

TRANSCANADA CORP  
Form 40-F  
February 27, 2007

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**U.S. Securities and Exchange Commission**

Washington, D.C. 20549

**Form 40-F**

o REGISTRATION STATEMENT PURSUANT TO SECTION 12 OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ý ANNUAL REPORT PURSUANT TO SECTION 13(a) OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

Commission File Number 1-31690

**TRANSCANADA CORPORATION**

*(Exact Name of Registrant as specified in its charter)*

**Canada**

*(Jurisdiction of incorporation or organization)*

**4922, 4923, 4924, 5172**

*(Primary Standard Industrial Classification Code Number (if applicable))*

**Not Applicable**

*(I.R.S. Employer Identification Number (if applicable))*

**TransCanada Tower, 450 - 1 Street S.W.**

**Calgary, Alberta, Canada, T2P 5H1**

**(403) 920-2000**

*(Address and telephone number of Registrant's principal executive offices)*

**CT Corporation, Suite 2610, 520 Pike Street**

**Seattle, Washington, 98101; (206) 622-4511; 1-800-456-4511**

*(Name, address (including zip code) and telephone number (including area code)  
of agent for service in the United States)*

**Securities registered pursuant to section 12(b) of the Act:**

**Title of each class**

**Name of each exchange on which registered**

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Common Shares  
(including Rights under Shareholder Rights Plan)

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

For annual reports, indicate by check mark the information filed with this Form:

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ý Annual Information Form

ý Audited annual financial statements

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

**At December 31, 2006, 488,975,399 common shares  
were issued and outstanding**

Indicate by check mark whether the Registrant by filing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934 (the "Exchange Act"). If "Yes" is marked, indicate the file number assigned to the Registrant in connection with such Rule.

Yes \_\_\_\_\_

No  X

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes  X

No \_\_\_\_\_

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The documents (or portions thereof) forming part of this Form 40-F are incorporated by reference into the following registration statements under the Securities Act of 1933, as amended:

<b>Form</b>	<b>Registration No.</b>
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S-8	333-5916
S-8	333-8470
S-8	333-9130
F-3	33-13564
F-3	333-6132
F-10	333-140150

### **CONSOLIDATED AUDITED ANNUAL FINANCIAL STATEMENTS AND MANAGEMENT'S DISCUSSION & ANALYSIS**

#### **A.**

##### **Audited Annual Financial Statements**

For consolidated audited financial statements, including the report of independent chartered accountants with respect thereto, see pages 78 through 119 of the TransCanada Corporation ("TransCanada") 2006 Annual Report to Shareholders included herein. See document 13.4 for the related supplementary note entitled "Reconciliation to United States GAAP" for a reconciliation of the differences between Canadian and United States generally accepted accounting principles, including the auditors' report as document 13.4.

#### **B.**

##### **Management's Discussion & Analysis**

For management's discussion and analysis, see pages 8 through 77 of the TransCanada 2006 Annual Report to Shareholders included herein under the heading "Management's Discussion & Analysis".

For the purposes of this Report, only pages 8 through 77 and 78 through 119 of the TransCanada 2006 Annual Report to Shareholders shall be deemed incorporated herein by reference and filed, and the balance of such 2006 Annual Report, except as otherwise specifically incorporated by reference in the TransCanada Annual Information Form, shall be deemed not filed with the Securities and Exchange Commission as part of this Report under the Exchange Act.

#### **C.**

##### **Management's Annual Report on Internal Control Over Financial Reporting**

For information on management's internal control over financial reporting, see "Report of Management" included in TransCanada's consolidated audited financial statements on page 78, the section entitled "Management's Annual Report on Internal Control Over Financial Reporting" under the heading "Controls and Procedures" in Management's Discussion and Analysis on page 69 of the TransCanada 2006 Annual Report to Shareholders, and Management's Report on Internal Control Over Financial Reporting attached as document 13.5.

Management's assessment of the effectiveness of TransCanada's internal control over financial reporting as of December 31, 2006 has been audited by TransCanada's independent auditors, KPMG LLP, a registered public accounting firm, as stated in their audit report on management's assessment. KPMG LLP has issued a report on the effectiveness of internal control over financial reporting as of December 31, 2006 filed as document 13.6 hereto.

### **UNDERTAKING**

The Registrant undertakes to make available, in person or by telephone, representatives to respond to inquiries made by the staff of the U.S. Securities and Exchange Commission (the "Commission"), and to furnish promptly, when requested to do so by the Commission staff, information relating to: the securities registered pursuant to Form 40-F; the securities in relation to which the obligation to file an Annual Report on Form 40-F arises; or transactions in said securities.

### **DISCLOSURE CONTROLS AND PROCEDURES**

For information on disclosure controls and procedures, see "Controls and Procedures" in Management's Discussion and Analysis on page 69 of the TransCanada 2006 Annual Report to Shareholders.

**AUDIT COMMITTEE FINANCIAL EXPERT**

The Registrant's board of directors has determined that it has at least one audit committee financial expert serving on its audit committee. Mr. Harry G. Schaefer has been designated an audit committee financial expert and is independent, as that term is defined by the New York Stock Exchange's listing standards applicable to the Registrant. The Commission has indicated that the designation of Mr. Schaefer as an audit committee financial expert does not make Mr. Schaefer an "expert" for any purpose, impose any duties, obligations or liability on Mr. Schaefer that are greater than those imposed on members of the audit committee and board of directors who do not carry this designation or affect the duties, obligations or liability of any other member of the audit committee.

**CODE OF ETHICS**

The Registrant has adopted codes of business ethics for its employees, its President and Chief Executive Officer, Chief Financial Officer and Contoller and its directors. The Registrant's codes are available on its website at [www.transcanada.com](http://www.transcanada.com). There has been no waiver of the codes granted during the 2006 fiscal year.

**PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The aggregate fees for professional services rendered by KPMG LLP for the TransCanada group of companies for the 2006 and 2005 fiscal years are shown in the table below:

Fees in millions of Canadian dollars	2006	2005
Audit Fees	\$ 4.94	\$ 3.15
Audit-Related Fees	0.07	0.11
Tax Fees	0.22	0.12
All Other Fees	0.07	0.14
Total	\$ 5.30	\$ 3.52

The nature of each category of fees is described below.

*Audit Fees*

Audit fees were incurred for professional services rendered by the auditors for the audit of the Registrant's and its subsidiaries' annual financial statements or services provided in connection with statutory and regulatory filings or engagements, the review of interim consolidated financial statements and information contained in various prospectuses and other offering documents.

*Audit-Related Fees*

Audit-related fees were incurred for the audit of the financial statements of the Registrant's certain pension plans.

*Tax Fees*

Tax fees were primarily incurred for tax compliance and tax advice. These services consisted of: tax compliance including the review of Canadian and US income tax returns and tax items and tax services related to domestic and international taxation including income tax, capital tax and Goods and Services Tax.

*All Other Fees*

Fees disclosed in the table above under the item "all other fees" were incurred for services other than the audit fees, audit-related fees and tax fees described above. These services consisted of advice with regards to compliance with the Sarbanes-Oxley Act of 2002.

*Pre-Approval Policies and Procedures*

TransCanada's Audit Committee has adopted a pre-approval policy with respect to permitted non-audit services. Under the policy, the Audit Committee has granted pre-approval for specified non-audit services. For engagements of \$25,000 CDN or less which are not within the annual pre-approved limit, approval by the Audit Committee is not required, and for engagements between \$25,000 CDN and \$100,000 CDN, approval of the Audit Committee Chair is required, and the Audit Committee is to be informed of the engagement at the next scheduled Audit Committee meeting. For all engagements of \$100,000 CDN or more, pre-approval of the Audit Committee is required. In all cases, regardless of dollar amount involved, where there is a potential for conflict of interest involving the external auditor on an engagement, the Audit Committee

Chair must pre-approve the assignment.

To date, TransCanada has not approved any non-audit services on the basis of the de-minimis exemptions. All non-audit services have been pre-approved by the Audit Committee in accordance with the pre-approval policy described above.

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### OFF-BALANCE SHEET ARRANGEMENTS

The Registrant has no off-balance sheet arrangements, as defined in this Form, other than the guarantees described in Note 21 of the Notes to the Consolidated Financial Statements attached to this Form 40-F and incorporated herein by reference.

### TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

For information on Tabular Disclosure of Contractual Obligations, see "Management's Discussion and Analysis - Contractual Obligations", which is incorporated herein by reference on page 59 of the TransCanada 2006 Annual Report to Shareholders.

### IDENTIFICATION OF THE AUDIT COMMITTEE

The Registrant has a separately-designated standing Audit Committee. The members of the Audit Committee are:

Chair:	H.G. Schaefer
Members:	D.H. Burney
	K.E. Benson
	P. Gauthier
	P.L. Joskow
	J.A. MacNaughton

### FORWARD-LOOKING INFORMATION

This document, documents incorporated herein by reference, and other reports and filings made with the securities regulatory authorities contain certain information that is forward-looking and is subject to important risks and uncertainties. The words "anticipate", "expect", "may", "should", "estimate", "project", "outlook", "forecast" or other similar words are used to identify such forward looking information. All forward-looking statements are based on TransCanada's beliefs and assumptions based on information available at the time such statements were made. The results or events predicted in this information may differ from actual results or events. Factors which could cause actual results or events to differ materially from current expectations include, among other things, the ability of TransCanada to successfully implement its strategic initiatives and whether such strategic initiatives will yield the expected benefits, the availability and price of energy commodities, regulatory decisions, changes in environmental and other laws and regulations, competitive factors in the pipeline and energy industry sectors, construction and completion of capital projects, access to capital markets, interest and currency exchange rates, technological developments and the current economic conditions in North America. By its nature, such forward-looking information is subject to various risks and uncertainties, including those material risks discussed herein, in TransCanada's Annual Information Form filed as document 13.1 hereto and in TransCanada's Management's Discussion and Analysis filed as document 13.2 hereto, which could cause TransCanada's actual results and experience to differ materially from the anticipated results or other expectations expressed. The material assumptions in making these forward-looking statements are disclosed in TransCanada's Management's Discussion and Analysis, filed as document 13.2 hereto, under the headings "TransCanada Overview", "TransCanada's Strategy", "Outlook", "Pipelines Opportunities and Developments", "Pipelines Outlook", "Energy Opportunities and Developments" and "Energy Outlook". Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date it is expressed in this document or otherwise, and TransCanada undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required by law.

