's gas transportation, gas purchase, gas sales and gas product sales contracts and also provides for a first floating charge on all remaining assets. All series of bonds, with the exception of the series denominated in pounds sterling, are subject to mandatory sinking fund provisions which require the Company to retire prescribed amounts of each series annually prior to maturity.

Debentures
In 1986, the Company issued $124.8 million of Series K debentures. The proceeds of the issue were used to finance, in part, an early redemption of notes denominated in United States dollars.

The Series A to H debentures are subject to mandatory sinking fund provisions. The terms of the Series A to G sinking fund debentures also provide for purchase funds which require the Company to purchase debentures in the market, if available at prices, including costs of purchase, that do not exceed the principal amount plus accrued interest to the date of purchase. The Series I, J and K debentures rank equally with the sinking fund debentures but are not subject to sinking or purchase funds.

Notes, Term Loans and Term Promissory Notes
The notes payable, the term loans and the term promissory notes rank equally with the debentures and prior to the subordinated debentures.

The notes denominated in Canadian dollars were issued with warrants exercisable into $75 million of additional notes. The warrants entitle the warrant holder to subscribe on or before December 6, 1989 for additional notes bearing interest at 12⅝% and maturing in 1994. As at December 31, 1986, 21,873 warrants have been exercised, resulting in the issuance of $21.9 million principal amount of notes due 1994.

In addition to purchase fund requirements which are applicable in certain circumstances, mandatory retirements of all long-term debt of the Company, as a result of maturities and sinking fund obligations, approximate: 1987–$143.9 million; 1988–$104.1 million; 1989–$183.9 million; 1990–$136.7 million; and 1991–$304.0 million.

NOTE 7.
NON-RECOURSE
LOANS

The non-recourse loans at December 31, 1985 were production loans in the amount of $398.0 million (including U.S. $236.5 million) and were secured by fixed and floating charges on the Company's interest in certain oil and gas properties held through a partnership. The loans bore interest at rates approximating the prime rate quoted by Canadian chartered banks with bankers' acceptance and London Interbank Offered Rate options, having an average rate of 10.27% at December 31, 1985.

Net proceeds from the Company's July 1986 issue of common shares, as discussed more fully in Note 11, were used to repay a portion of non-recourse loans outstanding at that time. In December 1986, the remainder of these non-recourse loans were repaid from the proceeds of short-term borrowings.

NOTE 8.
NOTES PAYABLE

December 31 (millions of dollars)	**1986**	1985
Bank loans	**267.8**	236.0
Commercial paper	**330.2**	304.7
	598.0	540.7

The weighted average cost of bank loans and commercial paper was: 1986–7.82% and 8.54% respectively; and 1985–9.15% and 9.26% respectively. The 7.82% and 9.15% rates for 1986 and 1985 respectively are an average of United States dollar and Canadian dollar bank borrowing rates.

NOTE 9.
INCOME TAXES

(a) The geographic components of income before income taxes are summarized below:

Year Ended December 31 (millions of dollars)	**1986**	1985	1984
Canada	**199.2**	263.4	188.7
Foreign	**90.0**	169.7	169.0
	289.2	433.1	357.7

(b) The provision for income taxes is summarized as follows:

Year Ended December 31 (millions of dollars)	**1986**	1985	1984
Current			
Canada	**137.2**	62.6	4.6
Foreign	**8.7**	9.3	1.9
	145.9	71.9	6.5
Deferred			
Canada	**(44.8)**	67.1	54.4
Foreign	**13.0**	16.0	30.9
	(31.8)	83.1	85.3
Total	**114.1**	155.0	91.8

(c) Deferred income taxes result from timing differences in the recognition of revenue and expense for tax and financial statement purposes. The sources of these differences and their effect on income taxes are as follows:

Year Ended December 31 (millions of dollars)	**1986**	1985	1984
Capital cost allowance deducted in excess of depreciation	**5.8**	22.9	27.3
Exploration and development expenditures deducted in excess of depreciation and depletion	**0.5**	18.5	8.6
Capitalized interest	**1.1**	5.8	13.9
Utilization/(benefit) of losses	**1.1**	(13.1)	–
Amortization of deferred amounts	**(39.6)**	37.4	37.2
Other	**(0.7)**	11.6	(1.7)
	(31.8)	83.1	85.3

NOTE 9.
INCOME TAXES
(CONTINUED)

(d) Total income tax expense differs from the amount computed by applying the basic Canadian federal income tax rate to income before income taxes. The reasons for these differences are as follows:

Year Ended December 31 (millions of dollars)	**1986**	1985	1984
Income before income taxes	**289.2**	433.1	357.7
Less:			
Canadian pipeline income not subject to tax currently	**(35.7)**	(44.5)	(64.6)
Equity in after tax net income of non-partnership investments	**(31.4)**	(29.7)	(34.5)
	222.1	358.9	258.6
Federal statutory tax rate	**47.8%**	46.9%	46.0%
Expected income tax expense	**106.2**	168.3	119.0
Effect of United States tax reform	**13.4**	–	–
Non-deductible royalties and payments to governments net of allowances	**5.2**	13.5	12.2
Non-deductible depreciation and depletion	**7.9**	10.2	7.5
Net difference between the federal statutory tax rate and rates of provincial, state and foreign authorities	**(14.3)**	(39.2)	(35.4)
Other	**(4.3)**	2.2	(11.5)
Actual income tax expense	**114.1**	155.0	91.8

(e) In October 1986, the United States adopted certain tax reform measures, the most significant being the reduction of the basic Federal corporate tax rate from 46% to 34%. This rate reduction is to be effective July 1, 1987. The effect of this is to reduce recorded deferred tax benefits arising from United States operations by $13.4 million.

