

**CANADIAN MAINLINE** Owned 100 per cent by TransCanada, the Canadian Mainline is a 14,101 km (8,762 miles) natural gas transmission system in Canada that extends from the Alberta/Saskatchewan border east to the Québec/Vermont border and connects with other natural gas pipelines in Canada and the U.S.

**ALBERTA SYSTEM** Owned 100 per cent by TransCanada, the Alberta System is a 23,705 km (14,730 miles) natural gas transmission system in Alberta. One of the largest transmission systems in North America, it gathers natural gas for use within the province and delivers it to provincial boundary points for connection with the Company's Canadian Mainline and Foothills natural gas pipelines and with the natural gas pipelines of other companies.

**ANR** Owned 100 per cent by TransCanada, ANR is a 17,000 km (10,563 miles) transmission system that transports natural gas from producing fields located primarily in Texas and Oklahoma on its southwest leg and in the Gulf of Mexico and Louisiana on its southeast leg. The system extends to markets located mainly in Wisconsin, Michigan, Illinois, Ohio and Indiana. ANR's natural gas pipeline also connects with other natural gas pipelines providing access to diverse sources of North American supply including Western Canada and the Rocky Mountain supply basin, and a variety of markets in the midwestern and northeastern U.S. ANR also owns and operates regulated underground natural gas storage facilities in Michigan with a total capacity of 250 Bcf.

**GTN SYSTEM** Owned 100 per cent by TransCanada, the GTN System is a 2,174 km (1,351 miles) natural gas transmission system that links Foothills with Pacific Gas and Electric Company's California Gas Transmission System, with Williams Companies, Inc.'s Northwest Pipeline in Washington and Oregon, and with Tuscarora.

**FOOTHILLS** Owned 100 per cent by TransCanada, the 1,241 km (771 miles) Foothills transmission system in Western Canada carries natural gas for export from central Alberta to the U.S. border to serve markets in the U.S. Midwest, Pacific Northwest, California and Nevada.

**NORTH BAJA** Owned 100 per cent by TransCanada, the North Baja natural gas transmission system extends 129 km (80 miles) from Ehrenberg in southwestern Arizona to a point near Ogilby, California on the California/Mexico border and connects with the Gasoducto Bajanorte natural gas pipeline system in Mexico.

**VENTURES LP** Owned 100 per cent by TransCanada, Ventures LP is comprised of a 161 km (100 miles) pipeline and related facilities that supply natural gas to the oil sands region near Fort McMurray, Alberta as well as a 27 km (17 miles) pipeline that supplies natural gas to a petrochemical complex at Joffre, Alberta.

**TAMAZUNCHALE** Owned 100 per cent by TransCanada, the 130 km (81 miles) Tamazunchale natural gas pipeline in east central Mexico extends from the facilities of Pemex Gas near Naranjos, Veracruz, to an electricity generating station near Tamazunchale, San Luis Potosi.

**TUSCARORA** Owned 100 per cent by PipeLines LP, Tuscarora is a 491 km (305 miles) pipeline system transporting natural gas from the GTN System at Malin, Oregon, to Wadsworth, Nevada, with delivery points in northeastern California and northwestern Nevada. TransCanada operates Tuscarora and effectively owns 32.1 per cent of the system through its 32.1 per cent interest in PipeLines LP.

**NORTHERN BORDER** Owned 50 per cent by Pipelines LP, the 2,250 km (1,398 miles) Northern Border natural gas transmission system serves the U.S. Midwest from a connection with Foothills near Monchy, Saskatchewan. TransCanada operates Northern Border and effectively owns 16.1 per cent of the system through its 32.1 per cent interest in PipeLines LP.

**GREAT LAKES** Owned 53.6 per cent by TransCanada and 46.4 per cent by Pipelines LP, the 3,404 km (2,115 miles) Great Lakes natural gas transmission system connects with the Canadian Mainline at Emerson, Manitoba, and serves markets in Central Canada and the midwestern U.S. TransCanada operates Great Lakes and effectively owns 68.5 per cent of the system through its 53.6 per cent direct ownership interest and its indirect ownership, which it has through its 32.1 per cent interest in PipeLines LP.

**IROQUOIS** Owned 44.5 per cent by TransCanada, the 666 km (414 miles) Iroquois pipeline system connects with the Canadian Mainline near Waddington, New York, and delivers natural gas to customers in the northeastern U.S.

**TQM** Owned 50 per cent by TransCanada, TQM is a 572 km (355 miles) pipeline system that connects with the Canadian Mainline and transports natural gas from Montréal to Québec City in Québec, and connects with the Portland system. TQM is operated by TransCanada.

**PORTLAND** Owned 61.7 per cent by TransCanada, Portland is a 474 km (295 miles) pipeline that connects with TQM near East Hereford, Québec and delivers natural gas to customers in the northeastern U.S. Portland is operated by TransCanada.

**BISON** The Bison pipeline project is a proposed 480 km (298 miles) pipeline from the Powder River Basin in Wyoming to the Northern Border system in North Dakota.

**KEYSTONE** Keystone is an oil pipeline consisting of 3,456 km (2,147 miles) of pipe under construction that will initially transport crude oil from Hardisty, Alberta to U.S. Midwest markets at Wood River and Patoka in Illinois, and to Cushing, Oklahoma. In addition, an expansion to the U.S. Gulf Coast is under development, which is expected to add approximately 2,720 km (1,690 miles) of pipe to the system. Commissioning of the segment to Wood River and Patoka is expected to begin in late 2009. Commissioning of the segment to Cushing is expected to begin in late 2010. The expansion to the U.S. Gulf Coast is expected to be commissioned in 2012, subject to regulatory approvals. In 2008, TransCanada agreed to increase its ownership interest in Keystone up to 79.99 per cent. At December 31, 2008, TransCanada owned 62 per cent of Keystone.

**TRANSGAS** Owned 46.5 per cent by TransCanada, TransGas is a 344 km (214 miles) natural gas pipeline system extending from Mariquita in the central region of Colombia to Cali in southwestern Colombia.

