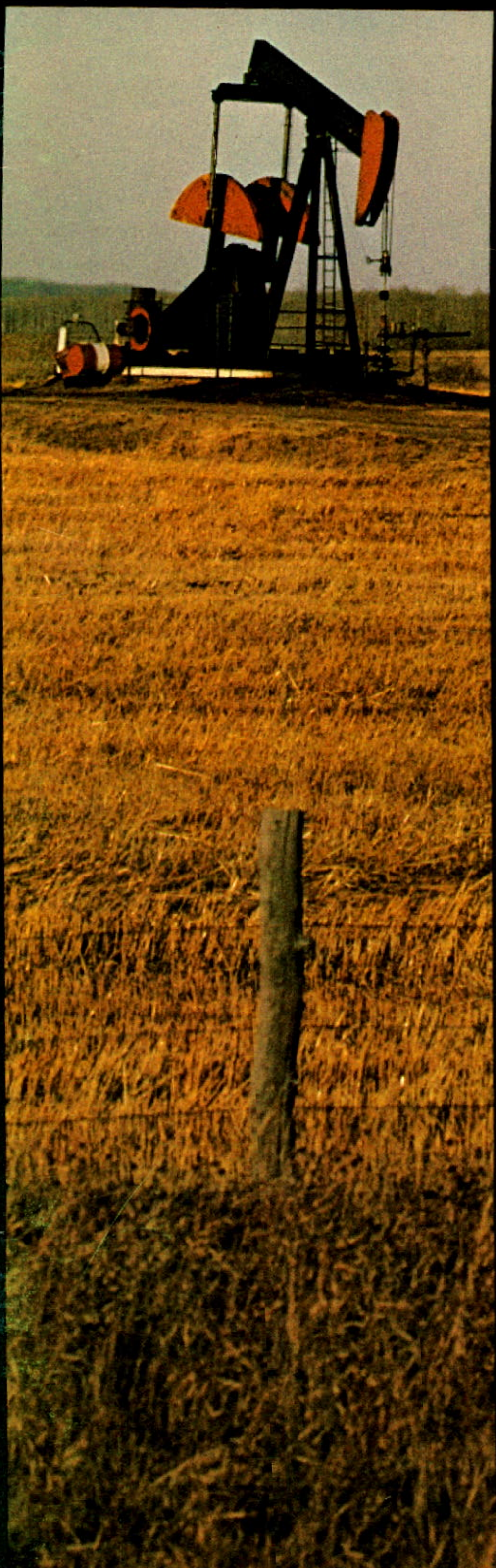
INTERPROVINCIAL PIPE LINE LIMITED

ANNUAL REPORT 1977



Interprovincial Pipe Line Limited

Annual Report 1977

(Incorporated by Special Act of the Parliament of Canada, April 30, 1949 and continued by Letters Patent August 1, 1973)

Directors

LORENZ P. BLASER
Executive Vice-President & Director
Gulf Oil Canada Limited, Toronto

C. WILLIAM DANIEL
President & Director
Shell Canada Limited, Toronto

J. WARREN FLANAGAN
Senior Vice-President & Director
Imperial Oil Limited, Toronto

JOHN H. HAMLIN
Senior Vice-President & Director
Imperial Oil Limited, Toronto

ROBERT K. HEULE
President
Interprovincial Pipe Line Limited, Toronto

*A. HAZLETT LEMMON
Chairman of the Board
The Canada Life Assurance Company, Toronto

JAMES G. LIVINGSTONE
Executive Vice-President & Director
Imperial Oil Limited, Toronto

*C. EDWARD MEDLAND
President, Chief Executive Officer & Director
Wood Gundy Limited, Toronto

*W. HAROLD REA
Vice President & Director
The Mutual Life Assurance Company of Canada, Toronto

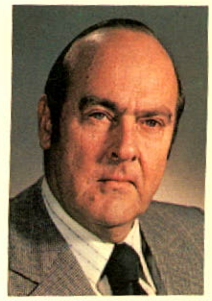
DAVID G. WALDON
Chairman & Chief Executive Officer
Interprovincial Pipe Line Limited, Toronto

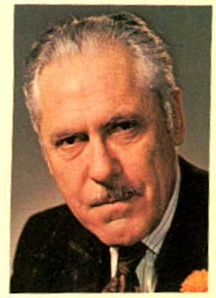
*GORDON D. deS. WOTHERSPOON
Chairman of the Board
Eaton Financial Services Limited, Toronto

*Members of Audit Committee


LORENZ P. BLASER


C. WILLIAM DANIEL


J. WARREN FLANAGAN

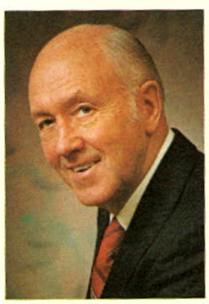

JOHN H. HAMLIN


ROBERT K. HEULE

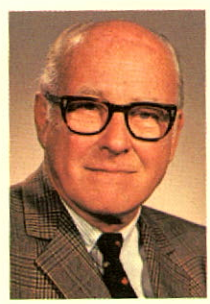

A. HAZLETT LEMMON


JAMES G. LIVINGSTONE


C. EDWARD MEDLAND


W. HAROLD REA


DAVID G. WALDON


GORDON D. deS. WOTHERSPOON

Officers

DAVID G. WALDON
Chairman & Chief Executive Officer

ROBERT K. HEULE, President

JOHN BLIGHT, Vice-President Finance

DAVID C. FLEMING
Vice-President & General Manager

E. GORDON SHEASBY
Vice-President, General Counsel & Secretary

LAWRENCE W. BLAINE, Treasurer

FREDERICK B. NEWTON, Assistant Treasurer

JOHN B. McWILLIAMS, Assistant Secretary

Annual Meeting

2:30 p.m. Wednesday, April 12, 1978,
"Toronto III" Room, Hotel Toronto,
145 Richmond Street West, Toronto.

The Notice of Meeting, Information Circular and form of Proxy are being mailed with this report to all shareholders of record on March 20, 1978.