(f) The Company follows the taxes payable method of accounting for those income taxes related to the regulated operations of the Pipeline segment. Had the deferral method of tax allocation accounting been prescribed by the NEB for this segment from the date of commencement of operations, additional deferred income taxes in the amount of $367 million would have been recorded and recovered in tolls to date through the tollmaking process.

NOTE 10.
PREFERRED
SHARES

The authorized number of preferred shares issuable in series is unlimited. Details of the Company's cumulative redeemable first preferred shares, all of which are without par value, are:

Authorized and Outstanding as at December 31	**1986**		1985		1984	
	Shares	**Amount***(1)*	Shares	Amount*(1)*	Shares	Amount*(1)*
First Preferred Shares						
Cumulative redeemable						
$2.80 *(2)*	**587,671**	**29.4**	600,377	30.0	618,251	30.9
Cumulative redeemable retractable						
$4.50 Series B *(3)*	–	–	–	–	940,840	47.0
Series D	–	–	–	–	2,200,000	110.0
Series E	**1,500,000**	**75.0**	1,500,000	75.0	1,500,000	75.0
Series F	**1,600,000**	**80.0**	1,600,000	80.0	1,600,000	80.0
Series H	**1,000,000**	**50.0**	1,000,000	50.0	–	–
Series I	**2,200,000**	**110.0**	2,200,000	110.0	–	–
Cumulative redeemable convertible						
Series G	**1,000,000**	**100.0**	1,000,000	100.0	1,000,000	100.0
		444.4		445.0		442.9

(1) Stated in millions of dollars.
(2) During 1986, 1985 and 1984, 12,706; 17,874; and 21,125 shares respectively were purchased by the Company for cancellation.
(3) During 1984, 800 shares were purchased by the Company for cancellation.

NOTE 10.
PREFERRED SHARES
(CONTINUED)

Additional information pertaining to the Company's preferred shares outstanding as at December 31, 1986 is as follows:

Preferred Share Issue	Stated Value Per Share	Dividend Rate Per Share	Redemption Premium Per Share	Retraction Date *(1)*	Annual Purchase Fund Requirement *(2)*
$2.80 First Preferred Shares	$ 50.00	$2.80	$0.50	Not applicable	2% of aggregate stated value of shares outstanding on previous December 31
Series E	$ 50.00	$5.16	reducing from $3.10 to nil over periods to 1989	November 1, 1989	3% of aggregate stated capital amount outstanding on December 31, 1989
Series F	$ 50.00	$7.18	$2.00 from May 1, 1987 to April 30, 1988; nil thereafter	May 1, 1988	3% of aggregate stated capital amount outstanding on May 2, 1984
Series G *(3)*	$100.00	$9.00	not redeemable prior to June 1, 1989; nil thereafter	Not applicable	None
Series H	$ 50.00	$4.35	not redeemable prior to August 1, 1990; nil thereafter	August 1, 1990	3% of aggregate stated capital amount outstanding on August 2, 1990
Series I	$ 50.00	$3.90	not redeemable prior to November 1, 1990; nil thereafter	November 1, 1990	3% of aggregate stated capital amount outstanding on November 2, 1990

(1) The retractable first preferred shares have a retraction feature which requires the Company, subject to certain conditions, to invite tenders for the purchase of all such shares on the specified dates at the stated value plus accrued and unpaid dividends. The Company may increase the dividend rate on such shares effective on each retraction date.
(2) The Company will be required to set aside on its books in purchase fund accounts up to a maximum of $3.0 million in each of the years 1987 to 1989 and $10.0 million in 1990. The operation of such accounts requires that shares may only be purchased at prices not exceeding $50 plus costs of purchase.
(3) Dividends are payable at a fixed rate of $9.00 per share per annum until May 31, 1989 and thereafter the rate fluctuates based on a formula measured against the prime rate of a Canadian chartered bank. These preferred shares may at any time after May 31, 1989, subject to certain provisions, be redeemed in whole or in part by the Company on payment of $100 per share. Holders have the right at any time after May 31, 1990, subject to certain limitations, to convert any or all of the Series G shares into common shares on the basis of four common shares for each preferred share, which conversion basis will be adjusted in specified circumstances.

In March 1985, the Company issued $50 million of Cumulative Redeemable Retractable First Preferred Shares, Series H. The proceeds were used to finance the redemption of all the outstanding Cumulative Redeemable Retractable $4.50 First Preferred Shares, Series B.

In November 1985, the Company issued $110 million of Cumulative Redeemable Retractable First Preferred Shares, Series I. The proceeds of this issue were used to finance the redemption of all the outstanding Cumulative Redeemable Retractable First Preferred Shares, Series D.

NOTE 11.
COMMON SHARES

The Company is authorized to issue an unlimited number of common shares of no par value. Details of the Company's common shares are:

	Number of Shares	Amount
		(millions of dollars)
Outstanding–January 1, 1984	90,919,800	124.6
Issued for cash or cash equivalent		
Under the dividend reinvestment and share purchase plan	3,766,357	58.0
Under the stock dividend and share purchase plan	72,922	1.1
Under employee stock purchase plans	473,250	7.6
Outstanding–December 31, 1984	95,232,329	191.3
Issued for cash or cash equivalent		
Under the dividend reinvestment and share purchase plan	3,424,790	75.9
Under the stock dividend and share purchase plan	81,061	1.8
Under employee stock purchase plans	385,000	7.7
Cancellation of common shares	(220,083)	(2.6)
Outstanding–December 31, 1985	98,903,097	274.1
Issued for cash or cash equivalent		
Under the dividend reinvestment and share purchase plan	**5,127,717**	**84.0**
Under the stock dividend and share purchase plan	**72,131**	**1.2**
Under employee stock purchase plans	**511,200**	**7.6**
Under public offering and concurrent sale to BCE	**18,604,650**	**296.6**
Cancellation of common shares	**(46,261)**	**(0.7)**
Outstanding–December 31, 1986	**123,172,534**	**662.8**