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**SIGNATURES**

Pursuant to the requirements of the Exchange Act, the Registrant certifies that it meets all of the requirements for filing on Form 40-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereto duly authorized, in the City of Calgary, Province of Alberta, Canada.

**TRANSCANADA CORPORATION**

Per: /s/ GREGORY A. LOHNES

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GREGORY A. LOHNES  
Executive Vice-President and Chief Financial Officer

Date: February 27, 2007

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**DOCUMENTS FILED AS PART OF THIS REPORT**

- 13.1 TransCanada Corporation Annual Information Form for the year ended December 31, 2006.
- 13.2 Management's Discussion and Analysis (included on pages 8 through 77 of the TransCanada 2006 Annual Report to Shareholders).
- 13.3 2006 Consolidated Audited Financial Statements (included on pages 78 through 119 of the TransCanada 2006 Annual Report to Shareholders), including the auditors' report thereon.
- 13.4 Related supplementary note entitled "Reconciliation to United States GAAP" and the auditors' report thereon.
- 13.5 Management's Report on Internal Control Over Financial Reporting.
- 13.6 Report of the Independent Registered Accounting Firm on Management's Report on Internal Control Over Financial Reporting.
- 99.1 Comments by Auditors for United States Readers on Canada-United States Reporting Difference.

**EXHIBITS**

- 23.1 Consent of KPMG LLP Chartered Accountants.
  - 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 32.1 Certification of Chief Executive Officer regarding Periodic Report containing Financial Statements.
  - 32.2 Certification of Chief Financial Officer regarding Periodic Report containing Financial Statements.
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**TRANSCANADA CORPORATION**  
**ANNUAL INFORMATION FORM**

February 22, 2007

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## TABLE OF CONTENTS

	Page
<b>TABLE OF CONTENTS</b>	i
<b>PRESENTATION OF INFORMATION</b>	ii
<b>FORWARD-LOOKING INFORMATION</b>	ii
<hr/>	
<b>TRANSCANADA CORPORATION</b>	1
Corporate Structure	1
Significant Subsidiaries	1
<hr/>	
<b>GENERAL DEVELOPMENT OF THE BUSINESS</b>	2
Developments in the Pipelines Business	2
Developments in the Energy Business	4
Recent Developments	6
<hr/>	
<b>BUSINESS OF TRANSCANADA</b>	7
Pipelines Business	8
Regulation	9
Energy Business	10
Other Interests	11
<hr/>	
<b>HEALTH, SAFETY AND ENVIRONMENT</b>	11
<hr/>	
<b>LEGAL PROCEEDINGS AND REGULATORY ACTIONS</b>	13
<b>MATERIAL CONTRACTS</b>	13
<b>TRANSFER AGENT AND REGISTRAR</b>	13
<b>INTEREST OF EXPERTS</b>	13
<hr/>	
<b>RISK FACTORS</b>	13
<hr/>	
<b>DIVIDENDS</b>	13
<b>DESCRIPTION OF CAPITAL STRUCTURE</b>	14
<b>CREDIT RATINGS</b>	15
<b>MARKET FOR SECURITIES</b>	16
<hr/>	
<b>DIRECTORS AND OFFICERS</b>	17
Directors	17
Officers	19
<hr/>	
<b>CORPORATE GOVERNANCE</b>	20
Audit Committee	20
Other Board Committees	22
Conflicts of Interest	23
<hr/>	
<b>ADDITIONAL INFORMATION</b>	23
<hr/>	
<b>GLOSSARY</b>	24
<hr/>	
<b>SCHEDULE "A" Metric Conversion Table</b>	A-1
<hr/>	
<b>SCHEDULE "B" Charter of the Audit Committee</b>	B-1
<hr/>	



## PRESENTATION OF INFORMATION

Unless otherwise noted, the information contained in this Annual Information Form ("AIF") is given at or for the year ended December 31, 2006 ("Year End"). Amounts are expressed in Canadian dollars unless otherwise indicated. Financial information is presented in accordance with Canadian generally accepted accounting principles.

Unless the context indicates otherwise, a reference in this AIF to "TransCanada" or the "Company" includes TransCanada Corporation and the subsidiaries of TransCanada Corporation through which its various business operations are conducted. In particular, "TransCanada" includes references to TransCanada PipeLines Limited ("TCPL"). Where TransCanada is referred to with respect to actions that occurred prior to its 2003 plan of arrangement with TCPL, which is described below under the heading "TransCanada Corporation Corporate Structure", these actions were taken by TCPL or its subsidiaries. The term "subsidiary", when referred to in this AIF, with reference to TransCanada means direct and indirect wholly-owned subsidiaries of, and entities controlled by, TransCanada or TCPL, as applicable.

TransCanada's Management's Discussion and Analysis dated February 22, 2007 ("MD&A") is incorporated by reference into this AIF and can be found on SEDAR at [www.sedar.com](http://www.sedar.com) under TransCanada's profile.

Information relating to metric conversion can be found at Schedule "A" to this AIF.

## FORWARD-LOOKING INFORMATION

This AIF, the documents incorporated by reference into this AIF, and other reports and filings made with the securities regulatory authorities contain certain information that is forward-looking and is subject to important risks and uncertainties. The words "anticipate", "expect", "may", "should", "estimate", "project", "outlook", "forecast" or other similar words are used to identify such forward looking information. All forward-looking statements are based on TransCanada's beliefs and assumptions based on information available at the time such statements were made. The results or events predicted in this information may differ from actual results or events. Factors which could cause actual results or events to differ materially from current expectations include, among other things, the ability of TransCanada to successfully implement its strategic initiatives and whether such strategic initiatives will yield the expected benefits, the availability and price of energy commodities, regulatory decisions, changes in environmental and other laws and regulations, competitive factors in the pipeline and energy industry sectors, construction and completion of capital projects, access to capital markets, interest and currency exchange rates, technological developments and the current economic conditions in North America. By its nature, such forward-looking information is subject to various risks and uncertainties, including those material risks discussed in this AIF under "Risk Factors" and in the MD&A under "Pipelines Business Risks" and "Energy Business Risks", which could cause TransCanada's actual results and experience to differ materially from the anticipated results or other expectations expressed. The material assumptions in making these forward-looking statements are disclosed in the MD&A under the headings "TransCanada Overview", "TransCanada's Strategy", "Outlook", "Pipelines Opportunities and Developments", "Pipelines Outlook", "Energy Opportunities and Developments" and "Energy Outlook". Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date it is expressed in this AIF or otherwise, and TransCanada undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required by law.

**TRANSCANADA CORPORATION**

**Corporate Structure**

TransCanada's head office and registered office are located at 450 - 1st Street S.W., Calgary, Alberta, T2P 5H1. TransCanada was incorporated pursuant to the provisions of the Canada *Business Corporation Act* on February 25, 2003 in connection with a plan of arrangement which established TransCanada as the parent company of TCPL. The arrangement was approved by TCPL common shareholders on April 25, 2003 and, following court approval and the filing of Articles of Arrangement, the arrangement became effective May 15, 2003. Pursuant to the arrangement, the common shareholders of TCPL exchanged each of their TCPL common shares for one common share of TransCanada. The debt securities and preferred shares of TCPL remained obligations and securities of TCPL. TCPL continues to hold the assets it held prior to the arrangement and continues to carry on business as the principal operating subsidiary of the TransCanada group of entities. TransCanada does not hold any material assets directly other than the common shares of TCPL and receivables from certain of TransCanada's subsidiaries.

At Year End, TransCanada's principal operating subsidiary, TCPL, had approximately 2,350 employees, substantially all of whom were employed in Canada and the United States.

**Significant Subsidiaries**

TransCanada's significant subsidiaries<sup>(1)</sup> at Year End and the jurisdiction under which each subsidiary was incorporated are noted below. TransCanada owns, directly or indirectly, 100 per cent of the voting shares of each of these subsidiaries.

(1) Excludes certain of TransCanada's subsidiaries where:

the total assets of the subsidiary do not exceed ten per cent of the consolidated assets of TransCanada at Year End;

the sales and operating revenues of the subsidiary do not exceed ten per cent of the consolidated sales and operating revenues of TransCanada for the year ended December 31, 2006;

the aggregate assets of all the excluded subsidiaries do not exceed 20 per cent of the consolidated assets of TransCanada at Year End; and

the aggregate sales and operating revenues of all the excluded subsidiaries do not exceed 20 per cent of the consolidated sales and operating revenues of TransCanada for the year ended December 31, 2006.



## GENERAL DEVELOPMENT OF THE BUSINESS

The general development of TransCanada's business during the last three financial years, and the significant acquisitions, dispositions, events or conditions which have had an influence on that development, are described below.