Table of Contents

Highlights

Financial

	1977	1976	Percentage Increase
Transportation revenue	$245,699,000	$196,712,000	25%
Deficiency Agreement	$ 28,988,000	$ 20,209,000	
Other income	$ 4,766,000	$ 3,725,000	
Expenses, excluding taxes	$174,983,000	$128,449,000	36%
Income and other taxes	$ 60,623,000	$ 53,082,000	14%
Earnings	$ 43,847,000	$ 39,115,000	12%
per share	$1.71	$1.53	
Dividends	$ 30,688,000	$ 30,688,000	
per share	$1.20	$1.20	
Capital expenditures	$ 20,197,000	$113,587,000	

Statistical

	1977	1976	Percentage Increase
Deliveries (barrels per day)			
By Quarters			
First	1,452,931	1,090,810	
Second	1,405,174	1,130,025	
Third	1,310,110	1,189,006	
Fourth	1,434,511	1,323,171	
Yearly average	1,400,383	1,183,651	18%
Highest month	1,545,416	1,447,576	
Lowest month	1,234,939	1,056,495	
Barrels delivered	511,140,000	433,216,000	
Barrel miles (millions)	679,916	579,436	17%
Number of employees—December 31	798	790	

D. G. Waldon—Chairman

R. K. Heule—President

Directors' Report to Shareholders:

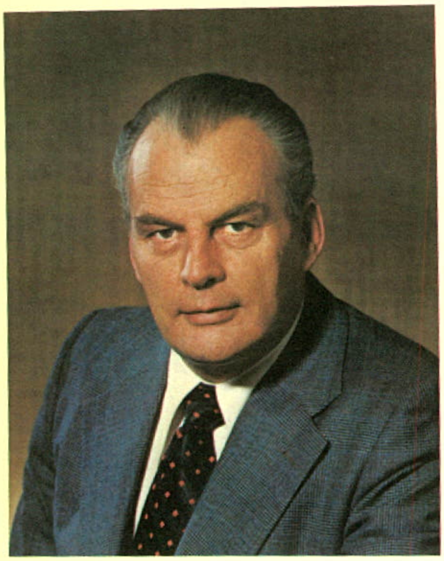
In terms of throughput and earnings 1977 was a good year for the company. Total deliveries of 511.1 million barrels of crude oil, natural gas liquids and refined products, equivalent to 1.4 million barrels per day, in fact established a new record, exceeding the previous high reached in 1973 by some 20,000 b/d. The average length of haul in 1977 was less than in 1973, however.

Earnings at $1.71 per share were the second highest in the company's history and would have been higher had it not been for the need to provide for the potential loss on discontinued capital projects. The projects in question are the proposed refined products terminal at Superior, Wisconsin ($3.6 million) and the related upgrading of Line 2 out of Edmonton to handle high vapour pressure natural gas liquids ($2.8 million). In the case of the refined products terminal, binding arbitration is being discussed with the two shippers involved as a means of determining the extent of their liability, if any. For details refer to Note 4 to Financial Statements.

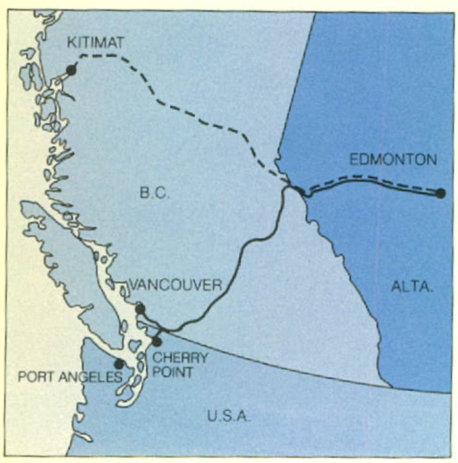
The increase in earnings over 1976 was entirely due to higher throughput. With the exception of the change in the rate to Montreal, tariffs remained unchanged throughout the year.

As shown in the tables on page 7, deliveries in Canada were substantially higher than in 1976, due to shipments to Montreal and to the new Petrosar refinery-petrochemical complex at Sarnia. Deliveries of Canadian crude in the United States continued to decline in 1977 as exports are phased out but not to the extent expected because of the need for a market for the heavier crudes.

1977 was the first year of the National Energy Board's policy of encouraging the production of heavier crudes. Such crudes are now licensed for export separately from light crudes and while authorized exports of light crude were reduced in 1977, the level of exports of heavy crude actually increased. Saskatchewan is the main source of heavy crudes and as a result receipts in that province were higher in 1977 than in the previous year.



E. G. Sheasby—Vice-President, General Counsel



---- Proposed Kitimat Pipe Line Ltd.

—— Trans Mountain Pipe Line Company Ltd.

Under the new N.E.B. heavy crude policy, the U.S. refiners are informed three weeks in advance of each quarter the quantity of heavy crude that has been allocated to them by months during the upcoming quarter. It is anticipated that this advance notice will result in even more heavy crude being produced and exported to the United States.

Increased receipts of U.S. domestic and offshore crudes into the Lakehead system, just about equalled the decline in Canadian oil delivered in the United States. "Exchanges" of U.S. crude for Canadian production between U.S. refineries and Ontario and Montreal refineries averaged 55,000 b/d in 1977 as compared with 7,000 b/d in 1976.

The new 125,000 b/d Syncrude oil sands plant is scheduled to come on stream in May 1978 at an initial volume of 50,000 b/d; and the new 95,000 b/d refinery at Nanticoke, Ontario is scheduled to commence operations in the third quarter of 1978 at a rate of 56,000 b/d.

Rate Hearing

The second phase of our three-phase rate hearing before the National Energy Board to determine the justness and reasonableness of our tariffs in Canada, commenced on December 6, 1976 and concluded on November 2, 1977. This phase was to establish a rate base, cost of service and appropriate rate of return. During this period the company was required to prepare and file extensive financial data on its operations and those of a wide range of other companies. It was also necessary to commit considerable time of our senior people, and that of outside consultants, to attendance at hearings.

On December 28, 1977 the N.E.B. rendered its decision on Phase II and its findings were disappointing. Not only did the Board find that a lower rate of return than we think we justified was appropriate, they also disallowed part of our proposed rate base and cost of service; and allowed no return whatsoever on the Montreal Extension—on the premise that it was financed entirely by debt. Particularly disturbing was the Board's disallowance of part of the cost of the Montreal Extension on the grounds that the construction had not been proceeded with in an entirely prudent manner. The consequences of the Phase II decision would be that the existing tariffs would have to be reduced and future earnings would be adversely affected.

An application for a review of certain aspects of this decision was filed with the N.E.B. on January 30, 1978 and after a hearing on February 23, the Board ruled that they would conduct such a review.

Phase III of the hearings, which is to determine the specific tolls and tariffs that the company will be permitted to charge in Canada, is scheduled to commence on April 4 and the N.E.B. has ruled that we will be permitted to update our rate base and cost of service to the 1978 level.

The ultimate impact on future earnings of the company will depend on whether or not the N.E.B. decides to modify any of its findings.

Kitimat Pipe Line Ltd.

The company continues as one of six participants in Kitimat Pipe Line Ltd. which was formed in 1976 to construct a 750-mile crude oil pipe line from the port of Kitimat, British Columbia to Edmonton.

After being in abeyance since June 1977 while Trans Mountain's proposal was being considered, the Kitimat application to the National Energy Board to construct such a line was reactivated in January 1978.

Trans Mountain had proposed to alternate the flow in its pipe line from Cherry Point, Washington to Edmonton to serve the so-called Northern Tier refineries. The proposal appears to have been blocked, however, by recently passed U.S. legislation barring expansion of crude oil unloading facilities in Puget Sound east of Port Angeles, Washington.

The Kitimat application is also being revised to provide for a 36-inch line instead of a 30-inch line with an initial throughput of 500,000 b/d and an ultimate capacity of 800,000 b/d. The capital cost of the port facilities and pipe line is now estimated at $750 million. The company's share of development costs to the end of 1977 was $571,000.