Equity Issue

On July 15, 1986, the Company completed a Canadian public offering of 9,632,372 units, each of which consisted of one common share and one-half of a common share purchase warrant, at a price of $16.75 per unit. The Company concurrently sold 8,972,278 units to Bell Canada Enterprises Inc. ("BCE") at the same price, enabling BCE to retain its pro rata ownership in the Company. Gross proceeds from the public offering and sale to BCE were $311.6 million. After tax expenses related to the issue aggregated $3.4 million. Net proceeds were used to repay a portion of non-recourse loans.

As at December 31, 1986, 9,302,325 whole common share purchase warrants were outstanding. Each whole warrant entitles the holder to buy one common share at $19.25 on or before July 13, 1989. The proceeds from the sale of the warrants of $11.6 million were credited to Contributed Surplus.

NOTE 11.
COMMON SHARES
(CONTINUED)

Net Income per Common Share

Net income per common share is calculated using the weighted average number of common shares outstanding during the respective periods and after provision for dividends on preferred shares, which amounted to $42.8 million in 1986, $44.8 million in 1985 and $41.5 million in 1984. The calculation of net income per common share on a fully diluted basis assumes conversion of all securities and exercise of all common share purchase warrants if such action would result in dilution of earnings per share. In 1986, 1985 and 1984, the effect of potential dilution was immaterial.

Employee Stock Purchase Plan

The Company has a Key Employee Stock Incentive Plan ("KESIP") under which the Company provides interest-free loans through a trustee to certain key employees, some of whom are also directors, to purchase common shares of the Company. These loans are repayable within ten years. The outstanding balance of these loans totalled $39.5 million and $33.7 million at December 31, 1986 and 1985 respectively. During 1986 and 1985, 46,020 and 220,000 shares issued under the KESIP were purchased by the Company for cancellation. The excess of the purchase price over the original issue price has been charged to Contributed Surplus.

Common Shares Reserved

At December 31, 1986, 517,350 common shares were reserved for issuance under the KESIP, 4,000,000 common shares were reserved for issuance upon conversion of the Cumulative Redeemable Convertible First Preferred Shares Series G and 9,302,325 common shares were reserved for the exercise of common share purchase warrants.

NOTE 12.
PAYMENTS ON
FUTURE GAS
SUPPLY

The majority of the Company's gas purchase contracts include provisions which require payments by the Company when it is unable to nominate for delivery specified minimum annual quantities of gas. As the contracted supply has exceeded the demand in recent years, the Company has outstanding direct payments ("take-or-pay payments") to producers totalling $44.4 million as at December 31, 1986 ($81.7 as at December 31, 1985). Costs associated with financing such payments up to October 31, 1986 were included in the Company's Alberta Cost of Service. Costs subsequent to October 31, 1986 are being recovered by the Company through producers' agreements or pursuant to regulations pertaining to the Alberta Take-or-Pay Costs Sharing Act. Reference should be made to Note 21(a) for other take-or-pay financing arrangements.

NOTE 13.
DEFERRED CHARGES AND OTHER ASSETS

December 31 (millions of dollars)	**1986**	1985
Deferred Amounts		
Subject to regulation	**177.0**	159.6
Not subject to regulation		
Unamortized foreign exchange losses	**190.3**	89.2
Other deferred amounts	**(2.6)**	(3.0)
	364.7	245.8
Other Assets		
Pipeline development projects	**6.2**	24.6
Mining investment	**23.0**	17.8
Other	**21.1**	13.9
	50.3	56.3
	415.0	302.1

In July 1986, the Company filed an application with the NEB in which it seeks to recover in new tolls to be effective from January 1, 1987 increased costs incurred from August 1, 1986. The NEB has directed the Company to continue to charge the tolls which had been in effect prior to August 1, 1986 as interim tolls until new tolls from the application come into effect. The hearing of this application has not been completed. Included above in deferred amounts subject to regulation is approximately $31 million which represents costs incurred in the period August 1 to December 31, 1986 in excess of amounts recovered in the interim tolls. In the current application the Company is seeking the NEB's approval to recover this revenue deficiency in tolls after January 1, 1987. The calculation of the revenue deficiency includes a return of 14½% on a deemed common equity of 30% being the return utilized by the NEB in the Company's most recent tolls decision.

The remainder of deferred amounts subject to regulation are amortized and recovered in future periods through the tollmaking process.

Reference should be made to Note 3(b) with respect to provisions for carrying value of certain investments and other assets.

NOTE 14.
PENSION PLANS

The Company has a non-contributory pension plan which covers all Canadian employees who have completed one year of service. This plan provides a defined benefit pension based on length of service and total career earnings.

Pension expense for the years ended 1986, 1985 and 1984 was $6.6 million, $5.3 million and $5.6 million respectively.

Pension costs are actuarially computed using the attained age normal method. Since the Company has no unfunded past service liability in respect of accrued benefits, the Company's annual contributions represent the current service cost.

In addition, the Company has a Supplemental Retirement Plan ("SRP") which provides a supplemental pension benefit to executive officers of the Company upon retirement. Any difference between pension plan benefits and supplemental benefits calculated under the SRP is paid by the Company.