Effective June 1, 2006, TransCanada revised the composition and names of its reportable business segments to *Pipelines* and *Energy*. Pipelines is principally comprised of the company's pipelines in Canada, the United States and Mexico. Energy includes the company's power operations, natural gas storage business and liquefied natural gas ("*LNG*") projects in Canada and the United States.

### Developments in the Pipelines Business

TransCanada's strategy in pipelines is focused on both growing its North American natural gas transmission network and maximizing the long-term value of its existing pipeline assets. Summarized below are significant developments that have occurred in TransCanada's pipelines business over the last three years.

#### 2006

##### *Pipeline Developments*

January 2006. TransCanada secured firm, long-term contracts for the Keystone oil pipeline project totalling 340,000 barrels per day with durations averaging 18 years;

April 2006. TC PipeLines, LP, an affiliate of TransCanada, acquired an additional 20 per cent general partnership interest in Northern Border Pipeline Company ("*NBPL*") for approximately US\$307 million which brings the total general partnership interest in NBPL to 50 per cent. TC PipeLines, LP also indirectly assumed approximately US\$122 million of the debt of NBPL. TransCanada expects to become the operator of NBPL in April 2007. TransCanada is the parent company of TC PipeLines GP, Inc., the general partner of TC PipeLines, LP;

April 2006. TransCanada sold its 17.5 per cent general partner interest in Northern Border Partners, L.P. for approximately US\$29.5 million;

December 2006. The 130 km Tamazunchale pipeline in east central Mexico went into commercial service;

December 2006. TC PipeLines, LP acquired 49 per cent of Sierra Pacific Resources' 50 per cent interest in Tuscarora Gas Transmission Company ("*Tuscarora*"), with an option to acquire the remaining one per cent interest, for US\$100 million, plus US\$37 million of assumed debt, subject to certain post closing adjustments. TC PipeLines, LP now holds a 99 per cent interest in Tuscarora and TransCanada indirectly holds a one per cent ownership interest. TransCanada became the operator of Tuscarora;

December 2006. TransCanada entered into a purchase and sale agreement (the "*ANR Purchase and Sale Agreement*") with El Paso Corporation, pursuant to which TransCanada agreed to acquire American Natural Resources Company and ANR Storage Company (collectively, "*ANR*"). TransCanada also agreed to purchase an additional 3.55 per cent interest in Great Lakes Gas Transmission Limited Partnership ("*Great Lakes*") from El Paso Corporation. The total purchase price is approximately US\$3.4 billion and includes approximately US\$488 million of assumed debt. The acquisition includes an approximately 17,000-kilometre pipeline system and 230 billion cubic feet ("*Bcf*") of storage capacity in the United States. The acquisition closed on February 22, 2007, as discussed under "General Development of the Business Recent Developments" in this AIF;

December 2006. TC PipeLines, LP agreed to acquire a 46.45 per cent interest in Great Lakes from El Paso Corporation for a purchase price of US\$962 million which includes the assumption of approximately US\$212 million of assumed debt, subject to certain post closing adjustments. The acquisition closed on February 22, 2007, as discussed under "General Development of the Business Recent Developments" in this AIF;

TransCanada continued to invest in the Canadian Mainline and the Alberta System;

2 TRANSCANADA CORPORATION

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TransCanada continued funding of the Mackenzie Valley Aboriginal Pipeline Limited Partnership for its participation in the Mackenzie Gas Pipeline Project; and

TransCanada continued discussions relating to the proposed Alaska Highway Pipeline Project.

### ***Regulatory Matters***

February 2006. TransCanada filed an application with the U.S. Federal Energy Regulatory Commission ("*FERC*") for a certificate for a two-phase expansion of its existing natural gas pipeline in southern California, the North Baja system ("*North Baja System*") and the construction of a new lateral pipeline in California's Imperial Valley;

April 2006. The National Energy Board (the "*NEB*") approved a negotiated settlement of the 2006 Canadian Mainline tolls which included a deemed common equity ratio of 36 per cent and incentives for managing cost through fixing certain components of the revenue requirement;

June 2006. TransCanada filed an application with the NEB seeking approval to transfer a portion of TransCanada's Canadian Mainline natural gas transmission facilities to the Keystone oil pipeline project for the purposes of transporting crude oil from Alberta to refining centres in the U.S. Midwest, which was approved by the NEB in February 2007. Additionally, in December 2006, TransCanada filed an application with the NEB for approval to construct and operate the Canadian portion of the Keystone oil pipeline, which is anticipated to be in service in late 2009; and

June 2006. TransCanada filed a rate case with the FERC requesting a number of tariff changes including an increase in rates for certain services on the Gas Transmission Northwest system ("*Gas Transmission Northwest System*"). Further information relating to the Gas Transmission Northwest System can be found in this AIF under "Business of TransCanada Regulation".

Further information about these developments can be found in this AIF under "General Development of the Business Recent Developments" and in the MD&A under the heading "TransCanada's Strategy Pipelines" and "Pipelines Opportunities and Developments".

### **2005**

#### ***Pipeline Developments***

February 2005. TransCanada announced the Keystone oil pipeline project, a US\$2.1 billion oil pipeline project to transport approximately 435,000 barrels per day of heavy crude oil from Alberta to Illinois;

March 2005. TransCanada sold 3,574,200 common units of TC PipeLines, LP for US\$153 million;

TransCanada continued discussions relating to the proposed Alaska Highway Pipeline Project;

June 2005. TransCanada acquired an additional interest in the Iroquois Gas Transmission System L.P. ("*Iroquois System*") for US\$13.6 million. The acquisition increased TransCanada's ownership interest from 40.96 per cent to 44.48 per cent;

June 2005. TransCanada commenced construction of the Tamazunchale Pipeline in east-central Mexico which went into service in December 2006; and

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TransCanada continued funding of the Mackenzie Valley Aboriginal Pipeline Limited Partnership for its participation in the Mackenzie Gas Pipeline Project.

### *Regulatory Matters*

March 2005. TransCanada reached a settlement with shippers and other interested parties regarding the annual revenue requirements of its Alberta System for the years 2005, 2006 and 2007. The settlement was approved by regulators; and

May 2005. TransCanada received the NEB's decision on the Canadian Mainline 2004 Tolls and Tariff Application (Phase II), approving an increase in the deemed common equity component of TransCanada's Canadian Mainline System's capital structure from 33 per cent to 36 per cent effective January 1, 2004.

TRANSCANADA CORPORATION 3

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2004

*Pipeline Developments*

November 2004. TransCanada acquired the Gas Transmission Northwest System and the North Baja System from National Energy & Gas Transmission, Inc. for US\$1.7 billion, including approximately US\$0.5 billion of assumed debt.

**Developments in the Energy Business**

In the past three years, TransCanada has grown its energy business and, in particular, has increased its power generation capacity from facilities it owns, operates and/or controls, including those under construction or in development, from approximately 5,700 megawatts ("MW") in 2004 to approximately 7,700 MW at Year End. Summarized below are significant developments that have occurred in TransCanada's energy business over the last three years.

2006

*Energy Developments*

TransCanada continued construction of the Cartier wind energy project ("*Cartier Wind Energy Project*"), of which 62 per cent is owned by TransCanada. The first of six proposed wind farm projects was commercial in late 2006 and construction commenced on the second which is expected to be in service in late 2007. The other phases of the Cartier Wind Energy Project will continue, subject to future appropriations and approvals, through 2012 at five different locations in the Gaspé region of Québec and capacity is expected to total 740 MW when all phases are complete. Once completed, the entire output of the Cartier Wind Energy Project will be supplied to Hydro-Québec Distribution under 20-year power purchase contracts;

September 2006. Portlands Energy Centre L.P., 50 per cent owned by TransCanada, signed a 20-year Accelerated Clean Energy Supply ("*ACES*") contract with the Ontario Power Authority for Portlands Energy Centre ("*PEC*"), a 550 MW high-efficiency, combined-cycle natural gas generation plant is being constructed in downtown Toronto. The capital cost of PEC is estimated to be approximately \$730 million. PEC is expected to be operational in simple-cycle mode and delivering 340 MW of electricity beginning June 2008, and is expected to be completed in the second quarter of 2009, delivering up to 550 MW of power under the ACES contract;

September 2006. Construction of the 550 MW Bécancour cogeneration plant near Trois Rivières, Québec, was completed and placed in commercial service providing power to Hydro-Québec Distribution;

November 2006. TransCanada was awarded a 20-year Clean Energy Supply contract by the Ontario Power Authority to build, own and operate a 683 MW natural gas-fired power plant near the Town of Halton Hills, Ontario. TransCanada expects to invest approximately \$670 million in the Halton Hills Generating Station, which is anticipated to be in service in the second quarter of 2010;

December 2006. The Edson gas storage facility was placed in service; and

TransCanada continued work on the restart and refurbishment project at Bruce A nuclear power generation facility in Ontario. The first unit is expected to be online in late 2009 subject to approval by the Canadian Nuclear Safety Commission.

**Regulatory Matters**

January 2006. TransCanada, on behalf of the Broadwater Energy project, filed an application with the FERC for approval of the LNG regasification project to be located in Long Island Sound, New York. The United States Coast Guard issued a report which determined that the waterways associated with the project are suitable if additional measures are implemented to manage the safety and security risks associated with the project. Broadwater's application to the New York Department of State for a determination that the project is consistent with New York's coastal zone policies was deemed complete by the

state in November of 2006. Also in

4 TRANSCANADA CORPORATION

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November, the FERC issued a statement which concludes that with strict adherence to federal and state permit requirements and regulations, and Broadwater's proposed mitigation measures and the FERC's recommendations, the Broadwater project will not result in significant impacts to the environment; and

December 2006. A public hearing on the Cacouna Energy LNG facility in Cacouna, Québec (the "*Cacouna Energy Project*") was held in May and June of 2006 and in December 2006 the Minister of the Environment for Québec and the federal Minister of the Environment, jointly released the report of the Joint Commission on the Cacouna Energy Project. The report has several recommendations and opinions but overall, in management's view, appears to be favourable to the project. TransCanada continues to work towards gaining regulatory approval and provided the necessary approvals are obtained, the facility is anticipated to be in service sometime in 2010;

Further information about each of these energy developments can be found in the MD&A under the heading "TransCanada's Strategy Energy" and "Energy Opportunities and Developments".