**GAS PACIFICO/INNERGY** Owned 30 per cent by TransCanada, Gas Pacifico is a 540 km (336 miles) natural gas pipeline extending from Loma de la Lata, Argentina to Concepción, Chile. TransCanada also has a 30 per cent ownership interest in INNERGY, an industrial natural gas marketing company based in Concepción that markets natural gas transported on Gas Pacifico.

## PIPELINES – HIGHLIGHTS

- Net income from Pipelines was \$902 million in 2008, an increase of \$216 million from \$686 million in 2007. Comparable earnings from Pipelines were \$740 million in 2008, an increase of \$54 million from \$686 million in 2007.
- The Keystone partnerships began building the portion of the Keystone pipeline that will deliver oil to markets in the U.S. Midwest and to Cushing, Oklahoma, and secured shipping commitments for a future expansion to serve markets on the U.S. Gulf Coast.
- TransCanada began construction of the North Central Corridor expansion at a cost of approximately \$925 million following approval from the Alberta Utilities Commission (AUC).
- TransCanada received approval from the AUC for the Alberta System's 2008-2009 Revenue Requirement Settlement.
- TransCanada filed an application with the National Energy Board (NEB) to establish federal jurisdiction over the Alberta System. A decision is expected in first quarter 2009.
- ANR completed the second phase of its storage enhancement project (STEP 2008), which added 14 Bcf of storage capacity.
- TransCanada was awarded a license from the State of Alaska to construct the Alaska Pipeline Project under the *Alaska Gasline Inducement Act* (AGIA).

### PIPELINES RESULTS

Year ended December 31 (millions of dollars)

	2008	2007	2006
<b>Wholly Owned Pipelines</b>			
Canadian Mainline	278	273	239
Alberta System	145	138	136
ANR <sup>(1)</sup>	132	104	n/a
GTN	65	58	46
Foothills	24	26	27
	<b>644</b>	599	448
<b>Other Pipelines</b>			
Great Lakes <sup>(2)</sup>	44	47	44
PipeLines LP <sup>(3)</sup>	25	18	4
Iroquois	18	15	15
Tamazunchale <sup>(4)</sup>	16	10	2
Other <sup>(5)</sup>	34	46	51
Northern Development	(9)	(7)	(5)
General, administrative, support costs and other	(32)	(42)	(30)
	<b>96</b>	87	81
<b>Comparable Earnings<sup>(6)</sup></b>	<b>740</b>	686	529
Calpine bankruptcy settlements <sup>(7)</sup>	152	–	–
GTN lawsuit settlement	10	–	–
Bankruptcy settlement with Mirant	–	–	18
Gain on sale of Northern Border Partners, L.P. interest	–	–	13
<b>Net Earnings</b>	<b>902</b>	686	560

<sup>(1)</sup> ANR's results include earnings from the date of acquisition of February 22, 2007.

- (2) Great Lakes' results reflect TransCanada's 53.6 per cent ownership in Great Lakes since February 22, 2007 and 50 per cent ownership prior to that date.
- (3) PipeLines LP's results include TransCanada's effective ownership of an additional 14.9 per cent interest in Great Lakes since February 22, 2007 as a result of PipeLines LP's acquisition of a 46.4 per cent interest in Great Lakes and TransCanada's 32.1 per cent interest in PipeLines LP. Prior to this date, TransCanada had a 13.4 per cent ownership interest in PipeLines LP.
- (4) Tamazunchale's results include operations since December 1, 2006.
- (5) Other includes results of Portland, Ventures LP, TQM, TransGas and Gas Pacifico/INNERGY.
- (6) Refer to the "Non-GAAP Measures" section of this MD&A for further discussion of comparable earnings.
- (7) GTN and Portland received shares of Calpine with an initial after-tax value of \$95 million and \$38 million (TransCanada's share), respectively, from the bankruptcy settlements with Calpine. These shares were subsequently sold for an additional after-tax gain of \$19 million.

Net earnings from the Pipelines business were \$902 million in 2008 compared to \$686 million in 2007 and \$560 million in 2006. Comparable earnings from the Pipelines business of \$740 million in 2008 excluded the \$152 million after-tax (\$279 million pre-tax) gains received by Portland and the GTN System from the bankruptcy settlements with Calpine and \$10 million after-tax (\$17 million pre-tax) proceeds received by GTN from a lawsuit settlement with a software supplier. The \$54 million increase in comparable earnings in 2008 from 2007 was primarily due to a full year of earnings from ANR, the Alberta System rate settlement and higher earnings for the Canadian Mainline. Comparable earnings in 2006 were \$529 million and excluded an \$18 million bankruptcy settlement with Mirant and a \$13 million gain on sale of TransCanada's general partner interest in Northern Border Partners, L.P. The increase in comparable earnings in 2007 compared to 2006 was primarily due to the acquisitions of ANR and additional interest in Great Lakes, higher earnings as a result of rate settlements for Canadian Mainline and the GTN System, and an increased ownership in PipeLines LP.

## PIPELINES – FINANCIAL ANALYSIS

### *Canadian Mainline*

The Canadian Mainline is regulated by the NEB, which sets tolls that provide TransCanada with the opportunity to recover projected costs of transporting natural gas, including a return on the Canadian Mainline's average investment base. The NEB also approves new facilities before construction begins. Net earnings from the Canadian Mainline are affected by changes in the investment base, the rate of return on common equity (ROE), the level of deemed common equity and potential incentive earnings.

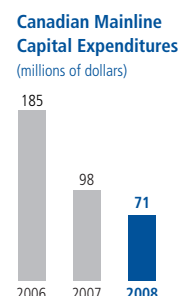
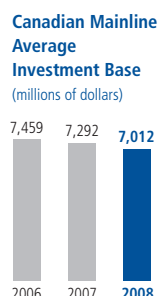
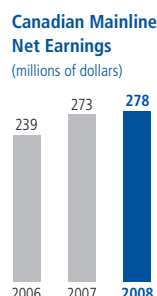
The Canadian Mainline currently operates under a five-year tolls settlement effective from 2007 to 2011. The cost of capital reflects an ROE as determined by the NEB's ROE formula on deemed common equity of 40 per cent. The remaining capital structure consists of short- and long-term debt, following the agreed upon redemption of the US\$460 million 8.25 per cent Preferred Securities in 2007.