NOTE 15.
RELATED PARTY TRANSACTIONS

Sales revenue from and payments by the Company for gas transportation services to each of Great Lakes and TQM, affiliates of the Company, were as follows:

Year Ended December 31 (millions of dollars)	**1986**	1985	1984
Gas Sales			
Great Lakes	**214.1**	245.2	243.0
TQM	**69.0**	62.6	37.6
Charges for Gas Transportation Services			
Great Lakes	**195.5**	144.4	145.2
TQM	**81.8**	86.9	86.6

The recovery in the Company's regulated cost of service of charges by Great Lakes and TQM for gas transportation services is subject to the NEB's tollmaking process.

The Company also has contracts for the purchase of natural gas to which one of its subsidiaries is an indirect party. As the Company does not purchase the natural gas directly from that subsidiary, neither the liability nor the total payments in any calendar year in respect to such purchase can be quantified.

Reference should be made to Note 11 regarding loan transactions between the Company and certain of its employees for the purchase of common shares.

As at December 31, 1986, BCE held approximately 48.5% of the Company's outstanding common shares and is a participant in the Company's Dividend Reinvestment and Share Purchase Plan. Reference should be made to Note 11 with respect to common shares and common share purchase warrants sold to BCE during 1986.

NOTE 16.
RESTRICTIONS ON DIVIDENDS

Declaration of dividends on both preferred and common shares is restricted under certain preferred share provisions and under several debt instruments. At December 31, 1986, under the most restrictive provisions, approximately $440 million was available for the payment of dividends on common shares.

NOTE 17.
RETAINED EARNINGS ADJUSTMENT

For tollmaking purposes an allowance for unaccounted for gas is included in the Company's cost of service. In its 1985 Tolls Decision the NEB established the allowance based on the Company's historical experience using a three-year average. The Company is matching, with retroactive effect from August 1, 1985, the tollmaking process in its accounts for unaccounted for gas, and accordingly, all unaccounted for gas gains or losses are being deferred and amortized over three years. The retroactive application in the Company's accounts of this matching of the tollmaking process resulted in a $16.5 million reduction of retained earnings in 1985.

NOTE 18.
FINANCIAL CHARGES

Year Ended December 31 (millions of dollars)	1986	1985	1984
Interest – long-term debt	**309.3**	307.7	309.5
– non-recourse loans	**32.2**	48.3	65.4
	341.5	356.0	374.9
Less: Interest capitalized on oil and gas properties	**(2.4)**	(12.2)	(26.6)
	339.1	343.8	348.3
Foreign exchange losses/(gains)	**33.8**	(18.1)	(7.3)
Short-term interest and other financial charges (net)	**22.0**	31.4	46.5
	394.9	357.1	387.5

NOTE 19.
CHANGES IN OPERATING WORKING CAPITAL

Year Ended December 31 (millions of dollars)	1986	1985	1984
Accounts receivable	**212.5**	(23.0)	(5.6)
Inventories	**9.7**	19.0	(19.2)
Accounts payable	**(194.1)**	3.2	25.5
Interest accrued	**(8.0)**	6.3	0.9
Decrease	**20.1**	5.5	1.6

NOTE 20.
FOREIGN EXCHANGE ADJUSTMENT

December 31 (millions of dollars)	1986	1985
Balance at beginning of year	**94.4**	61.2
Translation adjustments during the year	**(8.9)**	33.2
Balance at end of year	**85.5**	94.4

NOTE 21. COMMITMENTS AND CONTINGENCIES

Legal Proceedings
By a judgment dated July 12, 1985, the Saskatchewan Court of Queen's Bench dismissed a claim brought by Saskatchewan Power Corporation ("Sask. Power") against the Company. On August 7, 1985, Sask. Power filed a notice of appeal.

The claim arises from alleged overpayments made under protest for gas sold to Sask. Power by the Company, and is in the amount of $59.2 million plus accrued interest. Counsel to the Company is of the opinion that the Company should be successful in upholding the trial judgment.

Contractual Guarantees
(a) Gas Supply – During 1982 and 1983, the Company concluded arrangements (referred to as the "Topgas Programs") with syndicates of banks and substantially all of its producers to finance its take-or-pay payments incurred up to and including the contract year ended October 31, 1983. Pursuant to the Topgas Programs, Alberta corporations controlled by the banking syndicates advanced approximately $2.7 billion to these producers in respect of these take-or-pay payments. Pursuant to contractual arrangements, recovery of the advances commenced in 1984 and is being effected in instalments by the nomination for delivery of prepaid gas. Scheduled recovery of all the prepaid gas will be completed not later than 1994. As at December 31, 1986, approximately $700 million of these advances had been repaid. Interest costs associated with the advances up to October 31, 1986 were included in the Company's Alberta Cost of Service. Interest costs subsequent to October 31, 1986 are being recovered by the Company through producers' agreements or pursuant to regulations pertaining to the Alberta Take-or-Pay Costs Sharing Act.

Under the terms of the October 1985 Agreement on Natural Gas Markets and Prices between the governments of Canada and the producing provinces, the price of natural gas ceased to be regulated effective November 1, 1986, and will be determined by negotiation between buyers and sellers. One of the underlying principles of the agreement is that direct sellers and buyers of natural gas should be allowed appropriate access to the Company's pipeline system. The Alberta Take-or-Pay Costs Sharing Act provides for the sharing of take-or-pay interest costs by other users of the Company's pipeline system where contracted transportation services were entered into after October 31, 1985 and further provides for a mechanism by which the interest costs related to both the advances associated with the Topgas Programs and the Company's take-or-pay payments continue to be allocated to the producers from which the Company purchases gas.