Subsequent to Kitimat asking the N.E.B. to reactivate its application, the N.E.B. announced that commencing in May, it will be holding hearings to look into Canada's long term energy requirements, particularly the extent to which it will be necessary to import oil. This hearing was not unexpected and in itself should not result in an overall delay in the Kitimat project.

Financial Review

The Consolidated Financial Statements, Auditor's Report and accompanying Notes to the financial statements appear on pages 12 through 21 and include the accounts of Interprovincial Pipe Line Limited and its wholly-owned subsidiaries. These are Lakehead Pipe Line Company, Inc. which owns and operates the portion of the pipe line system in the United States and its subsidiary, Pipe Line Service Company Inc. which owns and operates the aircraft and radio communications system in the United States. A 10-year review of selected financial and statistical information is shown on pages 22 and 23 of this Report.

Income and Expenses

Transportation and other revenues were $279 million, an increase of 27% over 1976. Deliveries of crude oil, natural gas liquids and refined petroleum products averaged 1,400,000 b/d compared with 1,184,000 b/d in 1976. Total barrel miles increased 17% to 680 billion from 579 billion in the previous year. These increases reflect a full year's operation of the Sarnia to Montreal Extension. Of the $49 million improvement in transportation revenue $9 million resulted from the change in the Canadian/U.S. exchange rate used to convert Lakehead's transportation revenue into Canadian dollars.

Included in revenue is $29 million ($20 million in 1976) due from the Federal Government to cover the operating deficiency in respect of the Montreal Extension. The deficiency is defined as the excess of operating costs of the line, including interest and depreciation at 5%, over the transportation revenue based on an N.E.B. approved additional tariff from Sarnia. This tariff was 5 cents per barrel for January and February and 20 cents per barrel thereafter.

Other income at $4.8 million was $1.0 million higher than in 1976 because of larger amounts invested in the short term money market.

Power and fuel costs rose significantly due to the increase in barrels transported, greater deliveries of medium and heavy crudes and higher costs of electric power and for diesel engine fuel. Other operating costs, property taxes, depreciation and interest costs increased over 1976 due in large part to the full year's operation of the Montreal Extension, the total cost of which was $43 million.

Loss on discontinued capital projects consisted of $3.6 million to provide for the potential loss on the Superior Refined Products Terminal and $2.8 million in respect of the cancellation of plans to upgrade Line 2 to accommodate natural gas liquids. The Superior Terminal was cancelled in late 1976 due to delays in obtaining environmental approval. Any

J. Blight—Vice-President Finance

D. C. Fleming—Vice-President & General Manager

future recovery of loss on the terminal will depend on the sale of specialized tankage and materials and the outcome of any settlement between Lakehead and the two shippers involved.

Earnings and Dividends

Earnings for the year amounted to $43.8 million and $1.71 per share compared with $39.1 million and $1.53 per share for 1976.

Dividends of $1.20 per share were paid during the year on Class A and Class B shares totalling $30.7 million, the same as in 1976. In the light of improved earnings in 1977, an extra dividend of 10 cents per share was declared payable on March 1, 1978 to shareholders of record February 8 in addition to the regular quarterly dividend of 30 cents per share.

New Financing

To finance the remaining capital cost of the Montreal Extension, the company completed a private placement on April 29, 1977 of $50.5 million, 9⅝% sinking fund debentures Series F to mature May 1, 1996.

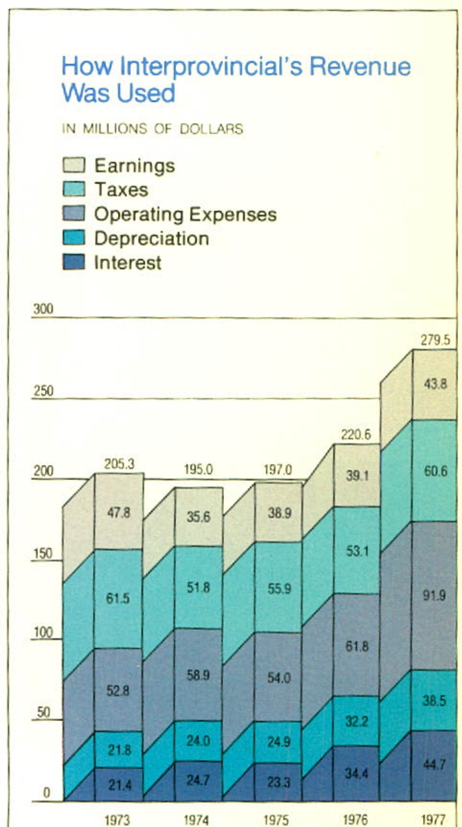
Tariffs

Interprovincial and Lakehead are engaged exclusively in the transportation of crude oil, natural gas liquids and refined petroleum products by pipe line at established tariffs. With the exception of the rate to Montreal which was increased by 15 cents per barrel effective March 1977, tariffs remained unchanged throughout the year. However by agreement with the National Energy Board, effective March 1, 1978 the company prepared separate tariff schedules for Interprovincial (in Canadian currency) and Lakehead (in U.S. currency). The Interprovincial tariffs were filed with the National Energy Board and the Lakehead tariffs were filed with the Federal Energy Regulatory Commission in Washington, D.C.

Combined Interprovincial and Lakehead rates for light crude from the three main receiving points to the principal delivery points are as follows:

	Rates for light crudes in cents per barrel		
	From		
To	Edmonton	Cromer	Chicago
Regina	18.7¢	—¢	—¢
Gretna	27.8	10.3	—
Clearbrook	33.5	20.0	—
Superior	39.5	26.0	—
Chicago	52.0	38.5	—
Sarnia	55.0	41.5	14.0
Toronto area	60.0	46.5	19.0
Buffalo	67.0	53.5	26.0
Montreal	75.0	61.5	34.0

The rates for heavier crudes, natural gas liquids and refined products are slightly higher.



Operations

The total volumes of crude oil and other liquid hydrocarbons received and delivered by the pipe line system during the year were as follows:

Receipts—by location (thousands of barrels per day)	1977	1976
Alberta	950.8	873.2
Saskatchewan	160.7	146.0
Manitoba	11.6	11.2
Ontario	2.5	1.6
United States	274.0	166.7
	1,399.6	1,198.7

Deliveries—by location (thousands of barrels per day)	1977	1976
Canada		
Canadian Production		
Prairie Provinces	124.8	123.5
Ontario	539.7	521.2
Montreal	229.9	83.1
	894.4	727.8
U.S. Domestic		
Ontario	52.2	6.4
Montreal	3.0	.6
	55.2	7.0

Deliveries—by location (thousands of barrels per day)	1977	1976
United States		
Canadian Production		
Minnesota-Wisconsin	179.0	171.9
Illinois-Indiana	15.6	25.0
Michigan-Ohio	33.1	72.5
New York-Pennsylvania	6.0	21.8
	233.7	291.2
U.S. Domestic and Offshore Oil		
Minnesota-Wisconsin	2.1	.1
Michigan-Ohio	85.8	48.3
New York-Pennsylvania	129.2	109.3
	217.1	157.7
	1,400.4	1,183.7

W. C. Cochrane—Vice-President & Manager of Lakehead

Deliveries—by type (thousands of barrels per day)	1977	1976
CRUDE OIL		
Conventional	1,151.0	943.9
Oil Sands	33.6	38.1
NATURAL GAS LIQUIDS		
Condensate	67.9	68.2
Propane/butane/condensate mix	83.1	72.4
REFINED PRODUCTS	64.8	61.1
	1,400.4	1,183.7

Construction

1977 Review

Capital expenditures for the year totalled $20.2 million of which $7.4 million was expended on the Sarnia to Montreal Extension, largely land restoration and payments to landowners. Present indications are that a further $1 million will have to be expended on the Montreal Extension in 1978, bringing the total cost of the extension to $248 million.