The settlement also established certain elements of the Canadian Mainline's fixed operating, maintenance and administration (OM&A) costs for each of the five years. The variance between actual and agreed-upon OM&A costs accrues entirely to TransCanada from 2007 to 2009, and will be shared equally between TransCanada and its customers in 2010 and 2011. All other cost elements of the revenue requirement are treated on a flow-through basis. The settlement also allows for performance-based incentive arrangements that the Company believes are mutually beneficial to both TransCanada and its customers.

Net earnings of \$278 million in 2008 were \$5 million higher than \$273 million in 2007 primarily due to higher performance-based incentives earned and increased OM&A cost savings and an ROE of 8.71 per cent in 2008, as determined by the NEB, compared to 8.46 per cent in 2007. These increases were partially offset by a lower average investment base.

Net earnings of \$273 million in 2007 were \$34 million higher than \$239 million in 2006. The increase primarily reflected the positive impact of the increase in deemed common equity ratio to 40 per cent from 36 per cent as a

result of the Canadian Mainline tolls settlement, performance-based incentives earned and OM&A cost savings. These increases were partially offset by a lower allowed ROE of 8.46 per cent in 2007 (2006 – 8.88 per cent) and a lower average investment base.



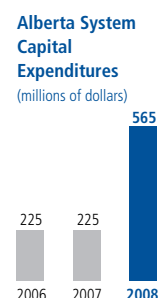
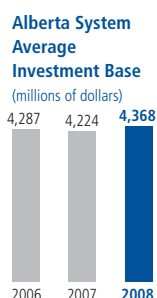
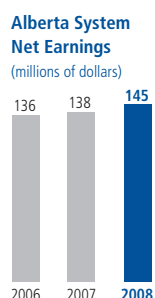
### Alberta System

Construction and operation of the Alberta System's facilities and the terms and conditions of its services, including rates, are regulated by the AUC, primarily under the provisions of the *Gas Utilities Act (Alberta)* and the *Pipeline Act (Alberta)*.

In December 2008, the AUC approved TransCanada's 2008-2009 Revenue Requirement Settlement Application, as discussed further in the "Pipelines – Opportunities and Developments" section of this MD&A.

The Alberta System's net earnings of \$145 million in 2008 were \$7 million higher than in 2007. The increase was due to the recognition of earnings related to the revenue requirement settlement. Earnings in 2007 reflected an ROE of 8.51 per cent on deemed common equity of 35 per cent.

Net earnings of \$138 million in 2007 were \$2 million higher than in 2006. The increase was primarily due to OM&A cost savings, partially offset by a lower allowed ROE and a lower investment base in 2007. The allowed ROE prescribed by the Alberta Energy and Utilities Board, the AUC's predecessor, was 8.51 per cent in 2007 compared with 8.93 per cent in 2006 on deemed common equity of 35 per cent.



### ANR

TransCanada completed the acquisition of ANR in February 2007. The operations of ANR are regulated primarily by the U.S. Federal Energy Regulatory Commission (FERC). ANR provides natural gas transportation, storage and various capacity-related services to a variety of customers in both the U.S. and Canada. ANR's transmission system has a peak-day capacity of 6.8 billion cubic feet per day (Bcf/d). Due to the seasonal nature of its business, ANR's volumes and revenues are generally expected to be higher in the winter months. ANR also owns and operates 250 Bcf of underground natural gas storage facilities in Michigan. ANR's regulated natural gas storage and transportation services operate under current FERC-approved tariff rates. These tariffs include maximum and minimum rate levels for services and permit ANR to discount or negotiate rates on a non-discriminatory basis.

ANR Pipeline Company's (ANR Pipeline) rates were established pursuant to a settlement approved by the FERC effective November 1997. ANR Storage Company's rates were established pursuant to a settlement approved by the FERC effective June 1990. None of ANR's FERC-regulated operations are required to file for new rates at any time in the future, nor are any of the operations prohibited from filing a rate case.

Net income for 2008 was \$132 million compared to \$104 million for the period from the date of acquisition on February 22, 2007 to December 31, 2007. The increase in 2008 was primarily due to a full year of earnings in 2008 and increased revenues from new growth projects, partially offset by higher OM&A costs, including remediation expenditures for damage caused by Hurricane Ike.

### **GTN**

Both of GTN's systems, the GTN System and North Baja (collectively, GTN), are subject to FERC-approved tariffs that establish maximum and minimum rates for various services. GTN's pipeline rates were established pursuant to a settlement approved by the FERC in January 2008, and these rates became effective January 1, 2007. Under the settlement, a five-year moratorium was established during which the GTN System and the settling parties are prohibited under the *Natural Gas Act of 1938* from taking certain actions, including any filings to adjust rates. The settlement also requires the GTN System to file a rate case within seven years of the effective date. The systems are permitted to discount or negotiate these rates on a non-discriminatory basis. GTN's earnings are affected by variations in contracted volume levels, volumes delivered and prices charged under the various service types, as well as by variations in the costs of providing services.

GTN's comparable earnings were \$65 million in 2008, an increase of \$7 million compared to 2007 primarily due to decreased OM&A expenses. An increase in revenues for North Baja was offset by a decrease in revenues for the GTN System.

Comparable earnings were \$58 million in 2007, a \$12 million increase from 2006. The increase was primarily due to the positive impact of the rate case settlement in 2007, partially offset by lower long-term firm contracted volumes, a higher provision taken for non-payment of contract revenues from Calpine and a weaker U.S. dollar in 2007.