### 2005

#### *Energy Developments*

February 2005. TransCanada advanced the 740 MW Cartier Wind Energy Project with the signing of long term electricity supply contracts;

April 2005. TransCanada acquired the hydroelectric power generation assets from USGen New England, Inc. for approximately US\$503 million;

September 2005. TransCanada sold all of its interests in TransCanada Power, L.P. ("*Power LP*") to EPCOR Utilities Inc. for net proceeds of \$523 million;

October 2005. Bruce Power A L.P. ("*Bruce A*") entered into agreements with the Ontario Power Authority to restart units 1 and 2, extend the operating life of unit 3 and replace the generators on unit 4 at Bruce A. The capital program for the restart and refurbishment work is expected to total approximately \$4.25 billion with TransCanada's share expected to be approximately \$2.125 billion;

December 2005. TransCanada sold its approximate 11 per cent interest in P.T. Paiton Energy Company to subsidiaries of The Tokyo Electric Power Company, resulting in gross proceeds of US\$103 million;

December 2005. TransCanada acquired the remaining rights and obligations of the 756-megawatt Sheerness Power Purchase Arrangement ("*PPA*") from the Alberta Balancing Pool for \$585 million;

TransCanada commenced construction of a natural gas storage facility located near Edson, Alberta; and

Ocean State Power successfully restructured its long-term natural gas fuel supply contracts with its supplier.

#### *Regulatory Matters*

TransCanada continued working toward gaining regulatory approval for its two LNG projects: Cacouna in Québec and the Broadwater Energy project, offshore of New York State in Long Island Sound.

### 2004

#### *Energy Developments*

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April 2004. TransCanada received approval from the Québec government to develop the 550 MW natural gas-fired Bécancour cogeneration plant located at an industrial park near Trois-Rivières, Québec ("*Bécancour Plant*") and which will supply its entire power output to Hydro-Québec Distribution under 20 year power purchase contracts. Construction of the 550 MW Bécancour Plant began in the third quarter of 2004;

April 2004. TransCanada sold its ManChief and Curtis Palmer power plants to Power LP for approximately US\$403 million, excluding closing adjustments;

September 2004. TransCanada and Petro-Canada signed a memorandum of understanding for the development of the Cacouna Energy Project. The proposed facility will be capable of receiving, storing and regasifying

TRANSCANADA CORPORATION 5

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imported LNG with an average annual send out capacity of approximately 500 million cubic feet per day of natural gas. The proposed facility requires regulatory and other approvals from federal, provincial and municipal governments and regulators;

October 2004. The Cartier Wind Energy Project, of which 62 per cent is owned by TransCanada, was awarded six wind energy projects by Hydro-Québec Distribution, representing a total of 740 MW in the Gaspé region of Québec. The six proposed projects are distributed throughout the Gaspésie-Iles-de-la-Madeleine region and the Regional County Municipality of Matane;

November 2004. TransCanada and Shell US Gas & Power LLC ("*Shell*") announced plans to jointly develop an offshore LNG regasification terminal, Broadwater Energy, in the New York State waters of Long Island Sound. The proposed floating storage and regasification unit will be capable of receiving, storing and regasifying imported LNG with an average send out capacity of approximately one Bcf per day of natural gas. TransCanada owns 50 per cent of Broadwater Energy LLC, which will own and operate the facility, while Shell will contract for the facility's entire regasification capacity and supply the LNG. The proposed Broadwater Energy LNG facility required regulatory approval from federal and state governments before construction could begin;

Construction of the 165 MW MacKay River power plant located in Alberta was completed in 2003 and the plant was put into commercial service in 2004; and

Construction of the 90 MW Grandview natural gas-fired cogeneration power plant on the site of the Irving Oil refinery in Saint John, New Brunswick ("*Grandview Plant*") was completed by the end of 2004 and was commissioned in January 2005. Under a 20-year tolling arrangement, a subsidiary of Irving Oil Limited will provide fuel to the Grandview Plant and has contracted for 100 per cent of the Grandview Plant's heat and electricity output.

### Recent Developments

On February 22, 2007, TransCanada closed its acquisitions of ANR and an additional 3.55 per cent interest in Great Lakes from El Paso Corporation for approximately US\$3.4 billion, and includes approximately US\$488 million of assumed long-term debt. For further information see "General Development of the Business - Developments in the Pipelines Business" in this AIF.

In February 2007, TC PipeLines, LP completed a private placement offering of 17,356,086 units at a price of US\$34.57 per unit. TransCanada acquired 50 per cent of the units for US\$300 million, increasing its total ownership to 32.1 per cent. TransCanada also invested an additional approximately \$12 million to maintain its general partnership ownership interest in TC PipeLines, LP. The total private placement resulted in gross proceeds of approximately US\$612 million which were used to partially finance TC PipeLines, LP's acquisition of its 46.45 per cent interest in Great Lakes.

On February 6, 2007, TransCanada entered into an agreement with a syndicate of underwriters, under which they agreed to purchase from TransCanada and sell to the public 39,470,000 subscription receipts. On February 14, 2007, TransCanada completed this public offering of subscription receipts. The purchase price of \$38.00 per subscription receipt resulted in proceeds of approximately \$1.5 billion, which were used by TransCanada towards financing the acquisition of ANR. The underwriters have an option to purchase an additional 5,920,500 common shares at a price of \$38.00 per common share at any time up to and including March 16, 2007.

TransCanada received NEB approval on February 9, 2007, to transfer a section of the Canadian Mainline natural gas transmission facilities to the Keystone oil pipeline project to transport crude oil from Alberta to refining centres in the U.S. Midwest. TransCanada continues to proceed with applications for U.S. regulatory approvals at federal and state levels. Construction of the Keystone pipeline is expected to begin in early 2008, with commercial operations scheduled to commence in the fourth quarter of 2009. In addition, TransCanada announced in January 2007 the start of a binding Open Season for an expansion and extension of the proposed Keystone oil pipeline. The purpose of the Open Season is to obtain binding commitments to support the expansion of the proposed Keystone pipeline from approximately 435,000 barrels per day to 590,000 barrels per day and the construction of a 468 km extension of the

United States portion of the pipeline. The US\$700 million expansion and extension project is targeted to be in-service in the fourth quarter of 2010.

In February 2007, TransCanada received approval from the NEB to integrate the B.C. system into the Foothills System in southern B.C. An agreement between the Company and shippers on the B.C. system includes a sharing mechanism for anticipated cost savings through increased administrative efficiencies arising from the integration of the two systems.

In January 2007, TransCanada received a procedural order from the FERC establishing a timeline for Gas Transmission Northwest System's rate case proceeding. The comprehensive filing requests a number of tariff changes, including increased rates for transportation services. The hearing into this rate case is scheduled to commence on October 31, 2007. For further information see this AIF under "Business of TransCanada Regulation".

## BUSINESS OF TRANSCANADA

TransCanada is a leading North American energy infrastructure company focused on pipelines and energy. At Year End, Pipelines accounted for approximately 53 per cent of revenues and 71 per cent of TransCanada's total assets and the Energy business accounted for approximately 47 per cent of revenues and 25 per cent of TransCanada's total assets. The following is a description of each of TransCanada's two main areas of operation.

The following table shows TransCanada's revenues from operations by segment, classified geographically, for the years ended December 31, 2006 and 2005.

<b>Revenues From Operations</b> ( <i>millions of dollars</i> )	<b>2006</b>	<b>2005<sup>(4)</sup></b>
<b>Pipelines</b>		
Canada Domestic Deliveries	<b>2,390</b>	2,281
Canada Export Deliveries <sup>(1)</sup>	<b>971</b>	1,159
United States	<b>629</b>	553
	<b>3,990</b>	3,993
<b>Energy<sup>(2)</sup></b>		
Canada Domestic Deliveries	<b>2,566</b>	1,218
Canada Export Deliveries <sup>(1)</sup>	<b>1</b>	1
United States	<b>963</b>	912
	<b>3,530</b>	2,131
<b>Total Revenues<sup>(3)</sup></b>	<b>7,520</b>	6,124

(1) Export deliveries include pipeline revenues attributable to deliveries to U.S. pipelines and power deliveries to U.S. markets.

(2) Revenues include sales of natural gas.

(3) Revenues are attributed to countries based on country of origin of product or service.

(4) Effective June 1, 2006, TransCanada revised the composition and names of its reportable business segments to *Pipelines* and *Energy*. The financial reporting of these segments was aligned to reflect the internal organizational structure of the Company. Pipelines principally comprises the Company's pipelines in Canada, the U.S. and Mexico. Energy includes the Company's power operations, natural gas storage business and liquefied natural gas projects in Canada and the U.S. The segmented information has been retroactively reclassified to reflect the changes in reportable segments. These changes had no impact on consolidated net income.