Under the agreements with the banking syndicates, the Company will indemnify the banking syndicates up to a combined maximum of $360 million for any losses arising due to the inability or failure of a producer to deliver gas covered by this arrangement. The Company will also indemnify the banking syndicates for any losses suffered as a result of a breach by the Company of its obligations or by reason of the failure to recover their interest costs from any other sources.

(b) Financing of Northern Border Pipeline Company – The debt financing of the Northern Border pipeline was provided by a syndicate of banks in a total amount of U.S. $874 million. As at December 31, 1986, U.S. $291 million has been repaid.

Under the terms of this debt financing the Company may be required to make available to the Northern Border partnership funds sufficient to enable the partnership to fully amortize the outstanding balance at the final maturity date in 1996. If the Company were required to make any payment pursuant to the foregoing it would have recourse against the other partners.

SUPPLEMENTARY DATA: OIL AND GAS PRODUCING ACTIVITIES (UNAUDITED)

The following financial information presents additional disclosure related to oil and gas producing activities. The Company's interests in synthetic oil projects are not reflected in this information.

(i) Capitalized costs

December 31 (millions of dollars)	**1986**	1985
Oil and gas properties		
Proved	**1,770.4**	1,561.2
Unproven	**151.8**	262.0
	1,922.2	1,823.2
Less: Accumulated depletion and depreciation	**(545.0)**	(348.7)
Net capitalized costs	**1,377.2**	1,474.5

(ii) Costs incurred

	Acquisition				
Year Ended December 31 (millions of dollars)	Proved	Unproven	Exploration	Development	Total
1986					
Canada	–	**2.3**	**18.4**	**20.9**	**41.6**
United States	**3.3**	**13.5**	**6.0**	**12.7**	**35.5**
Indonesia	–	–	**11.6**	**4.6**	**16.2**
Other Foreign	–	**0.9**	**16.5**	**0.8**	**18.2**
Total	**3.3**	**16.7**	**52.5**	**39.0**	**111.5**
1985					
Canada	–	10.2	39.0	16.9	66.1
United States	10.5	19.7	25.9	15.0	71.1
Indonesia	–	–	13.3	0.8	14.1
Other Foreign	0.5	1.3	10.5	2.2	14.5
Total	11.0	31.2	88.7	34.9	165.8
1984					
Canada	–	–	27.6	32.9	60.5
United States	146.8	10.3	22.1	18.0	197.2
Indonesia	–	–	5.5	17.5	23.0
Other Foreign	–	–	8.0	0.3	8.3
Total	146.8	10.3	63.2	68.7	289.0

SUPPLEMENTARY DATA: OIL AND GAS PRODUCING ACTIVITIES (UNAUDITED) (CONTINUED)

(iii) **Oil and gas reserves data**

The Company's proved developed and undeveloped oil and gas reserves data for the years 1986, 1985 and 1984 were determined by the Company, Dome Petroleum Limited and others.

Oil (including natural gas liquids) is measured in thousands of barrels. Gas is measured in billions of cubic feet.

	Canada		United States		Indonesia and Other Foreign		Total	
	Oil	Gas	Oil	Gas	Oil	Gas	Oil	Gas
Proved developed and undeveloped reserves:								
January 1, 1984	62,700	889.8	1,232	5.7	4,856	–	68,788	895.5
Revisions of previous estimates	6,263	21.2	(609)	(2.4)	13	–	5,667	18.8
Purchases of minerals in place	–	–	2,104	70.5	–	–	2,104	70.5
Extensions and discoveries	2,714	23.0	1,127	14.8	1,155	–	4,996	37.8
Production	(4,698)	(28.1)	(317)	(2.0)	(729)	–	(5,744)	(30.1)
Sales of minerals in place	(18)	(9.3)	–	–	–	–	(18)	(9.3)
December 31, 1984	66,961	896.6	3,537	86.6	5,295	–	75,793	983.2
Revisions of previous estimates	927	(29.0)	(98)	(17.6)	209	–	1,038	(46.6)
Purchases of minerals in place	–	–	1,622	2.0	21	–	1,643	2.0
Extensions and discoveries	3,206	21.5	1,797	14.9	1,386	–	6,389	36.4
Production	(5,014)	(30.9)	(632)	(4.4)	(1,296)	–	(6,942)	(35.3)
Sales of minerals in place	–	–	(55)	(0.4)	–	–	(55)	(0.4)
December 31, 1985	66,080	858.2	6,171	81.1	5,615	–	77,866	939.3
Revisions of previous estimates	(723)	(41.7)	(2,261)	(20.8)	275	–	(2,709)	(62.5)
Purchases of minerals in place	–	–	18	5.1	–	–	18	5.1
Extensions and discoveries	2,357	33.5	475	7.5	3,131	–	5,963	41.0
Production	(5,000)	(30.4)	(578)	(4.3)	(1,129)	–	(6,707)	(34.7)
Sales of minerals in place	–	(0.2)	(207)	(3.3)	(276)	–	(483)	(3.5)
December 31, 1986	**62,714**	**819.4**	**3,618**	**65.3**	**7,616**	**–**	**73,948**	**884.7**
Proved developed reserves:								
January 1, 1984	50,535	595.3	898	5.5	1,468	–	52,901	600.8
December 31, 1984	56,528	641.7	2,214	35.7	3,615	–	62,357	677.4
December 31, 1985	54,871	599.2	3,897	40.2	3,151	–	61,919	639.4
December 31, 1986	**51,528**	**538.7**	**3,152**	**50.4**	**4,877**	**–**	**59,557**	**589.1**

There have been no major discoveries since December 31, 1986 that would cause a significant change from the proved reserves reported. Reserve quantities do not reflect any adjustments for changes in the price of oil and gas since December 31, 1986.