The major new projects in 1977 were seven single-unit 2,500-h.p. electric pumping stations on the Chicago-Sarnia

Deer River Pumping Station

Pipe Line Maintenance Personnel at Superior

section of the system; and a 26-mile extension of the system from a point 20 miles downstream from Westover pumping station to the new Texaco 95,000 b/d refinery at Nanticoke, Ontario.

The seven new pumping stations were completed by year end and are now in operation. The addition of these stations increases the capacity of the Chicago-Sarnia section of the system from 630,000 b/d to 710,000 b/d.

Construction of the 16-inch delivery line to Nanticoke commenced in late September and aided by four weeks of dry weather, was completed before the end of the year, within budget. Erection of the two additional storage tanks and installation of a 2,000-h.p. pumping unit at Westover also began in the fall, but these facilities will not be ready for operation until the second quarter of 1978. Some oil will be delivered to the new refinery in May for testing and startup purposes, but regular deliveries are not scheduled to commence until July.

The replacement of eight 25-year old 900-h.p. diesel pumping units at Glenavon, Saskatchewan and Viking, Minnesota with 1,500-h.p. electric units was completed on schedule and the units are now in operation. Other miscellaneous projects undertaken in 1977 included replacement of fixed roofs with floating roofs on three tanks in Western Canada and pump modifications at Superior to improve efficiency.

1978 Forecast

New capital projects being undertaken in 1978 are estimated at $5.5 million. The principal items are: 25 additional main line valves on Line 1 between Edmonton and Gretna to improve safety; two tank roof replacements; and a new metering facility at Oakville, Ontario.

Upon completion of the projects now under way, the capacity of the pipe line system should be more than sufficient to handle the volumes forecast through 1979. Because of the increased volumes of U.S. domestic and offshore crude entering the system at Chicago, the Chicago to Sarnia section of the system will likely have to be operated at, or near, capacity for extended periods. This section and the north 30-inch line into Sarnia, should be the only

Edmonton Management Personnel

critical sections. Accordingly, no additions to the system which would increase capacity are planned for 1978.

General

Following the annual meeting on April 13, 1977, D. G. Waldon was elected to the newly created position of Chairman of the Board and Chief Executive Officer and R. K. Heule was elected President. Other changes in the officers of the company were: D. C. Fleming was elected Vice-President and General Manager; J. Blight was elected to the newly created position of Vice-President Finance; and L. W. Blaine was appointed Treasurer of the company.

Having reached retirement age, Mr. W. Harold Rea will not be standing for re-election to the Board of Directors. Mr. Rea has been a highly esteemed member of the Board since 1952 and his advice and counsel will be sorely missed.

Mr. C. William Daniel will also be leaving the Board, having decided not to stand for re-election. His contribution to the success of the company is also gratefully acknowledged.

The directors and management once again welcome this opportunity of expressing their appreciation to all employees for the high level of performance maintained throughout the year.

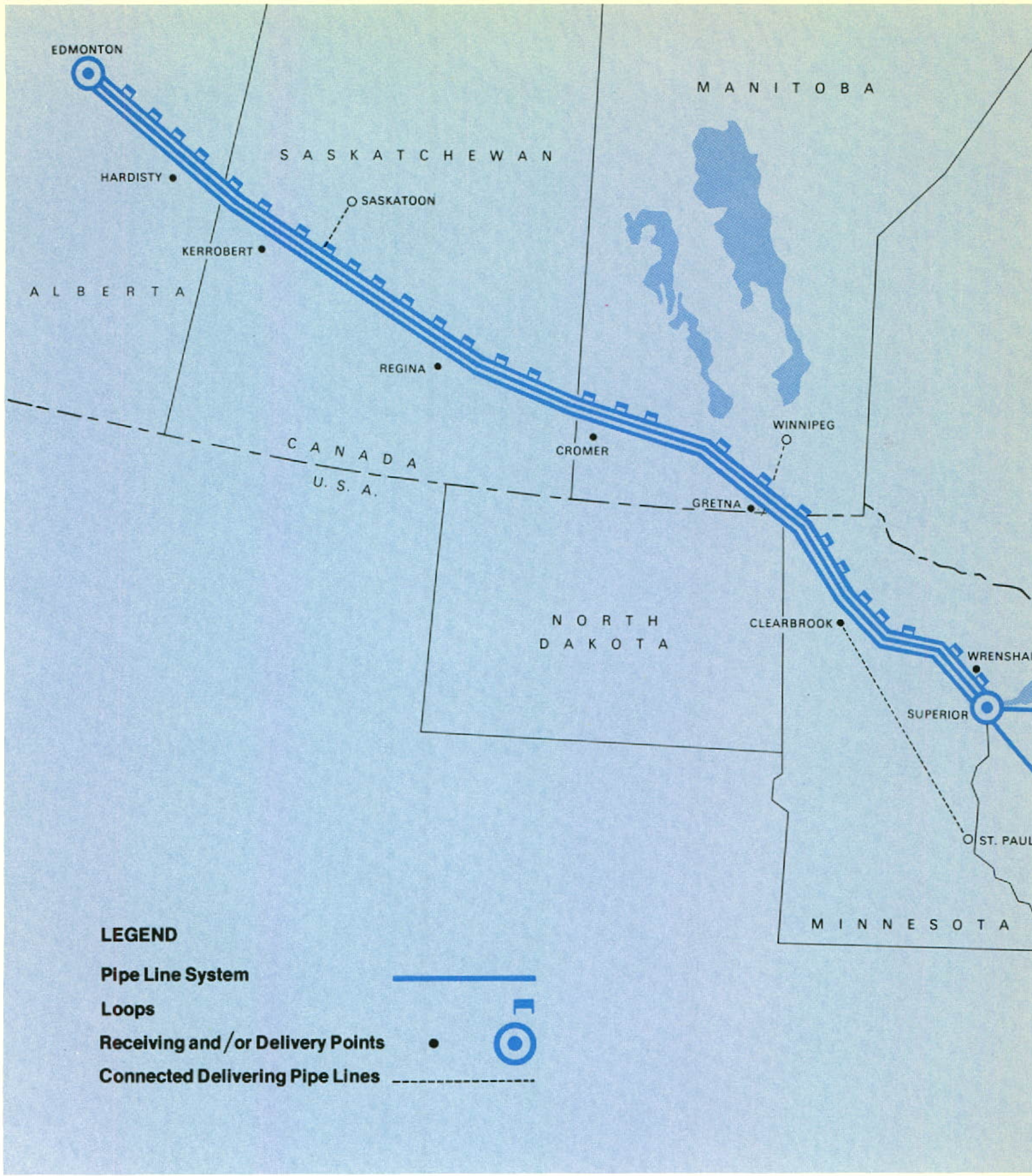
On behalf of the Board of Directors

D. G. Waldon

Chairman

R. K. Heule

President



Interprovincial Pipe Line Limited
and its United States Subsidiary
Lakehead Pipe Line Company, Inc.