### **Other Pipelines**

TransCanada's direct and indirect investments in various natural gas pipelines and its project development activities relating to natural gas and oil transmission opportunities throughout North America are included in Other Pipelines.

TransCanada's comparable earnings from Other Pipelines were \$96 million in 2008 compared to \$87 million in 2007. The increase was primarily due to lower general, administrative and support costs, and higher earnings from PipeLines LP, Tamazunchale and Iroquois, partially offset by lower earnings from Gas Pacifico/INNERGY, TransGas, Portland and Great Lakes.

Comparable earnings from Other Pipelines were \$87 million in 2007, a \$6 million increase compared to 2006. The increase was primarily due to higher PipeLines LP earnings resulting from TransCanada's increased ownership interests in PipeLines LP and Great Lakes, and a full year of earnings in 2007 from Tamazunchale. These increases were partially offset by higher project development and support costs associated with growing the Pipelines business, the effects of a weaker U.S. dollar in 2007 and proceeds of a bankruptcy settlement received by Portland in 2006.

At December 31, 2008, Other Assets included \$74 million and \$42 million for capitalized costs related to the Keystone expansion to the U.S. Gulf Coast and the Bison pipeline project, respectively.

## **PIPELINES – OPPORTUNITIES AND DEVELOPMENTS**

### **Keystone**

Keystone is expected to deliver crude oil from Hardisty, Alberta, to U.S. Midwest markets at Wood River and Patoka in Illinois, and to Cushing, Oklahoma.

In March 2008, the U.S. Department of State issued a Presidential Permit to Keystone authorizing construction, maintenance and operations of facilities at the U.S./Canada border for the transportation of crude oil between the two countries. Construction of Keystone began in May 2008 in both Canada and the U.S. Commissioning of the Wood River and Patoka segment is expected to commence in late 2009 with commercial operations to follow in early 2010. Commissioning of the Cushing segment is expected to commence in late 2010.

In June 2008, Keystone received approval from the NEB to add new pumping facilities to accommodate an increase to approximately 590,000 Bbl/d from 435,000 Bbl/d in volumes to be delivered to the Cushing markets.

After an open season conducted during third quarter 2008, Keystone secured additional firm, long-term contracts totaling 380,000 Bbl/d for an average term of approximately 17 years. With these shipper commitments, Keystone will proceed with the necessary regulatory applications in Canada and the U.S. for approvals to construct and operate an expansion of the pipeline system that will provide additional capacity from Western Canada to the U.S. Gulf Coast in 2012 and will increase the total commercial capacity of Keystone to approximately 1.1 million Bbl/d. With the additional contracts, Keystone now has secured long-term commitments for 910,000 Bbl/d for an average term of approximately 18 years. This includes commitments made by shippers to sign transportation service agreements for 35,000 Bbl/d of capacity in an open season to be held in 2009. The commitments represent approximately 83 per cent of the commercial design of the system.

The entire Keystone project is currently expected to cost approximately US\$12 billion between 2008 and 2012. In 2008, the Keystone partnerships made capital expenditures of approximately \$1.7 billion on the entire project, of which \$1.0 billion was contributed by TransCanada.

TransCanada has agreed to increase its equity ownership in the Keystone partnerships up to 79.99 per cent from 50 per cent with ConocoPhillips' equity ownership being reduced concurrently to 20.01 per cent. In accordance with this agreement, TransCanada will fund 100 per cent of the construction expenditures until the participants' project capital contributions are aligned with the revised ownership interests. At December 31, 2008, TransCanada's equity ownership in the Keystone partnerships was approximately 62 per cent. Certain parties that have made volume commitments to the Keystone expansion have an option to acquire up to a combined 15 per cent equity ownership in the Keystone partnerships by the end of first quarter 2009. If all of the options are exercised, TransCanada's equity ownership would be reduced to 64.99 per cent.

Keystone's tolls, tariffs and facilities are regulated by the NEB in Canada and the FERC in the U.S., and have been approved for the segments shipping to Wood River, Patoka and Cushing. The Company expects the tolls and tariffs to remain in place for the term of the initial shipper contracts, which comprise approximately 83 per cent of Keystone's commercial capacity.

#### ***Canadian Mainline***

In December 2008, the NEB announced that, pursuant to its formula, the 2009 allowed ROE for NEB-regulated pipelines, including the Canadian Mainline, will be 8.57 per cent, a decrease from 8.71 per cent in 2008.

#### ***Alberta System***

In December 2008, the AUC approved the Alberta System's 2008-2009 Revenue Requirement Settlement Application. As part of the settlement, fixed costs were established for ROE, income taxes and OM&A costs. Any variances between actual costs and those agreed to in the settlement accrue to TransCanada, subject to an ROE and income tax adjustment mechanism, which accounts for variances between actual and settlement rate base, and income tax assumptions. The other cost elements of the settlement are treated on a flow-through basis.

In November 2008, an NEB hearing concluded on TransCanada's application to establish Federal jurisdiction over the Alberta System. A decision is expected from the NEB at the end of February 2009. Changing from AUC to NEB jurisdiction will allow the expansion of the Alberta System beyond Alberta provincial borders.

In October 2008, the AUC approved TransCanada's application for a permit to construct the North Central Corridor expansion at a cost of approximately \$925 million. The expansion comprises a 300 km (186 miles) natural gas pipeline and associated compression facilities on the northern section of the Alberta System.

On September 8, 2008, TransCanada reached a proposed agreement with Canadian Utilities Limited (ATCO Pipelines) to provide seamless natural gas transmission service to customers. If approved by regulatory authorities, the arrangement will see the two companies combine physical assets under a single rates and services structure with a single commercial interface for customers but with each company separately managing assets within distinct operating territories in the province. TransCanada continues to work with all stakeholders to finalize this agreement.

In February 2008, the AUC initiated a Generic Cost of Capital proceeding to review the generic ROE and capital structures of AUC regulated utilities. In November 2008, TransCanada filed an application requesting an 11 per cent ROE on 40 per cent deemed common equity for the Alberta System in 2009. The hearing is scheduled to begin on May 19, 2009.