Proved reserves in Canada are determined by the deduction of freehold and overriding royalties but before the deduction of provincial royalties. Proved reserves in the United States are net of all royalties. Proved reserves in Indonesia and other foreign jurisdictions are attributable to the Company's gross working interest before host government takes.

SUPPLEMENTARY INFORMATION: QUARTERLY CONSOLIDATED FINANCIAL DATA (UNAUDITED)

(a) **Selected quarterly financial data**

The following sets forth selected quarterly financial data for the four quarters of 1986 and 1985 in millions of dollars except for per share amounts:

Three Months Ended	Mar. 31	June 30	Sept. 30	Dec. 31
1986				
Revenues	**1,287.9**	**993.5**	**864.8**	**999.1**
Income from operations	**152.4**	**132.2**	**132.8**	**132.5**
Net income/(loss)				
Before investment and asset provisions	**51.8**	**41.4**	**42.9**	**39.0**
After provisions	**51.8**	**41.4**	**42.9**	**(75.5)**
Net income/(loss) applicable to common shares				
Before investment and asset provisions	**41.1**	**30.7**	**32.2**	**28.3**
After provisions	**41.1**	**30.7**	**32.2**	**(86.2)**
Per share data				
Net income/(loss)				
Before investment and asset provisions	**$0.41**	**$0.31**	**$0.26**	**$0.22**
After provisions	**$0.41**	**$0.31**	**$0.26**	**($0.82)**
1985				
Revenues	1,267.5	1,138.4	1,049.1	1,246.5
Income from operations	171.5	160.2	157.1	168.5
Net income/(loss)				
Before investment and asset provisions	73.6	71.0	64.4	69.1
After provisions	73.6	71.0	64.4	(46.5)
Net income/(loss) applicable to common shares				
Before investment and asset provisions	62.3	59.7	53.1	58.2
After provisions	62.3	59.7	53.1	(57.4)
Per share data				
Net income/(loss)				
Before investment and asset provisions	$0.65	$0.62	$0.54	$0.59
After provisions	$0.65	$0.62	$0.54	($0.60)

Reference should be made to Note 3 of the Notes to the Consolidated Financial Statements with respect to investment and asset provisions.

(b) **Price range of common shares**

The Company's common shares are listed on the Vancouver, Alberta, Winnipeg, Toronto, Montreal and New York stock exchanges. The Toronto Stock Exchange is the principal market on which the Company's common shares are traded.

The following table sets forth the quarterly high and low sales prices of the Company's common shares as reported by The Toronto Stock Exchange and New York Stock Exchange respectively:

	Toronto Stock Exchange		**New York** Stock Exchange *(1)*	
	High	Low	High	Low
	(Cdn.$)		(U.S.$)	
1985				
First Quarter	$24.75	$21.00	$ –	$ –
Second Quarter	29.00	24.00	21.13	18.88
Third Quarter	28.00	24.00	20.75	17.63
Fourth Quarter	25.88	20.75	18.88	15.00
1986				
First Quarter	**$21.75**	**$17.00**	**$15.50**	**$12.00**
Second Quarter	**20.38**	**16.00**	**14.63**	**11.50**
Third Quarter	**18.13**	**15.50**	**13.13**	**11.25**
Fourth Quarter	**17.63**	**15.63**	**12.63**	**11.25**

(1) The Company's common shares commenced trading on the New York Stock Exchange on May 30, 1985.

INVESTMENT INFORMATION FOR FOREIGN INVESTORS

In Canada there are no restrictions on the export or import of capital that would affect the Company's remittance of dividends, interest or other payments to its non-resident security holders.

Dividends, including stock dividends, paid by the Company to United States shareholders and shareholders in other countries where Canadian tax treaties apply are generally subject to a 15% Canadian non-resident withholding tax. Interest payable on the Company's debt securities held by non-residents may be subject to Canadian withholding tax depending upon the terms and provisions of such securities.

Under the terms of the Company's Dividend Reinvestment and Share Purchase Plan and Stock Dividend and Share Purchase Plan, common shareholders resident in the United States, its territories or possessions are eligible to elect to receive stock dividends but are not eligible to reinvest dividends or make optional cash payments. Common shareholders outside of Canada and the United States may participate in the Dividend Reinvestment and Share Purchase Plan if permitted by law in the jurisdiction where they reside.