The Pipe Line Transportation System

as at December 31, 1977

	Canada	United States	Total
Miles of Right-of-Way	1,417	1,739	3,156
Number of Pumping Stations	32	49	81
Installed Horsepower—diesel	34,320	42,200	76,520
—electric	510,270	413,500	923,770
—total	544,590	455,700	1,000,290
Line Fill in Barrels (provided by shippers)	13,736,000	11,921,000	25,657,000
Separate Streams Transported			50

Annual Average Physical Capacity

Line Section	Thousands of Barrels per Day 1978	1979
Edmonton-Regina - -	1,533	1,533
Regina-Cromer - - -	1,466	1,466
Cromer-Superior - - -	1,560	1,560
Superior-Sarnia via Straits of Mackinac -	555	555
Superior-Chicago - -	740	740
Chicago-Sarnia - -	710	710
Sarnia-Port Credit - -	470	470
Westover-Nanticoke -	110	110
Westover-Buffalo - -	160	160
Sarnia-Montreal - -	350	350

Miles of Main Line Pipe

Size	Canada	United States	Total
12 inch - -	66	26	92
16 - - -	423	—	423
18 - - -	39	325	364
20 - - -	800	12	812
24 - - -	772	—	772
26 - - -	2	325	327
30 - - -	531	989	1,520
34 - - -	774	789	1,563
48 - - -	224	106	330
Total Miles of Main Line Pipe - -	3,631	2,572	6,203

Tankage: (thousands of barrels)

	Number of Tanks	Capacity
Edmonton - - - -	27	4,645
Stony Beach - - - -	3	66
Regina- - - - - -	8	580
Cromer - - - - -	14	1,006
Gretna- - - - - -	5	280
Clearbrook - - - -	7	474
Superior - - - - -	22	4,584
Griffith- - - - - -	8	1,985
Sarnia - - - - - -	15	2,250
Westover - - - - -	4	376
	113	16,246

Consolidated Statement of Earnings

(in thousands of dollars except per share amounts)

	Year ended December 31	
	1977	1976
Income:		
Transportation revenue	**$245,699**	$196,712
Montreal Extension Deficiency Agreement (Note 3)	**28,988**	20,209
Other income	**4,766**	3,725
	279,453	220,646
Expenses: (Note 1)		
Operating—power and fuel	**47,424**	30,902
—other	**37,733**	31,797
Property and other taxes	**15,371**	12,675
Provision for depreciation	**38,479**	32,224
Interest on long term debt	**44,657**	34,399
Foreign exchange	**267**	(873)
Loss on discontinued capital projects (Note 4)	**6,423**	—
	190,354	141,124
Earnings before income taxes	**89,099**	79,522
Provision for income taxes: (Note 1)		
Current	**42,649**	24,400
Deferred	**2,823**	15,168
Deferred investment tax credits	**(220)**	839
	45,252	40,407
Earnings for the year	**$ 43,847**	$ 39,115
Earnings per share (Note 1)	**$ 1.71**	$ 1.53

Consolidated Statement of Retained Earnings

(in thousands of dollars except per share amount)

	Year ended December 31	
	1977	1976
Balance at beginning of year	**$144,793**	$136,366
Earnings for the year	**43,847**	39,115
	188,640	175,481
Dividends paid—($1.20 per share) (Note 7)	**30,688**	30,688
Balance at end of year	**$157,952**	$144,793

Consolidated Statement of Changes in Financial Position

(in thousands of dollars)

	Year ended December 31 1977	1976
Source of Funds:		
Earnings for the year	**$ 43,847**	$ 39,115
Add—Charges (credit) to earnings not affecting working capital:		
Depreciation	**38,479**	32,224
Deferred income taxes	**2,823**	15,168
Deferred investment tax credits	**(220)**	839
Loss on discontinued capital projects	**6,423**	—
Other	**555**	530
Provided from operations	**91,907**	87,876
Long term debt:		
Interprovincial Pipe Line Limited		
Bank loans	**—**	39,400
Debentures	**50,500**	100,000
Other transactions	**1,999**	584
	144,406	227,860
Use of Funds:		
Dividends	**30,688**	30,688
Additions to pipe line transportation system	**20,197**	113,587
Long term debt retired or included in current liabilities	**24,476**	24,629
Bank loans	**39,400**	23,500
Cost of issuing long term debt	**353**	1,382
	115,114	193,786
Change in Working Capital	**29,292**	34,074
Working Capital (Deficit) at Beginning of Year	**11,499**	(22,575)
Working Capital at End of Year	**$ 40,791**	$ 11,499

Consolidated Balance Sheet

(in thousands of dollars)

ASSETS

	December 31 1977	December 31 1976
Current Assets:		
Cash	**$ 470**	$ 473
Term deposits with Canadian chartered banks	**26,828**	11,505
Short term investments, at cost which is equivalent to market	**17,545**	4,953
Accounts receivable—		
Transportation charges	**24,080**	18,546
Montreal Extension Deficiency Agreement (Note 3)	**28,857**	20,209
Other	**1,227**	1,098
Inventories—		
Crude oil, at quoted market price	**1,427**	179
Materials and supplies, at cost	**5,475**	5,148
Prepaid expenses	**257**	684
	106,166	62,795
Deferred Charges and Other Assets:		
Unamortized discount and expense on long term debt (Note 1)	**5,643**	5,844
Other (Notes 4 and 10)	**6,807**	7,345
	12,450	13,189
Pipe Line Transportation System, at cost (Notes 1 and 5)	**1,091,747**	1,085,984
Less—Accumulated depreciation	**331,166**	299,236
	760,581	786,748
	$ 879,197	$ 862,732

The financial statements have been approved by the Board:

A. H. LEMMON, *Director*

D. G. WALDON, *Director*

LIABILITIES

	December 31 1977	December 31 1976
Current Liabilities:		
Accounts payable	**$ 10,752**	$ 11,998
Interest accrued	**12,731**	12,740
Income and other taxes	**25,546**	12,370
Current portion of long term debt	**16,346**	14,188
	65,375	51,296
Long Term Debt (Note 6)	**474,483**	487,859
Deferred Income Taxes (Note 1)	**121,934**	119,111
Deferred Investment Tax Credits (Note 1)	**11,578**	11,798

SHAREHOLDERS' EQUITY

	1977	1976
Capital Stock (Note 7)	**25,573**	25,573
Contributed Surplus—premium on shares	**22,302**	22,302
Retained Earnings (Notes 1 and 8)	**157,952**	144,793
	205,827	192,668
	$879,197	$862,732

Auditors' Report

To the Shareholders of
INTERPROVINCIAL PIPE LINE LIMITED:

We have examined the consolidated balance sheet of Interprovincial Pipe Line Limited as at December 31, 1977 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was 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 present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Edmonton, Alberta
February 3, 1978

PRICE WATERHOUSE & CO.
Chartered Accountants

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies:

Principles of Consolidation

The consolidated financial statements include the accounts of Interprovincial Pipe Line Limited and its wholly-owned United States subsidiary Lakehead Pipe Line Company, Inc. and its subsidiary, Pipe Line Service Company, Inc.