#### **ANR**

In 2008, ANR completed its STEP 2008 project, which added 14 Bcf of storage and 200 million cubic feet per day (mmcf/d) of withdrawal capacity to the Cold Springs 1 storage field located in Northern Michigan, and increased ANR's total storage capacity to 250 Bcf. The project was completed under budget and service was provided on schedule. Supply on ANR's southwest leg was increased as a result of an interconnect with the Rockies Express natural gas pipeline, which commenced service in January 2008. There is strong potential for new supply on the southeast leg from shale gas in the mid-continent region, and another interconnect with the Rockies Express pipeline is planned for the southeast leg in Indiana in mid-2009. ANR is also pursuing other supply additions on both its southwest and southeast legs.

In September 2008, certain portions of the Company's Gulf of Mexico offshore facilities were impacted by Hurricane Ike. The Company estimates its total exposure to damage costs to be approximately US\$30 million to US\$40 million, mainly to replace, repair and abandon capital assets, including the estimated cost to abandon an offshore platform. At December 31, 2008, capital expenditures of US\$2 million and OM&A costs of US\$6 million had been incurred. The remaining costs are primarily expected to be capital expenditures. Service on the majority of the offshore facilities has been restored and related throughput volumes have returned to near pre-hurricane levels. The timing of the remaining facilities' return to service is primarily dependent upon decisions to be made by upstream producers regarding their damaged facilities in the Gulf of Mexico.

#### **Palomar**

In December 2008, Palomar Gas Transmission LLC filed with the FERC for a certificate to build a pipeline extending from the GTN System in central Oregon, to the Columbia River northwest of Portland. The proposed pipeline is expected to be capable of transporting up to 1.3 Bcf/d of natural gas. The project is a 50/50 joint venture of GTN and Northwest Natural Gas Co.

#### **North Baja**

In September 2008, the FERC approved North Baja's application to build a natural gas pipeline to serve the Yucca Power Plant owned by Arizona Public Service Company. Three miles of the proposed pipeline are expected to be in the U.S. and owned by North Baja, and another three miles in Mexico are owned by Gasoducto Bajanorte. Pending final approval by the U.S. Government, construction is expected to commence in first quarter 2009 with a projected in-service date of May 2009.

#### **Portland**

On April 1, 2008, Portland filed a general rate case with the FERC proposing a rate increase of approximately six per cent as well as other changes to its tariffs. In accordance with a FERC order dated May 1, 2008, the proposed tariffs went into effect on September 1, 2008, subject to refund. The hearing is scheduled to begin on July 13, 2009.

**TQM**

In December 2008, the NEB concluded a proceeding with respect to TQM's Cost of Capital application for 2007 and 2008. The application sought an ROE of 11 per cent on deemed equity of 40 per cent. The proceeding also provided an opportunity for TQM to propose alternatives to the current ROE formula. A decision from the NEB is expected in first quarter 2009.

**U.S. Rockies Pipeline Projects**

The Bison pipeline project is a proposed pipeline from the Powder River Basin in Wyoming to the Northern Border system in North Dakota. The project has shipping commitments for approximately 405 mmcf/d and is expected to be in service in fourth quarter 2010. The capital cost of the Bison pipeline project is estimated at US\$500 million to US\$600 million. TransCanada continues to work with Bison shippers to finalize the size and design of this project.

In addition, TransCanada is proposing the Pathfinder pipeline project, a 1,006 km (625 miles) pipeline from Meeker, Colorado to the Northern Border system in North Dakota. A portion of the Pathfinder pipeline may share a common route with the Bison pipeline and may also share some common facilities. TransCanada continues to work with prospective Pathfinder shippers to advance this project.

TransCanada and Williams Gas Pipeline Company, LLC (Williams) are evaluating the development of the Sunstone pipeline, a proposed pipeline from Wyoming to Stanfield, Oregon. This project would provide Pacific Northwest and California markets with access to incremental Rockies supply. TransCanada and its partner continue to work with customers to determine the appropriate size, time and route for this project.

**Mackenzie Gas Pipeline Project**

The MGP is a proposed 1,200 km (746 miles) natural gas pipeline to be constructed from a point near Inuvik, Northwest Territories to the northern border of Alberta, where it is expected to connect to the Alberta System.

TransCanada's involvement with the MGP arises from a 2003 agreement between the Mackenzie Valley Aboriginal Pipeline Group (APG) and the MGP, whereby TransCanada agreed to finance the APG's one-third share of the pre-development costs associated with the project. Cumulative advances made by TransCanada totaled \$140 million at December 31, 2008 and are included in Other Assets. These amounts constitute a loan to the APG, which becomes repayable only after the natural gas pipeline commences commercial operations. The total amount of the loan is expected to form part of the rate base of the pipeline and to subsequently be repaid from the APG's share of future natural gas pipeline revenues or from alternate financing. If the project does not proceed, TransCanada has no recourse against the APG for recovery of advances made. Accordingly, TransCanada's ability to recover its investment through loan repayments and/or equity ownership in the project depends upon a successful outcome of the project.

Under the terms of certain MGP agreements, TransCanada holds an option to acquire up to a five per cent equity ownership in the natural gas pipeline at the time of the decision to construct it. In addition, TransCanada gains certain rights of first refusal to acquire 50 per cent of any divestitures by existing partners and an entitlement to obtain a one-third interest in all expansion opportunities once the APG reaches a one-third ownership share, with the other natural gas pipeline owners and the APG sharing the balance.

TransCanada and the other co-venture companies involved in the MGP continue to pursue approval of the proposed project, focusing on obtaining regulatory approval and the Canadian government's support of an acceptable fiscal framework. Project timing continues to be uncertain. Detailed discussions with the Canadian government have taken place and have resulted in a proposal in January 2009 from the government to the MGP. The co-venture group is considering the proposal and is expected to respond to the government in the near future. In the event the co-venture group is unable to reach an agreement with the government on an acceptable fiscal framework, the parties will need to determine the appropriate next steps for the project. For TransCanada, this may result in a reassessment of the carrying amount of the APG advances.