**Pipelines Business**

TransCanada has substantial Canadian and U.S. natural gas pipeline and related holdings, including:

**Canada**

a natural gas transmission system running from the Alberta border east to delivery points in eastern Canada and at various U.S. border points ("*Canadian Mainline*");

a natural gas transmission system throughout the province of Alberta ("*Alberta System*");

a natural gas transmission system in southeastern B.C., southern Alberta and southwestern Saskatchewan (the "*B.C. and Foothills Systems*");

a 121 km natural gas transmission pipeline and related facilities which supply natural gas to the oil sands region of northern Alberta and a 27 km natural gas pipeline which supplies natural gas to a petrochemical complex at Joffre, Alberta; and

a 50 per cent interest in Trans Québec & Maritimes Pipeline Inc. ("*TQM*") which operates a natural gas transmission system in southeastern Québec (the "*TQM*" System).

**United States**

effective February 22, 2007, TransCanada owns the ANR system (the "*ANR System*"), a natural gas transmission system which extends approximately 17,000 km from producing fields in Louisiana, Oklahoma, Texas and the Gulf of Mexico to markets in Wisconsin, Michigan, Illinois, Ohio and Indiana;

the Gas Transmission Northwest System, a natural gas transmission system running from northwestern Idaho, through Washington and Oregon to the California border;

the North Baja System, a natural gas transmission system which extends from southwestern Arizona to a point near Ogilby, California on the California/Mexico border;

effective February 22, 2007, a 68.5 per cent effective ownership interest in the Great Lakes Gas Transmission system ("*Great Lakes System*") which is located in the north central U.S., roughly parallel to the Canada-U.S. Border. Of this interest 53.55 per cent is held directly by TransCanada and the remainder is held through TransCanada's interest in TC PipeLines, LP;

a 44.5 per cent interest in the Iroquois System which runs southwards down through the eastern part of the State of New York terminating at points in Long Island and New York City;

a 61.7 per cent interest in the Portland Natural Gas Transmission system ("*Portland System*") which runs through Maine and New Hampshire into Massachusetts;

effective February 22, 2007, a 16.1 per cent effective ownership interest, held through TC PipeLines, LP, in the NBPL system ("*NBPL System*") which is located in the upper midwestern portion of the U.S.; and

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effective February 22, 2007, a 32.8 per cent effective ownership interest in the Tuscarora system ("*Tuscarora System*") which runs from Oregon eastwards to the upper portion of Nevada. One per cent of this interest is held directly through a subsidiary of TransCanada and the remainder is held through TransCanada's interest in TC PipeLines, LP.

As at February 22, 2007, TransCanada holds a 32.1 per cent interest in TC PipeLines, LP, a publicly held limited partnership of which a subsidiary of TransCanada acts as the general partner. The remaining interest of TC PipeLines, LP is widely held by the public. At Year End, TC PipeLines, LP also held a 50 per cent interest in NBPL and a 99 per cent interest in Tuscarora. Additionally, as at February 22, 2007, TC PipeLines, LP owns the remaining 46.45 per cent in Great Lakes.

### *International*

TransCanada also has the following natural gas pipeline and related holdings in Mexico and South America:

a 46.5 per cent interest in the TransGas system which runs from Mariquita in central Colombia to Cali in southwest Colombia;

8 TRANSCANADA CORPORATION

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a 30 per cent interest in the Gas Pacifico pipeline which extends from Loma de la Lata, Argentina to Concepción, Chile;

a 30 per cent interest in INNERGY Holdings S.A. which is an industrial natural gas marketing and distribution company based in Concepción, Chile; and

a 100 per cent interest in the Tamazunchale pipeline, which extends from the Pemex Gas facilities near Naranjos, Veracruz, Mexico to an electricity generation station near Tamazunchale, San Luis Potosi, Mexico.

Further information about TransCanada's pipeline holdings, developments and opportunities and significant regulatory developments which relate to pipelines can be found in the MD&A under the headings "Pipelines Opportunities and Developments" and "Pipelines Financial Analysis".

In addition, information about the Mackenzie Gas Pipeline Project and the Alaska Highway Pipeline Project can be found in the MD&A under the headings "Pipelines Opportunities and Developments Mackenzie Gas Pipeline Project" and "Pipelines Opportunities and Developments Alaska Highway Pipeline Project", respectively.

### Regulation

#### *Canada*

#### CANADIAN MAINLINE

Under the terms of the *National Energy Board Act* (Canada), the Canadian Mainline and B.C. and Foothills Systems are regulated by the NEB. The NEB sets tolls which provide TransCanada the opportunity to recover projected costs of transporting natural gas, including the return on the Canadian Mainline's and B.C. and Foothills System's average investment base. In addition, new facilities are approved by the NEB before construction begins and the NEB regulates the operation of the Canadian Mainline and B.C. and Foothills Systems. Net earnings of the Canadian Mainline and B.C. and Foothills Systems may be affected by changes in investment base, the allowed return on equity, the level of deemed common equity and any incentive earnings.

#### ALBERTA SYSTEM

The Alberta System is regulated by the Alberta Energy and Utilities Board ("*EUB*") primarily under the provisions of the *Gas Utilities Act* ("*GUA*") and the *Pipeline Act*. Under the *GUA*, the Alberta System rates, tolls and other charges, and terms and conditions of services are subject to approval by the EUB. Under the provisions of the *Pipeline Act*, the EUB oversees various matters including the economic, orderly and efficient development of pipeline facilities, the operation and abandonment of the facilities and certain related pollution and environmental conservation issues. In addition to requirements under the *Pipeline Act*, the construction and operation of natural gas pipelines in Alberta are subject to certain provisions of other provincial legislation such as the *Environmental Protection and Enhancement Act*.

#### *United States*

TransCanada's wholly-owned and partially owned U.S. pipelines, including ANR System, Gas Transmission Northwest System, Great Lakes System, Iroquois System, Portland System, NBPL System, North Baja System and Tuscarora System, are 'natural gas companies' operating under the provisions of the *Natural Gas Act of 1938* and the *Natural Gas Policy Act of 1978*, and are subject to the jurisdiction of the FERC. The *Natural Gas Act of 1938* grants the FERC authority over the construction and operation of pipelines and related facilities. The FERC also has authority to regulate rates for natural gas transportation and interstate commerce.

#### GAS TRANSMISSION NORTHWEST SYSTEM AND NORTH BAJA SYSTEM

Rates and tariffs of the Gas Transmission Northwest System and the North Baja System have been approved by the FERC. These two systems operate under fixed rate models, whereby rates for various service types have been approved by the FERC and under which each of the two systems is permitted to discount or negotiate rates on a non-discriminatory basis. Currently effective rates for mainline capacity on the Gas Transmission Northwest System went into effect on January 1, 2007, following Gas Transmission Northwest System's filing of a general rate case in



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June 2006 under Section 4 of the *Natural Gas Act of 1938*. Gas Transmission Northwest System's current rates were accepted for filing by the FERC, subject to refund. Refunds, with interest, may be due following approval of final rates by the FERC. Gas Transmission Northwest System's previously effective rates, which remained in effect through December 31, 2006, were established through a 1994 rate proceeding which culminated in a settlement that was approved by the FERC in 1996. Rates for capacity on the North Baja System were established in the FERC's initial order certifying construction and operations of its system.

### PORTLAND SYSTEM

In 2003, the Portland System received final approval from the FERC of its general rate case under the *Natural Gas Act of 1938*. The Portland System is required to file a general rate case under the *Natural Gas Act of 1938* with a proposed effective date of April 1, 2008.

### **Energy Business**

The Energy segment of TransCanada's business includes the acquisition, development, construction, ownership and operation of electrical power generation plants, the purchase and marketing of electricity, the provision of electricity account services to energy and industrial customers, and the development, construction, ownership and operation of natural gas storage and LNG facilities in Canada and the United States.

The electrical power generation plants and power supply that TransCanada owns, operates and/or controls, including those under development or in construction, in the aggregate, represent approximately 7,700 MW of power generation capacity. Power plants and power supply in Canada account for approximately 85 per cent of this total, and power plants in the United States account for the balance, being approximately 15 per cent.

TransCanada owns and operates:

natural gas-fired cogeneration plants in Alberta at Carseland (80 MW), Redwater (40 MW), Bear Creek (80 MW) and MacKay River (165 MW);

the natural gas-fired cogeneration plant (90 MW) near Saint John, New Brunswick (Grandview);

a waste-heat fuelled power plant at the Cancarb facility in Medicine Hat, Alberta (27 MW) (Cancarb);

a natural gas-fired, combined-cycle plant in Burrillville, Rhode Island (560 MW) (Ocean State Power);

hydroelectric generation assets in New Hampshire, Vermont and Massachusetts (567 MW) (TC Hydro);

a natural gas-fired cogeneration plant near Trois-Rivières, Québec (550 MW) (Bécancour); and

a natural gas storage facility near Edson, Alberta (Edson).

TransCanada has long-term power purchase arrangements in place for:

100 per cent of the production of the Sundance A (560 MW) and a 50 per cent interest, through a partnership, in the production of the Sundance B (353 MW of 706 MW) power facilities near Wabamun, Alberta; and

756 MW of the production from the Sheerness facility near Hanna, Alberta.

TransCanada has:

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a 60 per cent interest in CrossAlta Gas Storage Services Ltd., an underground natural gas storage facility located near Crossfield, Alberta;

a long-term natural gas storage lease with a third party located in Alberta; and

a 62 per cent interest in the Baie-des-Sables Cartier Wind Energy Project in the Gaspé region of Québec (68 MW of a total 109.5 MW).