Earnings of Lakehead are subject to a 15% U.S. withholding tax when paid as dividends to Interprovincial. It has not been considered necessary to provide for this tax on retained earnings of $62,267,000 U.S. of Lakehead at December 31, 1977 because they have been reinvested in that company.

Foreign Exchange

United States dollar amounts have been translated into Canadian dollars on the following bases:

Current assets and liabilities—at the rate of exchange December 31;

Other assets and liabilities—at historical rates of exchange except for accumulated depreciation which is translated on the basis of equivalent Canadian dollar cost of the related fixed assets;

Income and expenses—at monthly rates of exchange except provision for depreciation which is translated on the same basis as the related fixed assets.

Net gains or losses arising from the foregoing methods are shown on the Consolidated Statement of Earnings as Foreign exchange.

Discount and Expense on Long Term Debt

The balance of unamortized discount and expense is being amortized on the straight-line method over the life of the debt with adjustments as debt is retired. Amortization charged to earnings amounted to $554,000 in 1977 and $479,000 in 1976.

Pipe Line Transportation System and Depreciation

Expenditures for system expansion and major renewals and betterments are capitalized whereas maintenance and repair costs are charged to operating expenses as incurred.

In 1977 Interprovincial adopted the accounting practice of capitalizing an allowance for the interest and equity costs on funds required to finance construction work in progress in Canada. The National Energy Board approved a rate of 9.65% which resulted in the capitalization of $185,000. Previously both Interprovincial and Lakehead followed the practice, which Lakehead will continue, of capitalizing interest during the construction period but only when funds are borrowed for additions to the pipe line transportation system and this amounted to $7,327,000 in 1976.

The companies provide for depreciation of fixed assets, excluding the Sarnia to Montreal pipe line extension, on the straight-line method at annual rates which will amortize the cost of depreciable properties over their estimated service lives after taking into account possible salvage values. The rate of depreciation on these facilities averages approximately 3%.

In accordance with terms of the Deficiency Agreement with the Canadian Government (Note 3), commencing June 3, 1976 Interprovincial is providing for depreciation of all Montreal Extension depreciable facilities on a 20-year straight-line basis.

When fixed assets are retired or otherwise disposed of, the cost and accumulated depreciation are cleared from the related accounts and any resultant profit or loss is credited or charged to accumulated depreciation, except for an unusual disposal for which the profit or loss is included in earnings.

Deferred Income Taxes

Under Canadian and United States income tax regulations depreciation deducted for tax purposes may differ from the amount recorded in the accounts; also, during construction periods interest capitalized and, in the United States, sales taxes capitalized, may be claimed for tax purposes in the year incurred. The companies are using the maximum deductions permitted for tax purposes which result in deferment of taxes to future years when amounts deductible will be less than the depreciation recorded in the accounts.

Deferred Investment Tax Credits

The United States subsidiary companies are allowed credits against income taxes payable of a specified percentage of the cost of most depreciable assets acquired and placed into service. These credits have been deferred and are being taken into earnings over the life of the related assets.

Earnings per Share

Earnings per share are computed on the weighted average number of shares outstanding during the year. There would be no material dilution of earnings per share if the stock options had been exercised during the year.

Pension Plans

Interprovincial and Lakehead have pension plans which cover substantially all employees. The principal amount of the unfunded liability for past service benefits, including experience deficiencies, was approximately $10,200,000 at December 31, 1976. This amount, together with interest, will be charged to earnings in varying annual installments to 1991. The companies fund accrued pension costs. In the years 1977 and 1976 total costs of the plans amounted to $2,581,000 and $2,260,000 respectively, of which $1,303,000 and $1,140,000 were applicable to past service benefits. At December 31, 1976 pension fund assets exceeded the actuarially computed value of the vested portion of the benefits.

2. Regulation:

Interprovincial and Lakehead own and operate a pipe line system for the transportation of crude oil and other liquid hydrocarbons.

Interprovincial operates the Canadian section of the system under provisions of the National Energy Board Act. The National Energy Board has regulatory authority over such matters as construction, operations, accounting and rates.

Interprovincial has completed the second phase of a three-phase public hearing before the N.E.B. to determine the justness and reasonableness of its tariffs and tolls. Following completion of the first phase the N.E.B. ordered that the method of regulating Interprovincial's tolls and tariffs should change, that a historic cost rate base and rate of return methodology is the appropriate means of regulation and that tolls and tariffs for the Montreal Extension will be established on an additive basis. In late December 1977 the N.E.B. issued its decision on Phase II dealing with rate base, cost of service and rate of return. These determinations were less than requested and would have a negative effect on the future earnings from Canadian operations. As the company has made application to the Board for review and rehearing the ultimate effect on future earnings is uncertain. Phase III of the hearing, which is expected to commence in April 1978, will deal with determination of rate design and tolls and tariffs based on an updated cost of service and rate base.

Lakehead Pipe Line Company, Inc. is an interstate common carrier within the meaning of the Interstate Commerce Act. The Interstate Commerce Commission has had regulatory authority over the rates, regulations, accounting and other practices of common carrier oil pipe lines. On October 1, 1977, all regulatory functions formerly vested in the Interstate Commerce Commission with respect to oil pipe lines were transferred to the Federal Energy Regulatory Commission—a new commission established within the recently created Department of Energy.

3. Montreal Extension Deficiency Agreement:

Interprovincial and the Canadian Government have entered into a Deficiency Agreement whereby the Government will pay the deficiency if operating revenue in respect of the Extension is not sufficient to meet the fixed and variable costs of the Extension. The Government has announced a policy that "as an interim measure pending the National Energy Board's determination of just and reasonable tolls on Interprovincial's system, Montreal refineries should have access to Canadian crude at the same cost as plants in the Toronto area". The N.E.B. has ordered Interprovincial to file interim tariffs which have regard for the Government decision to utilize in part the Deficiency Agreement to subsidize the cost of transportation beyond Toronto. Compliance with these orders during 1977 has resulted in a deficiency of $28,988,000 which will be submitted to the Minister of Energy, Mines and Resources for approval and payment.