***Alaska Pipeline Project***

In November 2007, TransCanada submitted an application to the State of Alaska for a license to construct the Alaska Pipeline Project under the AGIA. In January 2008, Alaska Governor Sarah Palin's administration determined that TransCanada's application was the only proposal that met all of the state's requirements and in December 2008 the State of Alaska issued the AGIA license to TransCanada. Under the AGIA, the State of Alaska has agreed to reimburse a share of TransCanada's eligible pre-construction costs to a maximum of US\$500 million.

The Alaska Pipeline Project will be a 4.5 Bcf/d natural gas pipeline extending approximately 2,760 km (1,715 miles) from a new natural gas treatment plant at Prudhoe Bay, Alaska to Alberta. This pipeline will integrate with the Alberta System to provide access to diverse markets across North America. The application included provision for expansions up to 5.9 Bcf/d through the addition of compressor stations in Alaska and Canada. TransCanada estimated the total capital cost of the entire project to be approximately US\$26 billion in 2007 dollars.

Since the AGIA license was awarded, TransCanada has moved forward with developing the project, which involves engineering, environmental, aboriginal relations and commercial work to conclude an initial binding open season by mid-2010. TransCanada continues its efforts to align with potential shippers and if sufficient firm contracts are secured in the open season, construction would begin following regulatory approvals, with an anticipated in-service date of 2018.

**PIPELINES – BUSINESS RISKS*****Supply, Markets and Competition***

TransCanada faces competition at both the supply and market ends of its systems. This competition comes from other natural gas pipelines accessing the increasingly mature WCSB and markets served by TransCanada's pipelines. In addition, the continued expiration of long-term firm contracts has resulted in significant reductions in long-term firm contracted capacity and shifts to short-term firm and interruptible contracts on the Canadian Mainline, the Alberta System, Foothills and the GTN System.

In 2008, the gas supply environment changed. Production out of the WCSB declined while supply in the U.S. grew. Previously it had been expected that U.S. supply would decline. Furthermore, with lower natural gas prices, lower cost U.S. gas developments may hinder the further development of WCSB gas supplies.

TransCanada's primary source of natural gas supply is the WCSB. The WCSB has remaining discovered natural gas reserves of approximately 57 trillion cubic feet and a reserves-to-production ratio of approximately nine years at current levels of production. Historically, sufficient additional reserves have been discovered on an ongoing basis to maintain the reserves-to-production ratio at close to nine years, however, supply from the WCSB has declined in recent years due to a continued reduction in levels of drilling activity in the basin. The reduced drilling activity is a result of lower prices, higher supply costs, which include higher royalties in Alberta, and competition for capital from other North American basins that have lower exploration costs. Drilling levels in the WCSB are expected to reach a low point in 2009 and then should begin to recover in the ensuing years assuming that gas prices stabilize at \$6 to \$7 per gigajoule (GJ) and that finding and development costs become more economical. TransCanada anticipates there will be excess natural gas pipeline capacity out of the WCSB in the foreseeable future as a result of capacity expansions on its wholly owned and partially owned natural gas pipelines over the past decade, competition from other pipelines, and significant growth in natural gas demand within Alberta driven by oil sands and electricity generation requirements.

TransCanada's Alberta System is the major natural gas gathering and transportation system for the WCSB, connecting most of the natural gas processing plants in Alberta to domestic and export markets. Despite reduced overall drilling levels, activity remains robust in certain areas of the WCSB, which has resulted in the need for new transmission infrastructure. The primary areas of high activity have been deeper conventional drilling in western Alberta and in the foothills region of B.C., and coalbed methane development in central Alberta. Recently, shale gas production in B.C. has emerged as a potentially significant natural gas supply source.

Historically, TransCanada's eastern natural gas pipeline system has been supplied by long-haul flows from the WCSB and by short-haul volumes received from storage fields and interconnecting pipelines in southwestern Ontario. Over the last few years, the Canadian Mainline has experienced reductions in long-haul flows, which have been partially offset by increases in short-haul volumes, resulting in an increase in Canadian Mainline tolls.

Demand for natural gas in TransCanada's key eastern markets, which are served by the Canadian Mainline, is expected to continue to increase, particularly to meet the expected growth in natural gas-fired power generation. However, the Company believes the current environment could reverse this trend in the short term given sufficient levels of erosion of market demand. Although there are opportunities to increase market share in Canadian domestic and U.S. export markets, TransCanada faces significant competition in these regions. Consumers in the northeastern U.S. generally have access to an array of natural gas pipeline and supply options. Eastern markets that historically received Canadian supplies only from TransCanada are now capable of receiving supplies from new natural gas pipelines that source U.S. and Atlantic Canadian supplies.

The source of oil supply for Keystone is located primarily in Alberta, which produces approximately 79 per cent of the oil in the WCSB. In 2008, the WCSB produced a total of approximately 2.4 million Bbl/d, comprised of 1.2 million Bbl/d of conventional crude oil and condensate, and 1.2 million Bbl/d of oil from the oil sands area of Alberta. The production of conventional oil has been declining but has been offset by increases in production of oil from the Alberta oil sands. The Alberta Energy Resources Conservation Board has estimated that there are 173 billion barrels of remaining established reserves in the Alberta oil sands.

A decline in oil prices in late 2008 has resulted in announcements of delays in oil sands projects and upgraders, however, in December 2008, the Canadian Association of Petroleum Producers forecast WCSB oil supply would increase from 2.4 million Bbl/d in 2008 to 3.5 million Bbl/d by 2015 and 4.1 million Bbl/d by 2020.

Keystone has 910,000 Bbl/d of contracts for capacity, on a ship or pay basis, with an average contract life of 18 years, which the Company believes will provide incentive for contract shippers to ship on Keystone. However, Keystone must compete for spot throughput with other oil pipelines from Alberta.