TransCanada owns, but does not operate:

a 48.7 per cent partnership interest in the Bruce A nuclear power generation facility in Ontario (730.5 MW of a total of 1,500 MW that is currently in operation. Another 1,500 MW, of which 730.5 MW are attributable to

**10 TRANSCANADA CORPORATION**

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TransCanada, will be generated from two other units currently under refurbishment with restart expected to begin in late 2009 or early 2010);

a 31.6 per cent partnership interest in the Bruce B nuclear power generation facilities in Ontario (1,011 MW of a total of 3,200 MW that is in operation); and

a 16.7 per cent interest in Huron Wind L.P. whose assets are located at the Bruce site (2 MW of a total of 9 MW that is in operation).

TransCanada owns the following facilities which are under construction or development:

a 62 per cent interest in the Cartier Wind Energy Project which is expected to construct five additional wind energy projects in the Gaspé region of Québec over the period 2007 to 2012 (391 MW of a total of 630 MW), subject to future appropriations and approvals;

a 50 per cent interest in the Portlands Energy Centre, a 550 MW natural gas-fired power plant located in the Portlands area of Toronto, which is expected to be in commercial service in second quarter 2009;

the 683 MW Halton Hills natural gas-fired power plant located near the Town of Halton Hills, Ontario, which is anticipated to be in service in the second quarter of 2010;

a joint venture with Shell on the Broadwater LNG project located offshore of New York State in Long Island Sound, a facility when completed that would be capable of receiving, storing and regasifying imported LNG with an average send-out capacity of approximately one billion cubic feet per day of natural gas; and

a joint venture with Petro-Canada on the Cacouna LNG project located in Québec at Gros Cacouna harbour on the St. Lawrence River, a facility when completed that would be capable of receiving, storing and regasifying imported LNG with an average send-out capacity of approximately 500 million cubic feet per day of natural gas.

Further information about TransCanada's energy holdings and significant developments and opportunities relating to energy can be found in the MD&A under the headings "Energy" "Financial Analysis" and "Energy Opportunities and Developments".

### **Other Interests**

#### ***Cancarb Limited***

TransCanada owns Cancarb Limited, a world scale thermal carbon black manufacturing facility located in Medicine Hat, Alberta.

#### ***TransCanada Turbines***

TransCanada owns a 50 per cent interest in TransCanada Turbines Ltd., a repair and overhaul business for aero-derivative industrial gas turbines. This business operates primarily out of facilities in Calgary, Alberta, with offices in Bakersfield, California; East Windsor, Connecticut; and Liverpool, England.

#### ***TransCanada Calibrations***

TransCanada owns an 80 per cent interest in TransCanada Calibrations Ltd., a gas meter calibration business certified by Measurement Canada, located at Ile des Chênes, Manitoba.

### **HEALTH, SAFETY AND ENVIRONMENT**



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TransCanada is committed to providing a safe and healthy environment for its employees, contractors, the public and to the protection of the environment. Health, safety and environment ("*HS&E*") is a priority in all of TransCanada's operations. The HS&E Committee of TransCanada's Board of Directors ("*Board*") monitors conformance with the TransCanada HS&E corporate policy through regular reporting provided by TransCanada's department of Community, Safety & Environment. TransCanada's senior executives are also committed to ensuring TransCanada is in conformance with its policies and regulated requirements and is an industry leader. Senior executives are regularly advised of all

TRANSCANADA CORPORATION 11

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important operational issues and initiatives relating to HS&E by way of formal reporting processes. TransCanada's HS&E management system and performance are assessed by an independent outside firm every three years or more often if the HS&E Committee requests it. The most recent assessment was conducted in November 2006 by Det Norsk Veritas. These assessments involve senior executive and employee interviews, review of policies, procedures, objectives, performance measurement and reporting.

TransCanada's HS&E management system is modeled to the elements of the International Organization for Standardization's (ISO) standard for environmental management systems, ISO 14001. The HS&E management system facilitates the focus of resources on the areas of significant risk to the organization's HS&E business activities. The system highlights opportunities for improvement, enables TransCanada to work towards defined HS&E expectations and objectives, and provides a competitive business advantage. Independent third party assessments, internal management system assessments and work place and facility planned inspections are used to evaluate the implementation effectiveness of the HS&E programs, processes and procedures, and confirms TransCanada's compliance with regulatory requirements.

TransCanada employs full-time staff dedicated to HS&E matters, and incorporates HS&E policies and principles into the planning, development, construction and operation of all its projects. Environmental protection requirements have not had a material impact on the capital expenditures of TransCanada to date. However, there can be no assurance that such requirements will not have a material impact on TransCanada's financial or operating results in future years. Such requirements can be dependent on a variety of factors including the regulatory environment in which TransCanada operates.

### **Environment**

Climate change remains a serious issue for TransCanada. The change of government in Canada in early 2006 resulted in a shift of focus from meeting environmental regulation targets to a broader emphasis on clean air as well as greenhouse gas emissions. The government of Canada released the *Clean Air Act* on October 19, 2006. At this time, however, the policy framework for the new regulations has not been released by the federal government and detailed sectoral targets and timeframes as well as compliance options have not been set. At a provincial level, the Québec government has passed legislation for a hydrocarbon royalty on industrial greenhouse gas emitters. The details as to how the royalty will be applied have not yet been determined but it is expected these details will be set in the coming year. In Alberta, the government has indicated it will continue with its own plan for implementing regulations to manage greenhouse gas emissions. It is yet to be determined how this effort will tie into a federal program.

In the United States, state level initiatives are under way to limit greenhouse gas emissions, particularly in the north-eastern United States and California. Details have not been finalized and the impact to TransCanada's United States based assets is uncertain.

Despite this uncertainty, TransCanada continues with its programs to manage greenhouse gas emissions from its assets, and to evaluate new processes and technologies that result in improved efficiencies and lower greenhouse gas emissions rates. In addition, TransCanada remains involved in policy discussions in those jurisdictions where policy development is under way and where the Company has operations.

## LEGAL PROCEEDINGS AND REGULATORY ACTIONS

The Canadian Alliance of Pipeline Landowners' Association (CAPLA) and two individual landowners commenced an action in 2003 under Ontario's *Class Proceedings Act*, 1992, against TransCanada and Enbridge Inc. for damages of \$500 million alleged to arise from the creation of a control zone within 30 metres of the pipeline pursuant to Section 112 of the *National Energy Board Act*. On November 20, 2006, the Ontario Superior Court granted the motion of TransCanada and Enbridge Inc. for a dismissal of the case. CAPLA has now appealed the decision. TransCanada continues to believe the claim is without merit and will vigorously defend the action. TransCanada has made no provision for any potential liability. Any liability, if any, would be dealt with through the regulatory process.

TransCanada and its subsidiaries are subject to various other legal proceedings and actions arising in the normal course of business. While the final outcome of such legal proceedings and actions cannot be predicted with certainty, it is the opinion of TransCanada's management that the resolution of such proceedings and actions will not have a material impact on TransCanada's consolidated financial position or results of operations.

## MATERIAL CONTRACTS

The ANR Purchase and Sale Agreement as described in this AIF under "General Development of the Business - Developments in the Pipelines Business" is available on SEDAR at [www.sedar.com](http://www.sedar.com) under TransCanada's profile.

## TRANSFER AGENT AND REGISTRAR

TransCanada's transfer agent and registrar is Computershare Trust Company of Canada with transfer facilities in the Canadian cities of Vancouver, Calgary, Winnipeg, Toronto, Montréal and Halifax.

## INTEREST OF EXPERTS

Our auditors, KPMG LLP, have confirmed that they are independent within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Alberta.

## RISK FACTORS

A discussion of the Company's risk factors can be found in the MD&A for the year ended December 31, 2006, which is incorporated by reference, under the headings "Pipelines - Opportunities and Developments", "Pipelines - Business Risks", "Energy - Opportunities and Developments", "Energy - Business Risks" and "Risks and Risk Management".

## DIVIDENDS

TransCanada's Board of Directors has not adopted a formal dividend policy. The Board reviews the financial performance of TransCanada quarterly and makes a determination of the appropriate level of dividends to be declared in the following quarter. Currently, TransCanada's payment of dividends on its common shares is funded from dividends TransCanada receives as the sole common shareholder of TCPL. Provisions of various trust indentures and credit arrangements to which TCPL is a party restrict TCPL's ability to declare and pay dividends to TransCanada under certain circumstances and, if such restrictions apply, they may, in turn, have an impact on TransCanada's ability to declare and pay dividends on its common shares. In the opinion of TransCanada management, such provisions do not currently restrict or alter TransCanada's ability to declare or pay dividends.

The dividends declared per common share of TransCanada during the past three completed financial years are set forth in the following table:

	2006	2005	2004
Dividends declared on common shares	\$1.28	\$1.22	\$1.16

## DESCRIPTION OF CAPITAL STRUCTURE

### Share Capital

TransCanada's authorized share capital consists of an unlimited number of common shares, of which 488,975,399 were issued and outstanding at Year End, and an unlimited number of first preferred shares and second preferred shares, issuable in series, of which none are outstanding. The following is a description of the material characteristics of each of these classes of shares.

#### *Common Shares*

The common shares entitle the holders thereof to one vote per share at all meetings of shareholders, except meetings at which only holders of another specified class of shares are entitled to vote, and, subject to the rights, privileges, restrictions and conditions attaching to the first preferred shares and the second preferred shares, whether as a class or a series, and to any other class or series of shares of TransCanada which rank prior to the common shares, entitle the holders thereof to receive (i) dividends if, as and when declared by the Board out of the assets of TransCanada properly applicable to the payment of the dividends in such amount and payable at such times and at such place or places as the Board may from time to time determine and (ii) the remaining property of TransCanada upon a dissolution.