The Agreement provides for the granting to the Government of an option to purchase the Extension at its capital cost less depreciation, plus related expenses but this option is exercisable only if a deficiency payment has been made or it is agreed that a deficiency will occur. The Government has confirmed that they do not intend to exercise the option to purchase the Montreal Extension as a result of any deficiency created by Interprovincial's compliance filing of the interim tariffs pending the N.E.B.'s determination of just and reasonable tolls on Interprovincial's system.

4. Loss on Discontinued Capital Projects:

The construction by Lakehead of a refined products terminal at Superior, Wisconsin, originally scheduled for 1974, was delayed pending environmental clearance from the U.S. Army Corps of Engineers. Due to the prolonged delay and other factors the two shippers who had expressed their intent to use the facilities advised that they had found it necessary to make other arrangements and were no longer interested in the project. Therefore, Lakehead did not proceed with the construction and at year end the estimated salvage value of $759,000 for the specialized tankage and other remaining materials are recorded as Other assets. Pending disposal of the materials and settlement with the two shippers as to their responsibility for the costs of cancellation, Lakehead has charged $3,566,000 to earnings during 1977 as the estimated total provision for loss on the discontinued project.

The proposed new pipe line safety regulations in Canada and cancellation of the refined products terminal caused management to reassess the economics of and need to proceed with related construction projects to upgrade Line 2 to accommodate high vapour pressure natural gas liquids for which certain equipment purchases and other expenditures had been made. These projects, in both Interprovincial and Lakehead, have now been cancelled and pending disposal the remaining materials are recorded as Other assets at their estimated salvage value of $3,337,000. Cancellation of these projects has resulted in an additional provision for loss during 1977 of $2,857,000.

5. Pipe Line Transportation System: Accumulated Depreciation:

The pipe line transportation system and accumulated depreciation by major classes were as follows:

	Investment, at cost	Accumulated depreciation	Net investment December 31	
	December 31, 1977		1977	1976
	(in thousands of dollars)			
System, excluding Montreal Extension:				
Land	$ 3,040		$ 3,040	$ 2,921
Rights-of-way	14,832	$ 5,005	9,827	10,250
Pipe line	584,570	230,062	354,508	370,747
Pumping equipment, buildings and tanks	236,097	76,602	159,495	159,096
Construction in progress	6,143	—	6,143	10,871
Montreal Extension	247,065	19,497	227,568	232,863
	$1,091,747	$331,166	$760,581	$786,748

It is estimated that 1978 capital expenditures will amount to approximately $10,000,000 and will be financed by funds generated within the companies.

6. Long Term Debt:

Long Term Debt (excluding current portion) outstanding at December 31 was as follows:
(in thousands of dollars)

	1977	1976
Interprovincial Pipe Line Limited		
First Mortgage and Collateral Trust Bonds—		
Series E—5½% due April 1, 1985	$ 7,030	$ 7,630
Sinking Fund Debentures (unsecured)—		
Series A—6% due November 1, 1986	22,400	23,800
B—9⅜% due December 1, 1990	50,400	52,800
C—8⅛% due May 1, 1993	45,749	48,000
D—10⅜% due July 15, 1996	75,000	75,000
E—10⅞% due February 1, 1996	75,000	75,000
F—9⅝% due May 1, 1996	47,840	—
Serial Debentures (unsecured)—		
Series D—9¼%, $5,000 due annually July 15, 1978-1981	15,000	20,000
E—9⅞%, $5,000 due annually February 1, 1978-1981	15,000	20,000
Bank Loans (unsecured)—		
Interim financing—repaid April 29, 1977	—	39,400
Lakehead Pipe Line Company, Inc.		
Sinking Fund Debentures (guaranteed by Interprovincial)—		
Series A—6½% due August 1, 1992 (1977—$23,400 U.S.; 1976—$24,384 U.S.)	25,192	26,252
B—7⅛% due April 15, 1993 (1977—$61,622 U.S.; 1976—$65,435 U.S.)	66,350	70,455
C—7.60% due June 15, 1997 ($30,000 U.S.)	29,522	29,522
	$474,483	$487,859

The First Mortgage and Collateral Trust Bonds of Interprovincial are secured by charges on all its assets; no further Bonds may be issued.

Principal repayments required on Long Term Debt for the years 1979 through 1982 are $24,420,000, $27,132,000, $27,132,000 and $27,132,000 respectively.

Long Term Debt payable in U.S. currency translated at historical rates of exchange amounts to $121,064,000 and if translated at the December 31, 1977 rate of exchange would be $125,880,000.

7. Capital Stock:

	Class A	Class B
Number of common shares, par value $1 each		
Authorized	100,000,000	100,000,000
Issued—December 31, 1977	24,484,530	1,089,100
December 31, 1976	24,528,169	1,045,461

Each class of share is voting, convertible into the other on a share-for-share basis and ranks equally with respect to dividends and in all other respects except that, in declaring dividends on Class B shares, the Directors may provide for tax-deferred dividends to be paid out of either or both tax-paid undistributed surplus on hand or 1971 capital surplus on hand, both as defined in the Income Tax Act of Canada. If a dividend is declared on the Class A shares, the Directors must declare an equivalent dividend on the Class B shares.

Parliament has enacted legislation effective March 31, 1977 amending income tax rules to permit companies to pay dividends out of 1971 capital surplus without having to pay the 15% tax on all their 1971 undistributed income. Effective June 1, 1977 Interprovincial's Class B dividends have been paid out of 1971 capital surplus. Corporations will not be permitted to distribute tax-deferred dividends after December 31, 1978.

Under the Employee Incentive Stock Option Plan options may be granted to full-time employees to purchase shares of capital stock at not less than 90% of market value of the shares on the day that an option is granted. During 1977 no options were granted or exercised. At December 31, 1977 options were outstanding on a total of 114,525 shares at prices ranging from $17 to $25.80 per share exercisable over varying periods up to April 1981.

Outstanding options include 25,500 shares to officers, including two directors who are full-time employees. At year end 55,500 shares were available for future grants.

8. Canadian Anti-Inflation Legislation:

Interprovincial is subject to, and believes it has complied with, the Canadian Government's anti-inflation legislation controlling employee compensation and dividends.

9. Remuneration of Directors and Officers:

In 1977 aggregate remuneration of eleven directors, two of whom were not paid as directors, was $48,000. Aggregate remuneration of six officers was $361,000. Two officers were also directors. No director or officer received remuneration from any subsidiary.

10. Kitimat Pipe Line Project:

Interprovincial is one of six participants in the Kitimat Pipe Line Project which is considering the construction of a 750-mile, 36-inch pipe line from Kitimat, British Columbia to Edmonton, Alberta. The project is currently estimated to cost about $750,000,000, the major portion of which will be financed by long term debt. Interprovincial is entitled to a 15% equity participation in the project and in addition would assume a guarantee of a like percentage of any cash deficiency including principal and interest payments of the debt. In 1977 and 1976 Interprovincial contributed $375,000 and $196,000 respectively, towards the preliminary costs of the project. These amounts are recorded as Other assets.