Keystone's markets for crude oil are refiners in the U.S. Midwest and Gulf Coast regions. A competing pipeline can also deliver WCSB crude oil to the Midwest markets supplied by Keystone. Currently, competing pipelines can deliver oil to the U.S. Gulf Coast, through interconnections with other pipelines. Keystone must also compete with U.S. domestically produced oil and imported oil for markets in the Midwest and Gulf Coast regions.

ANR's natural gas supply is primarily sourced from the Gulf of Mexico and mid-continent U.S. regions, which are also served by competing natural gas pipelines. ANR also has competition from other natural gas pipelines and storage operations in its primary markets in the U.S. Midwest. The Gulf of Mexico region is extremely competitive given its extensive natural gas pipeline network. ANR is one of many interstate and intrastate pipelines in the region competing for new and existing production as well as for new supplies from shale production in the mid-continent, from the Rockies Express natural gas pipeline originating in the Rocky Mountain region, and from LNG. Several new natural gas pipelines are proposed or under construction to connect new supplies to the numerous pipelines in the Gulf of Mexico region. ANR competes with other natural gas pipelines in the region to attract supply to its pipeline for alternative markets and storage. In addition to pipeline competition for market and supply, current difficult economic conditions are expected to reduce energy demand and may put future ANR capacity renewals at risk as the North American economy slows or potentially contracts in key markets in the upper U.S. Midwest. As lower natural gas prices reduce drilling activity, the supply growth that has been fuelling the growth in pipeline infrastructure in the mid-continent could slow down but is still expected to exceed demand requirements in the near term. These factors could negatively affect pipeline capacity value as transportation capacity becomes more abundant.

The GTN System must compete with other pipelines to access natural gas supplies and markets. Transportation service capacity on the GTN System provides customers in the U.S. Pacific Northwest, California and Nevada with access to supplies of natural gas primarily from the WCSB. These three markets may also access supplies from other basins. In the Pacific Northwest market, natural gas transported on the GTN System competes with the Rocky Mountain natural gas

supply and with additional western Canadian supply transported by other pipelines. Historically, natural gas supplies from the WCSB have been competitively priced in relation to supplies from the other regions serving these markets. The GTN System has experienced significant contract non-renewals since 2005 as the natural gas it transports from the WCSB competes for the California and Nevada markets against supplies from the Rocky Mountain and southwestern U.S. basins. Recently, Pacific Gas and Electric Company, the GTN System's largest customer, received California Public Utilities Commission approval to commit to capacity on a proposed competing project out of the Rocky Mountain basin to the California border.

#### ***Regulatory Financial Risk***

Regulatory decisions continue to have a significant impact on the financial returns from existing investments in TransCanada's Canadian wholly owned pipelines and are expected to have a similarly significant impact on financial returns from future investments. TransCanada remains concerned that current financial returns approved by regulators are not as competitive as returns from other assets with similar risk profiles. In recent years, TransCanada applied to the NEB and the AUC for an ROE of 11 per cent on 40 per cent deemed common equity for both the Canadian Mainline and the Alberta System. The NEB has reaffirmed its ROE formula and the AUC has established a generic ROE that is largely aligned with the NEB formula. Through rate applications and negotiated settlements, TransCanada has been able to improve the common equity components of its Canadian wholly owned pipeline capital structures, but there is no assurance that this success can be repeated.

Most recently, TransCanada has continued to address concerns about financial returns on the Alberta System in the AUC's 2009 Generic Cost of Capital Proceeding. In November 2008, TransCanada filed an application requesting an ROE of 11 per cent on 40 per cent deemed common equity for the Alberta System. TQM filed an application with the NEB in December 2007 requesting a fair return on capital, consisting of an ROE of 11 per cent on 40 per cent deemed common equity. The outcome of these proceedings may influence the regulators' view of fair financial returns on equity associated with TransCanada's other Canadian wholly owned pipelines.

#### ***Throughput Risk***

As transportation contracts expire, TransCanada's U.S. natural gas pipelines are expected to become more exposed to the risk of reduced throughput and their revenues more likely to experience increased variability. Throughput risk is created by supply and market competition, gas basin pricing, economic activity, weather variability, natural gas pipeline competition and pricing of alternative fuels.

#### ***Execution and Capital Cost Risk***

Capital costs related to the construction of Keystone are subject to a capital cost risk- and reward-sharing mechanism with its customers. This mechanism allows Keystone to adjust its tolls by a factor based on the percentage change in the capital cost of the project. Toll for the portion of Keystone to Wood River, Patoka and Cushing will be adjusted by a factor equal to 50 per cent of the percentage change in capital cost. Toll on the expansion to the U.S. Gulf Coast will be adjusted by a factor equal to 75 per cent of the percentage change in capital cost.

Refer to the "Risk Management and Financial Instruments" section of this MD&A for information on managing risks in the Pipelines business.

## **PIPELINES – OUTLOOK**

TransCanada assumes that its operations in 2009 will be materially consistent with those in 2008 except for the impact of those factors discussed in this section.

Although demand for natural gas and crude oil has declined and is expected to further decline in North America in 2009 due to the current economic downturn, the Company expects demand to increase in the long term. TransCanada's Pipelines business will continue to focus on the delivery of natural gas to growing markets, connecting new supply, progressing development of new infrastructure to connect natural gas from the north and unconventional supplies such as shale gas, coalbed methane and LNG, and construction and expansion of Keystone.

TransCanada expects producers will continue to explore and develop new fields in Western Canada, particularly in northeastern B.C. and the west and central foothills regions of Alberta. There is also expected to be significant exploration and development activity aimed at unconventional resources such as coalbed methane and shale gas.

In 2008, TransCanada filed an application with the NEB to establish federal jurisdiction for the Alberta System. If the application is approved, the Alberta System will switch from AUC regulation to NEB regulation, allowing it to construct and operate pipeline extensions into other provinces and allowing it to provide direct integrated Alberta System natural gas transmission service to gas production locations outside of Alberta. Extensions of the Alberta System beyond Alberta's borders are currently prohibited under provincial regulation. An NEB jurisdiction decision is expected in first quarter 2009.