#### *First Preferred Shares*

Subject to certain limitations, the Board may, from time to time, issue first preferred shares in one or more series and determine for any such series, its designation, number of shares and respective rights, privileges, restrictions and conditions. The first preferred shares as a class, have, among others, provisions to the following effect.

The first preferred shares of each series shall rank on a parity with the first preferred shares of every other series, and shall be entitled to preference over the common shares, the second preferred shares and any other shares ranking junior to the first preferred shares with respect to the payment of dividends, the repayment of capital and the distribution of assets of TransCanada in the event of a liquidation, dissolution or winding up of TransCanada.

Except as provided by the *Canada Business Corporations Act* or as referred to below, the holders of the first preferred shares will not have any voting rights nor will they be entitled to receive notice of or to attend shareholders' meetings. The holders of any particular series of first preferred shares will, if the directors so determine prior to the issuance of such series, be entitled to such voting rights as may be determined by the directors if TransCanada fails to pay dividends on that series of preferred shares for any period as may be so determined by the directors.

The provisions attaching to the first preferred shares as a class may be modified, amended or varied only with the approval of the holders of the first preferred shares as a class. Any such approval to be given by the holders of the first preferred shares may be given by the affirmative vote of the holders of not less than  $66\frac{2}{3}$  per cent of the first preferred shares represented and voted at a meeting or adjourned meeting of such holders.

#### *Second Preferred Shares*

The rights, privileges, restrictions and conditions attaching to the second preferred shares are substantially identical to those attaching to the first preferred shares, except that the second preferred shares are junior to the first preferred shares with respect to the payment of dividends, repayment of capital and the distribution of assets of TransCanada in the event of a liquidation, dissolution or winding up of TransCanada.

**CREDIT RATINGS**

Although TransCanada has not issued debt to the public, it has been assigned an issuer rating by Moody's Investors Service of A3 with a stable outlook. TransCanada does not presently intend to issue debt securities to the public in its own name and future financing requirements are expected to continue to be funded primarily through its subsidiary, TCPL. The following table sets out the credit ratings assigned to those outstanding classes of securities of TCPL which have been rated:

<b>Overall</b>	<b>DBRS</b>	<b>Moody's</b>	<b>S&amp;P</b>
Senior Secured Debt <i>First Mortgage Bonds</i>	A	A2	A
Senior Unsecured Debt <i>Debentures</i>	A	A2	A
<i>Medium-term Notes</i>	A	A2	A
Subordinated Debt	A (low)	A3	BBB+
Junior Subordinated Debt	Pfd-2	A3	BBB
Preferred Shares	Pfd-2 (low)	Baa1	BBB
Commercial Paper	R-1 (low)	P-1	
Trend/Rating Outlook	Stable <sup>(1)</sup>	Stable	Negative

(1) At February 22, 2007, the DBRS rating was confirmed as stable. At December 31, 2006 the rating was under review. Discussed further, in DBRS section below.

Credit ratings are intended to provide investors with an independent measure of credit quality of an issue of securities. Credit ratings are not recommendations to purchase, hold or sell securities and do not address the market price or suitability of a specific security for a particular investor. There is no assurance that any rating will remain in effect for any given period of time or that any rating will not be revised or withdrawn entirely by a rating agency in the future if, in its judgment, circumstances so warrant. A description of the rating agencies' credit ratings listed in the table above is set out below.

**Dominion Bond Rating Service (DBRS)**

DBRS has different rating scales for short and long-term debt and preferred shares. "High" or "low" grades are used to indicate the relative standing within a rating category. The absence of either a "high" or "low" designation indicates the rating is in the "middle" of the category. The R-1 (low) rating assigned to TCPL's short-term debt is the third highest of ten rating categories and indicates satisfactory credit quality. The overall strength and outlook for key liquidity, debt and profitability ratios is not normally as favourable as with higher rating categories, but these considerations are still respectable. Any qualifying negative factors that exist are considered manageable, and the entity is normally of sufficient size to have some influence in its industry. The A ratings assigned to TCPL's senior secured and senior unsecured debt and the A (low) rating assigned to its subordinated debt are the third highest of ten categories for long-term debt. Long-term debt rated A is of satisfactory credit quality. Protection of interest and principal is still substantial, but the degree of strength is less than that of AA rated entities. While a respectable rating, entities in the A category are considered to be more susceptible to adverse economic conditions and have greater cyclical tendencies than higher rated entities. The Pfd-2 and Pfd-2 (low) ratings assigned to TCPL's junior subordinated debt and preferred shares are the second highest of six rating categories for preferred shares. Preferred shares rated Pfd-2 are of

satisfactory credit quality. Protection of dividends and principal is still substantial; however, earnings, the balance sheet and coverage ratios are not as strong as Pfd-1 rated companies.

Subsequent to TransCanada's December 22, 2006 announcement of its plans to acquire ANR, DBRS put TCPL's rating under review with developing implications. On February 22, 2007, DBRS confirmed the rating of TCPL with a stable trend and subsequently removed TCPL's rating from under review.

#### Moody's Investor Services (Moody's)

Moody's has different rating scales for short and long-term obligations. Numerical modifiers 1, 2 and 3 are applied to each rating classification, with 1 being the highest and 3 being the lowest. The P-1 rating assigned to TCPL's short-term debt is the highest of four rating categories and indicates a superior ability to repay short-term debt obligations. The A2 ratings assigned to TCPL's senior secured and senior unsecured debt and the A3 ratings assigned to its subordinated debt and junior subordinated debt are the third highest of nine rating categories for long-term obligations. Obligations rated A are considered upper-medium grade and are subject to low credit risk. The Baa1 rating assigned to TCPL's preferred shares is the fourth highest of nine rating categories for long-term obligations. Obligations rated Baa are subject to moderate credit risk, are considered medium-grade, and as such, may possess certain speculative characteristics.

#### Standard & Poor's (S&P)

S&P has different rating scales for short and long-term obligations. Ratings may be modified by the addition of a plus (+) or minus ( ) sign to show the relative standing within a particular rating category. The A and A ratings assigned to TCPL's senior secured and senior unsecured debt, respectively, are the third highest of ten rating categories for long-term obligations. An A rating indicates the obligor's capacity to meet its financial commitment is strong; however, the obligation is somewhat susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. The BBB+ rating assigned to TCPL's subordinated debt and the BBB ratings assigned to its junior subordinated debt and preferred shares are the fourth highest of ten rating categories for long-term obligations. An obligation rated BBB exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

#### MARKET FOR SECURITIES

TransCanada's common shares are listed on the Toronto Stock Exchange ("TSX") and the New York Stock Exchange ("NYSE"). The following table sets forth the reported monthly high and low closing prices and monthly trading volumes of the common shares of TransCanada on the TSX for the period indicated:

#### Common Shares (TRP)

Month	High (\$)	Low (\$)	Volume Traded
December 2006	40.77	38.95	20,122,013
November 2006	39.14	36.50	21,499,249
October 2006	36.34	33.95	19,350,398
September 2006	35.97	34.65	22,209,089
August 2006	36.35	34.86	22,367,872
July 2006	34.75	31.70	17,073,298
June 2006	34.50	31.55	23,121,387
May 2006	33.50	30.94	30,019,492
April 2006	34.73	33.02	20,961,283
March 2006	35.38	33.67	25,708,683
February 2006	35.25	34.57	21,932,670
January 2006	37.01	34.75	24,218,158

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In addition, the following securities of TransCanada's subsidiary, TCPL, are listed on the markets specified:

TCPL's Cumulative Redeemable First Preferred Shares, Series U and Series Y are listed on the TSX;

TCPL's 8.25% preferred securities due 2047, are listed on the NYSE; and

TCPL's 16.50% First Mortgage Pipe Line Bonds due 2007, are listed on the London Stock Exchange.

### DIRECTORS AND OFFICERS

As of February 22, 2007, the directors and officers of TransCanada as a group beneficially owned, directly or indirectly, have exercisable options to own, or exercised control or direction over 1,676,238 common shares of TransCanada which constitutes less than one per cent of TransCanada's common shares and less than one per cent of the voting securities of any of its subsidiaries or affiliates. TransCanada collects this information from its directors and officers but otherwise has no direct knowledge of individual holdings of its securities. Further information as to securities beneficially owned, or over which control or direction is exercised, is provided in TransCanada's Proxy Circular under the heading "Business to be Transacted at the Meeting Election of Directors". See also "Additional Information" in this AIF.

#### Directors

Set forth below are the names of the thirteen directors who served on TransCanada's Board at Year End, together with their jurisdictions of residence, all positions and offices held by them with TransCanada and its significant affiliates, their principal occupations or employment during the past five years and the year from which each director has continually served as a director of TransCanada and, prior to the arrangement, with TCPL. Positions and offices held with TransCanada are also held by such person at TCPL.