Five-Year Financial and Operating Highlights

Financial	1986	1985	1984	1983	1982
(millions of dollars except where indicated)					
Revenues					
Pipeline	**$3,923.9**	$4,382.5	$4,214.3	$3,459.7	$3,453.9
Natural resources and other	**$ 221.4**	$ 319.0	$ 258.2	$ 174.5	$ 153.0
	$4,145.3	$4,701.5	$4,472.5	$3,634.2	$3,606.9
Income from Operations	**$ 549.9**	$ 657.3	$ 586.2	$ 528.3	$ 552.3
Income from Investments	**$ 118.2**	$ 114.3	$ 140.6	$ 100.9	$ 61.3
Net Income for the Year	**$ 60.6**	$ 162.5	$ 247.9	$ 218.5	$ 177.0
Net Income Applicable to Common Shares	**$ 17.8**	$ 117.7	$ 206.4	$ 182.3	$ 139.3
Net Income per Average Common Share					
Basic–before provision	**$ 1.20**	$ 2.40	$ 2.41	$ 2.13	$ 1.81
–after provision	**$ 0.16**	$ 1.21	$ 2.22	$ 2.03	$ 1.56
Funds Generated from Operations	**$ 439.9**	$ 505.5	$ 441.5	$ 381.4	$ 311.0
Per average common share	**$ 3.99**	$ 5.21	$ 4.75	$ 4.24	$ 3.49
Assets					
Plant, property and equipment					
Pipeline	**$2,493.7**	$2,515.7	$2,567.7	$2,614.6	$2,636.5
Natural resources and other	**$1,494.1**	$1,597.2	$1,581.8	$1,362.7	$1,263.4
Investments–pipelines	**$ 376.3**	$ 401.7	$ 450.6	$ 441.5	$ 394.9
Total assets	**$5,969.3**	$6,322.2	$6,291.7	$5,530.0	$5,283.6
Capitalization					
Long-term debt	**$2,173.8**	$2,215.0	$2,276.4	$2,218.0	$2,152.9
Non-recourse loans	**$ –**	$ 398.0	$ 441.0	$ 501.1	$ 557.5
Shareholders' equity					
Total	**$2,102.3**	$1,818.5	$1,711.0	$1,393.5	$1,240.8
Common	**$1,657.9**	$1,373.5	$1,268.1	$1,049.4	$ 895.6
Per common share at year end	**$ 13.46**	$ 13.89	$ 13.32	$ 11.54	$ 10.00
Capital Expenditures	**$ 184.4**	$ 217.5	$ 351.8	$ 237.1	$1,450.1
Dividends Declared per Common Share	**$ 1.12**	$ 1.12	$ 1.00	$ 0.75	$ 0.595
Common Shares Outstanding *(millions)*					
Year end	**123.2**	98.9	95.2	90.9	89.6
Weighted average	**110.2**	97.0	93.0	89.9	89.1
Number of Shareholders					
December 31	**24,259**	21,143	21,652	22,415	22,378
Number of Regular Employees					
December 31	**2,026**	1,945	1,938	1,953	1,798

Note: The above Five-Year Financial Highlights reflects a restatement of common shares outstanding and per share data resulting from the two-for-one share split and a restatement resulting from a change in the Company's method of accounting for its investment in oil and gas joint ventures from the equity method to the proportionate consolidation method. In addition, Investment and Asset Provisions, as described in Note 3 to the Consolidated Financial Statements on pages 56 and 57, are included in Net Income for the Year for the years 1986, 1985, 1984, 1983 and 1982 respectively.

Operating	1986	1985	1984	1983	1982
Pipeline Operations					
Gas delivered for sales and transportation *(millions of cubic metres)*					
annual	**33,085**	34,134	32,922	28,576	32,497
maximum day	**130**	125	131	121	125
Kilometres of pipeline– including loop line	**10,593**	10,593	10,632	10,626	10,631
Compressor power *(kilowatts)*	**1,020,500**	1,020,500	1,020,500	1,020,500	1,020,500
Natural Resources					
Liquid sales volumes *(barrels per day)*					
Crude oil					
Canada–conventional	**11,365**	11,138	11,043	9,655	9,431
–synthetic	**803**	801	541	691	496
United States	**1,484**	1,687	817	190	141
Indonesia and other foreign	**3,148**	3,500	1,991	1,208	707
Natural gas liquids					
Canada	**2,987**	3,117	2,364	1,773	2,241
United States	**99**	43	50	110	60
	19,886	20,286	16,806	13,627	13,076
Natural gas sales volumes *(millions of cubic feet per day)*					
Canada	**80.8**	87.3	80.0	63.4	64.7
United States	**11.6**	12.0	5.3	1.5	1.4
	92.4	99.3	85.3	64.9	66.1

Note: In the above Five-Year Operating Highlights, Natural Resources sales volumes for Canada are gross and include all volumes attributable to the Company's working interests before the deduction of royalties. Sales volumes for the United States are net of royalties. Sales volumes for Indonesia are attributable to the Company's gross working interests before government takes. Daily sales volume is calculated by dividing total sales for the respective year by the number of days in that year.

Shareholders and others desiring additional information on TransCanada PipeLines may request a copy of the booklet "Operating and Statistical Information – 1986" from Mr. R. G. Lloyd, Director, Investor Relations, TransCanada PipeLines, P.O. Box 54, Commerce Court West, Toronto, Ontario, M5L 1C2.

Directors

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Partner, McCarthy & McCarthy, Toronto

J. V. Raymond Cyr
President, Bell Canada Enterprises Inc., Montreal

A. Jean de Grandpré, O.C., Q.C.*
Chairman and Chief Executive Officer, Bell Canada Enterprises Inc., Montreal

John P. Gallagher
Chairman, Galtannia Investments Ltd., Calgary

Russell E. Harrison*
Director,
Canadian Imperial Bank of Commerce, Toronto

Robert H. Jones*
Chairman,
Investors Group Inc., Winnipeg

Robert H. Knight*
Partner, Shearman & Sterling, New York

Gerald J. Maier
President and Chief Executive Officer
TransCanada PipeLines Limited, Toronto

Gordon P. Osler
Chairman, TransCanada PipeLines Limited, Toronto; Chairman, North American Life Assurance Company, Toronto

Herbert C. Pinder
President, Saskatoon Trading Company Limited, Saskatoon

Frank A. Schultz
Independent Oil Operator, Dallas

J. Stuart Spalding
Executive Vice-President, Finance
Bell Canada Enterprises Inc., Montreal

Allan R. Taylor
Chairman and Chief Executive Officer, The Royal Bank of Canada, Toronto