Most of TransCanada's current expansion plans in Canadian natural gas transmission are focused on the Alberta System. TransCanada recently concluded a binding open season process for natural gas transmission service for the Montney shale gas region located in northeastern B.C. Five shippers have committed to firm gas transportation contracts on the Groundbirch pipeline that will serve the Montney region. Volumes associated with these commitments will reach 1.1 Bcf/d by 2014. The Groundbirch pipeline is expected to commence service in fourth quarter 2010, subject to receipt of necessary approvals.

In addition, TransCanada is finalizing details associated with a binding open season and pipeline extension project to service the Horn River shale gas region located in northeastern B.C. Five shippers have committed to firm gas transportation contracts for a total volume of 378 mmcf/d by second quarter 2012. Subject to concluding a successful binding open season, the Horn River project is expected to commence operation in second quarter 2011, subject to receipt of necessary approvals.

Both the Groundbirch and Horn River projects are proposed as extensions to the Alberta System, which will provide B.C. producers with direct integrated gas transmission service from receipt points in B.C. These pipeline projects will increase netbacks to producers and increase the throughput on the Alberta System and on its downstream pipelines that serve markets located throughout North America, as well as increase usage of the Nova Inventory Transfer commercial hub that is used by buyers and sellers of natural gas throughout North America.

In addition to extensions into B.C., new facilities are required to expand the integrated Alberta System in response to changes in the distribution of supply and in markets across the Alberta System.

In the U.S., TransCanada expects unconventional production will continue to be developed from shale gas reservoirs in east Texas, northwest Louisiana, Arkansas, and southwest Oklahoma. Supplies from coalbed methane and tight gas sands in the Rocky Mountain region are also expected to grow. Additionally, in the medium to long term, some level of incremental supply is anticipated from LNG imports into the U.S., particularly in the summer months. The resulting growth in supply will provide additional commercial opportunities for TransCanada. In particular, the southwest leg of ANR is expected to continue to remain fully subscribed for the foreseeable future, and new transport routes are being developed to move the additional Rocky Mountain and shale gas production to midwestern and eastern U.S. markets, including interconnections with ANR. As mid-continent supplies develop, the southeast leg of ANR has capacity to transport additional volumes of Rocky Mountain and mid-continent shale production, as well as LNG.

Producers continue to develop new oil supply in Western Canada. There are several new oil sands projects under construction that will begin production in 2009 and 2010. By 2015, oil sands production is expected to double from 1.2 million Bbl/d in 2008 and total Western Canada oil supply is projected to grow over the same period to approximately 3.5 million Bbl/d from 2.4 million Bbl/d. The primary market for new oil production extends from the U.S. Midwest to the U.S. Gulf Coast and contains a large number of refineries that are well equipped to handle Canadian light and heavy crude oil blends. Incremental western Canadian crude oil production is expected to replace declining U.S. imports of crude oil from other countries.

This increase in WCSB crude oil exports requires new pipeline capacity, including Keystone and further expansions to the U.S. Gulf Coast. TransCanada will continue to pursue additional opportunities to move crude oil from Alberta to U.S. markets.

TransCanada will continue to focus on operational excellence and on collaborative efforts with all stakeholders to achieve negotiated settlements and service options that will increase the value of the Company's business to customers and shareholders.

### Earnings

The Company expects continued growth on its Alberta System. The Company also anticipates a modest level of investment in its other existing Canadian natural gas pipelines, resulting in an expected continued net decline in the average investment base due to annual depreciation. A net decline in the average investment base has the effect of reducing year-over-year earnings from these assets. Under the current regulatory model, earnings from Canadian pipelines are not affected by short-term fluctuations in the commodity price of natural gas, changes in throughput volumes or changes in contract levels.

Reduced firm transportation contract volumes due to customer defaults, lower supply available for export from the WCSB and expiry of long-term contracts could have a negative impact on short-term earnings from TransCanada's U.S. natural gas pipelines, unless the available capacity can be recontracted. The ability to recontract available capacity is influenced by prevailing market conditions and competitive factors, including competing natural gas pipelines and supply from other natural gas sources in markets served by TransCanada's U.S. pipelines. Earnings from Pipelines' foreign operations are also impacted by changes in foreign currency exchange rates.

### Capital Expenditures

Total capital spending for all pipelines in 2008 was \$1.8 billion. Capital spending for the wholly owned pipelines in 2009 is expected to be approximately \$1.1 billion. In addition, capital spending for TransCanada's share of constructing Keystone is expected to be approximately \$3.6 billion in 2009.

### NATURAL GAS THROUGHPUT VOLUMES

(Bcf)

	2008	2007	2006
Canadian Mainline <sup>(1)</sup>	3,467	3,183	2,955
Alberta System <sup>(2)</sup>	3,800	4,020	4,051
ANR <sup>(3)</sup>	1,655	1,210	n/a
GTN System	783	827	790
Foothills	1,292	1,441	1,403
North Baja	104	90	95
Great Lakes	784	829	816
Northern Border	731	800	799
Iroquois	376	394	384
TQM	170	207	158
Ventures LP	165	178	179
Gas Pacifico	73	71	52
Portland	50	58	52
Tamazunchale <sup>(4)</sup>	53	29	n/a
Tuscarora	30	28	28
TransGas	26	24	22

<sup>(1)</sup> Canadian Mainline physical receipts originating at the Alberta border and in Saskatchewan in 2008 were 1,898 Bcf (2007 – 2,090 Bcf; 2006 – 2,207 Bcf).

<sup>(2)</sup> Field receipt volumes for the Alberta System in 2008 were 3,843 Bcf (2007 – 4,047 Bcf; 2006 – 4,160 Bcf).

<sup>(3)</sup> ANR's results include delivery volumes from the date of acquisition of February 22, 2007.

<sup>(4)</sup> Tamazunchale's results include volumes since December 1, 2006.