Interprovincial Pipe Line Limited
and subsidiary companies

Ten Year Review

Financial (in thousands of dollars except per share amounts)	1977
Income—Transportation revenue	$ 245,699
—Deficiency Agreement	$ 28,988
—Other income	$ 4,766
Expenses—Operating—power and fuel	$ 47,424
—other	$ 44,423
—Property and other taxes	$ 15,371
—Depreciation	$ 38,479
—Interest	$ 44,657
Income taxes	$ 45,252
Earnings	$ 43,847
per share, weighted average	$ 1.71
Dividends paid	$ 30,688
per share	$ 1.20
percentage of earnings	70%
Working capital (deficit)	$ 40,791
Funds provided from operations	$ 91,907
Additions to pipe line system	$ 20,197
Investment in pipe line system (cost)	$1,091,747
Long term debt	$ 474,483
Statistical	
Shares outstanding at year end (thousands)	25,573
Percentage of shares registered in Canada	95%
Shareholders at year end	21,942
Number of employees at year end	798
Investment in pipe line system, per employee	$1,368,000
Receipts (b/d)—Alberta	950,782
—Saskatchewan	160,632
—Manitoba	11,594
—Ontario	2,500
—United States	274,066
	1,399,574
Deliveries (b/d)	
Canada—Prairie Provinces	124,796
—Ontario	591,919
—Quebec	232,884
	949,599
United States—Minnesota-Wisconsin	181,087
—Illinois-Indiana	15,573
—Michigan-Ohio	118,907
—New York-Pennsylvania	135,217
	450,784
	1,400,383
Barrel miles (millions)	679,916
Average mileage per barrel delivered	1,330
Average transportation revenue (including Deficiency Agreement)	
—per barrel	53.7¢
—per 100 barrel miles	4.04¢

1976	1975	1974	1973	1972	1971	1970	1969	1968
196,712	194,715	192,944	202,831	164,207	144,393	133,707	114,465	105,532
20,209	—	—	—	—	—	—	—	—
3,725	2,300	2,074	2,461	1,689	2,871	1,643	994	1,049
30,902	27,550	31,603	30,699	18,735	13,213	11,186	11,053	12,514
30,924	26,491	27,277	22,075	18,088	17,176	16,164	14,841	13,282
12,675	12,588	11,218	8,415	9,612	8,814	9,643	8,338	5,789
32,224	24,889	24,044	21,803	19,674	18,115	17,519	16,070	13,677
34,399	23,273	24,724	21,481	19,010	18,890	18,810	13,898	8,608
40,407	43,323	40,567	53,034	40,693	35,416	32,531	26,833	29,377
39,115	38,901	35,585	47,785	40,084	35,640	29,497	24,426	23,334
1.53	1.52	1.39	1.87	1.57	1.40	1.16	0.96	0.92
30,688	30,688	30,688	28,127	23,976	21,892	20,352	18,316	18,316
1.20	1.20	1.20	1.10	0.94	0.86	0.80	0.72	0.72
78%	79%	86%	59%	60%	61%	69%	75%	78%
11,499	(22,575)	(16,695)	(4,800)	(707)	(818)	31,848	(10,490)	(14,122)
87,876	78,859	69,193	84,230	70,510	61,719	52,825	49,137	45,864
113,587	151,202	31,192	94,056	66,022	44,783	17,795	70,595	114,189
1,085,984	978,725	828,725	801,416	708,688	646,172	602,312	587,340	518,799
487,859	396,588	296,554	315,874	282,142	264,279	292,829	265,184	223,470
25,573	25,573	25,573	25,573	25,527	25,476	25,443	25,439	25,439
93%	95%	94%	94%	94%	93%	93%	92%	91%
20,359	21,010	20,423	19,621	18,864	19,576	21,066	21,996	21,486
790	755	751	730	706	677	641	603	562
1,375,000	1,296,000	1,103,000	1,098,000	1,004,000	954,000	940,000	974,000	923,000
873,220	924,151	1,059,695	1,134,985	877,474	743,411	659,382	542,093	475,437
145,968	148,053	192,951	217,423	217,768	217,034	224,890	225,755	236,613
11,215	12,215	13,193	14,216	14,931	15,575	16,452	17,489	17,524
1,556	1,596	842	4,134	3,196	2,751	817	550	205
166,712	76,393	42,241	11,123	8,440	3,228	2,579	—	—
1,198,671	1,162,408	1,308,922	1,381,881	1,121,809	981,999	904,120	785,887	729,779
123,510	137,479	155,755	147,033	115,939	116,163	116,386	111,504	106,832
527,536	510,167	524,805	467,893	414,305	390,798	380,570	351,270	338,624
83,723	—	—	—	—	—	—	—	—
734,769	647,646	680,560	614,926	530,244	506,961	496,956	462,774	445,456
172,004	166,274	169,435	195,467	175,534	159,142	142,686	135,451	116,196
24,971	81,782	164,324	229,302	145,397	89,309	49,836	—	—
120,857	141,311	165,119	200,978	142,973	120,098	121,822	105,540	96,847
131,050	123,185	127,639	136,742	121,365	101,840	89,619	72,206	58,228
448,882	512,552	626,517	762,489	585,269	470,389	403,963	313,197	271,271
1,183,651	1,160,198	1,307,077	1,377,415	1,115,513	977,350	900,919	775,971	716,727
579,436	581,850	668,864	707,037	573,456	488,862	444,318	366,287	337,978
1,338	1,374	1,402	1,406	1,405	1,370	1,351	1,293	1,288
50.1	46.0	40.4	40.3	40.2	40.5	40.7	40.4	40.2
3.74	3.35	2.88	2.87	2.86	2.95	3.01	3.13	3.12

Edmonton Manifold

Corporate Information

EXECUTIVE OFFICE
1, First Canadian Place
Toronto, Ontario M5X 1A9

HEAD OFFICE AND OPERATING HEADQUARTERS
Toronto Dominion Tower
Edmonton Centre
Edmonton, Alberta T5J 2J9

STOCK TRANSFER AGENTS
The Royal Trust Company - Halifax, Montreal, Toronto, Winnipeg, Regina, Edmonton, Vancouver

Chemical Bank, New York

(Change of address should be sent to the closest branch of the Transfer Agents)

STOCK REGISTRARS
Montreal Trust Company - Halifax, Montreal, Toronto, Winnipeg, Regina, Edmonton, Vancouver

Bank of Montreal Trust Company, New York

DIVIDEND DISBURSING AGENT
The Royal Trust Company
P.O. Box 7500, Postal Station 'A'
Toronto, Ontario M5W 1P9

TRUSTEE AND REGISTRAR FOR FIRST MORTGAGE AND COLLATERAL TRUST BONDS
The Royal Trust Company
Toronto and Montreal

TRUSTEE AND REGISTRAR FOR SERIAL AND SINKING FUND DEBENTURES
Montreal Trust Company
Montreal, Toronto, Winnipeg, Edmonton and Vancouver

LISTING OF STOCK
Toronto and Montreal Stock Exchanges

AUDITORS
Price Waterhouse & Co.
Edmonton, Alberta

PRINTED IN CANADA