George W. Woods
Director and Consultant,
TransCanada PipeLines Limited, Toronto

**Member of the Audit Committee*

Principal Officers

Gordon P. Osler
Chairman

Gerald J. Maier
President and Chief Executive Officer

James M. Cameron
Executive Vice-President

John K. Archambault
Senior Vice-President

George M. Hugh
Senior Vice-President

H. Neil Nichols
Senior Vice-President and Chief Financial Officer

C. Kennedy Orr
Senior Vice-President

Richard D. Walker
Senior Vice-President

George C. Britton
Vice-President, Pipeline Investments

Gavin J. Couper
Vice-President, Engineering and Operations

Artel A. Douloff
Vice-President, Transportation

Mitchell T.G. Graye
Vice-President, Finance and Treasurer

Derek E. Henwood
Vice-President, Project Development

Brian F. Hill
Vice-President, Corporate Planning

Gordon A. Leslie
Vice-President

James W.S. McOuat, Q.C.
Vice-President, Law

Raymond F. Sim
Vice-President and Corporate Secretary

Ray T. Smith
Vice-President and Controller, Pipeline

John W. Stinson
Vice-President, Human Resources

Kenneth G. Whiteside
Vice-President, Administration and Control

Arthur A. Wilkins
Vice-President

Principal Officers

Wholly Owned Operating Subsidiaries

TCPL Resources Ltd.

Gerald J. Maier
Chairman

Arthur A. Wilkins
Executive Vice-President

H. Neil Nichols
Chief Financial Officer

Sandro Silenzi
Vice-President, Exploration

A. Raymond Travers
Controller

Wessely Energy Company

Arthur J. Wessely
President

David G. Hanson
Executive Vice-President

Jacob I. Morrow
Executive Vice-President

John B. Hastings
Vice-President

George H. Walbert
Vice-President

Wayne B. Abernathy
Vice-President

Keith H. Perkins
Controller

Western Gas Marketing Limited

C. Kennedy Orr
President and Chief Operating Officer

John Anthony
Vice-President, Export Sales

H. Fred Button
Vice-President, Market Planning and Development

Craig R. Frew
Vice-President, Operations

Barry G. Luft
Vice-President, Gas Supply

Robert J. Reid
Vice-President, Canadian Sales

Cancarb Limited

A. Russell Steele
President and Chief Operating Officer

Klaus E. Grodd
Vice-President

Philip H. Stach
Controller and Assistant Secretary

TransCanada PipeLine USA Ltd.

David G. Hanson
Executive Vice-President

TCPL Nederland B.V.
TCPL Investments AG

Lionel H. Pilon
Managing Director

International PipeLine Engineering Limited

Richard D. Walker
Chief Executive Officer

Donald C. Ingram
President

Kopp AG International Pipeline Services

Richard D. Walker
Chief Executive Officer

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Subsidiaries

Cancarb Limited

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Kopp AG International Pipeline Services

TCPL Great Lakes Ltd.

TCPL Investments AG

TCPL Nederland B.V.

TCPL Resources Ltd.

TransCan Holdings Ltd.

TransCanada Border PipeLine Ltd.

TransCanada Iroquois Ltd.

TransCanada PipeLine Alaska Ltd.

TransCanada PipeLine USA Ltd.

TransCanada PipeLines Finance USA Ltd.

TransCanada PipeLines (Nova Scotia) Limited

Wessely Energy Company

Western Gas Marketing Limited

Affiliates

Great Lakes Gas Transmission Company

Sable Gas Systems Limited

Trans Québec & Maritimes Pipeline Inc.

Common Shares

Transfer Agents and Registrars:
Montreal Trust Company, Montreal, Toronto, Winnipeg, Regina, Calgary and Vancouver The Royal Bank and Trust Company, New York

Preferred Shares

Transfer Agents and Registrars:
$2.80 cumulative redeemable first preferred shares
National Trust Company, Montreal, Toronto, Winnipeg, Calgary and Vancouver

Cumulative redeemable retractable first preferred shares series E, series F, series H and series I
The Royal Trust Company, Montreal, Toronto, Winnipeg, Regina, Calgary and Vancouver

Cumulative redeemable convertible first preferred shares series G are transferable at the office of the company in Toronto.

Stock Exchanges

Preferred and common shares are listed on the Toronto, Montreal, Vancouver, Alberta and Winnipeg stock exchanges. The common shares are also listed on the New York Stock Exchange.

Stock Symbols

Common shares: TRP
Common share warrants: TRP.WT
$2.80 cumulative redeemable first preferred shares: TRP.PR.A
Cumulative redeemable retractable first preferred shares:
Series E: TRP.PR.E
Series F: TRP.PR.F
Series H: TRP.PR.H
Series I: TRP.PR.I

Bonds

Trustee:
National Trust Company, Toronto

Registrar Canadian Series:
9¼% and 8⅞% first mortgage pipe line bonds, National Trust Company, Montreal, Toronto, Winnipeg, Calgary and Vancouver

Co-Registrars U.S. Series:
7⅞%, 16% and 16¾% first mortgage pipe line bonds, National Trust Company and Morgan Guaranty Trust Company of New York

Co-Registrars U.K. Series:
16½% first mortgage pipe line bonds, National Trust Company and The Royal Bank of Scotland plc

Debentures

Trustee and Registrar:
Central Trust Company, Montreal, Toronto, Winnipeg, Calgary and Vancouver

10% series A sinking fund,
9¾% series B sinking fund,
9% series C sinking fund,
8⅞% series D sinking fund,
9% series E sinking fund,
11½% series F sinking fund,
9.60% series G sinking fund,
18% series H sinking fund,
11.70% series I,
11.40% series J, and 10.45% series K debentures

Form 10-K

The company's report to the Securities and Exchange Commission on Form 10-K is available to common shareholders at no charge by writing to:

The Corporate Secretary
TransCanada PipeLines
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