Name and Place of Residence	Principal Occupation During the Five Preceding Years	Director Since
Kevin E. Benson <sup>(1)</sup> Wheaton, Illinois United States	President and Chief Executive Officer, Laidlaw International, Inc. (transportation services) since June 2003, and Laidlaw, Inc. from September 2002 to June 2003. President and Chief Executive Officer, The Insurance Corporation of British Columbia from December 2001 until September 2002. Director, Laidlaw International, Inc.	2005
Derek H. Burney, O.C. Ottawa, Ontario Canada	Senior strategic advisor at Ogilvy Renault LLP (law firm). President and Chief Executive Officer, CAE Inc. (technology) from October 1999 to August 2004. Lead director at Québecor World Inc. (communications and media) from April 2003 to November 2005. Chairman, CanWest Global Communications Corp. and Lead Director, Shell Canada Limited.	2005
Wendy K. Dobson Uxbridge, Ontario Canada	Professor, Rotman School of Management and Director, Institute for International Business, University of Toronto (education). Vice Chair, Canadian Public Accountability Board. Director, Toronto-Dominion Bank.	1992
E. Linn Draper Lampasas, Texas United States	Corporate Director. Chairman, President and Chief Executive Officer of Columbus, Ohio-based American Electric Power Co., Inc. from April 1993 to April 2004. Director, Alliance Data Systems Corporation, Lead Director, Alpha Natural Resources, Inc., Chair of NorthWestern Corporation and Director, Temple-Inland Inc.	2005

TRANSCANADA CORPORATION 17

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The Hon. Paule Gauthier, P.C., O.C., O.Q., Q.C. Québec, Québec Canada	Senior Partner, Desjardins Ducharme LLP (law firm). Director, Cossette Communication Group Inc., Institut Québécois des Hautes Études Internationales, Laval University, Metro Inc., RBC Dexia Investor Services Trust, Rothmans Inc. and Royal Bank of Canada.	2002
Kerry L. Hawkins Winnipeg, Manitoba Canada	Corporate Director. President, Cargill Limited (agricultural) from September 1982 to December 2005. Director, NOVA Chemicals Corporation and Shell Canada Limited.	1996
S. Barry Jackson Calgary, Alberta Canada	Corporate Director. Chair of the Board, TransCanada since April 2005. Chair of Resolute Energy Inc. (oil and gas) from January 2002 to April 2005 and Chair of Deer Creek Energy Limited (oil and gas) from April 2001 to September 2005. Director, Cordero Energy Inc. and Nexen Inc.	2002
Paul L. Joskow Brookline, Massachusetts United States	Professor, Department of Economics, Massachusetts Institute of Technology (MIT) (education). Director of the MIT Center for Energy and Environmental Policy Research. Director, National Grid PLC and Putnam Mutual Funds.	2004
Harold N. Kvisle Calgary, Alberta Canada	President and Chief Executive Officer, TransCanada since May 2003 and TCPL since May 2001. Director, Bank of Montreal and PrimeWest Energy Inc. Chair of the Mount Royal College Board of Governors.	2001
John A. MacNaughton, C.M. Toronto, Ontario Canada	Corporate Director. Chairman of the Canadian Trading and Quotation System Inc. Founding President and Chief Executive Officer of the Canadian Pension Plan Investment Board from 1999 to 2005. Director, Nortel Networks Corporation.	2006
David P. O'Brien <sup>(2)</sup> Calgary, Alberta Canada	Corporate Director. Chair, EnCana Corporation (oil and gas) since April 2002 and Chair, Royal Bank of Canada since February 2004. Chair and Chief Executive Officer of PanCanadian Energy Corporation (oil and gas) from October 2001 to April 2002. Director, Focus Energy Trust, Molson Coors Brewing Company, and C.D. Howe Institute. Chancellor, Concordia University.	2001
Harry G. Schaefer, F.C.A. Calgary, Alberta Canada	President, Schaefer & Associates (business advisory services). Vice-Chair of the Board, TransCanada since May 2003 and TCPL since June 1998. Director, Agrium Inc. and Trustee of Fording Canadian Coal Trust.	1987
D. Michael G. Stewart Calgary, Alberta Canada	Principal of the privately held Ballinacurra Group of Investment Companies since March 2002. A number of senior executive positions with Westcoast Energy Inc. (energy infrastructure, services and utilities) including Executive Vice-President, Business Development from September 1993 to March 2002. Director Canadian Energy Services Inc. and Pengrowth Corporation.	2006

(1) Mr. Benson was President and Chief Executive Officer of Canadian Airlines International Ltd. from July 1996 to February 2000. Canadian Airlines International Ltd. filed for protection under the *Companies' Creditors Arrangement Act* (Canada) and applicable bankruptcy protection statutes in the United States on March 24, 2000.

(2) Mr. O'Brien was a director of Air Canada on April 1, 2003 when Air Canada filed for protection under the *Companies' Creditors Arrangement Act* (Canada). Mr. O'Brien resigned as a director from Air Canada in November 2003.



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Each director holds office until the next annual meeting or until his or her successor is earlier elected or appointed. Mr. Stewart was elected to the Board on April 28, 2006 and Mr. MacNaughton was appointed to the Board on June 14, 2006. In addition, Mr. Schaefer will retire effective April 27, 2007 and Mr. W.T. Stephens has been selected as a new nominee for election. Mr. Stephens previously served on the Board from 2000 to 2005.

### Officers

All of the executive officers and corporate officers of TransCanada reside in Calgary, Alberta, Canada. References to positions and offices with TransCanada prior to May 15, 2003 are references to the positions and offices held with TCPL. Current positions and offices held with TransCanada are also held by such person at TCPL. As of the date hereof, the officers of TransCanada, their present positions within TransCanada and their principal occupations during the five preceding years are as follows:

#### *Executive Officers*

Name	Present Position Held	Principal Occupation During the Five Preceding Years
Harold N. Kvisle	President and Chief Executive Officer	President and Chief Executive Officer.
Russell K. Girling	President, Pipelines	Executive Vice-President, Corporate Development and Chief Financial Officer, March 2003 to June 2006. Prior to March 2003, Executive Vice-President and Chief Financial Officer.
Gregory A. Lohnes	Executive Vice-President and Chief Financial Officer	Prior to June 2006, President and Chief Executive Officer of Great Lakes Gas Transmission Company.
Dennis J. McConaghy	Executive Vice-President, Pipeline Strategy and Development	Prior to June 2006, Executive Vice-President, Gas Development.
Sean McMaster <sup>(1)</sup>	Executive Vice-President, Corporate and General Counsel and Chief Compliance Officer	Executive Vice-President, General Counsel and Chief Compliance Officer from October 2006 to January 2007. Prior to October 2006, General Counsel and Chief Compliance Officer. Prior thereto, General Counsel since June 2006. Vice-President, Transactions, Power Division, TCPL from April 2003 to June 2006. President TransCanada Power Services Ltd., general partner of TransCanada Power LP from June 2003 to August 2005. Prior to June 2003, Vice-President, Power Services Ltd.
Alexander J. Pourbaix	President, Energy	Executive Vice-President, Power March 2003 to June 2006. Prior to March 2003, Executive Vice-President, Power Development.
Sarah E. Raiss	Executive Vice-President, Corporate Services	Executive Vice-President, Corporate Services.
Donald M. Wishart	Executive Vice-President, Operations and Engineering	Prior to March 2003, Senior Vice-President, Field Operations.

<sup>(1)</sup> Mr. McMaster was appointed Executive Vice-President, General Counsel and Chief Compliance Officer on October 30, 2006.

*Corporate Officers*

<b>Name</b>	<b>Present Position Held</b>	<b>Principal Occupation During the Five Preceding Years</b>
Ronald L. Cook	Vice-President, Taxation	Prior to April 2002, Director, Taxation.
Donald J. DeGrandis	Corporate Secretary	Prior to June 2006, Associate General Counsel, Corporate.
Garry E. Lamb	Vice-President, Risk Management	Vice-President, Risk Management.
Donald R. Marchand	Vice-President, Finance and Treasurer	Vice-President, Finance and Treasurer.
G. Glenn Menuz	Vice President and Controller	Prior to June 2006, Assistant Controller.

**CORPORATE GOVERNANCE**

The Board and the members of TransCanada's management are committed to the highest standards of corporate governance. TransCanada's corporate governance practices comply with the governance rules of the Canadian Securities Administrators ("CSA"), those of the NYSE applicable to foreign issuers and of the U.S. Securities and Exchange Commission ("SEC"), and those mandated by the United States *Sarbanes-Oxley Act of 2002* ("SOX"). As a non-U.S. company, TransCanada is not required to comply with most of the NYSE corporate governance listing standards; however, except as summarized on its website at [www.transcanada.com](http://www.transcanada.com), the governance practices followed are in compliance with the NYSE standards for U.S. companies in all significant respects. TransCanada is in compliance with the CSA's Multilateral Instrument 52-110 pertaining to audit committees. TransCanada is also in compliance with the CSA's National Policy 58-201, Corporate Governance Guidelines, and National Instrument 58-101, Disclosure of Corporate Governance Practices (collectively, the "*Canadian Governance Guidelines*"). In 2005, the Canadian Governance Guidelines came into effect and for purposes of the TSX replaced the TSX Corporate Governance Guidelines. Further information about TransCanada's corporate governance can be found on TransCanada's website under the heading "Corporate Governance".

**Audit Committee**

TransCanada has an Audit Committee which is responsible for assisting the Board in overseeing the integrity of TransCanada's financial statements and compliance with legal and regulatory requirements and in ensuring the independence and performance of TransCanada's internal and external auditors. The members of the Audit Committee at Year End were Harry G. Schaefer (Chair), Kevin E. Benson, Derek H. Burney, Paule Gauthier, Paul L. Joskow and John A. MacNaughton. Mr. Jackson is a non-voting member of the Audit Committee.

The Board believes that the composition of the Audit Committee reflects a high level of financial literacy and expertise. Each member of the Audit Committee has been determined by the Board to be "independent" and "financially literate" within the meaning of the definitions under Canadian and U.S. securities laws and the NYSE rules. In addition, the Board has determined that Mr. Schaefer is an "Audit Committee Financial Expert" as that term is defined under U.S. securities laws. The Board has made these determinations based on the education and breadth and depth of experience of each member of the Audit Committee. The following is a description of the education and experience, apart from their respective roles as directors of TransCanada, of each member of the Audit Committee that is relevant to the performance of his or her responsibilities as a member of the Audit Committee:

Mr. Schaefer earned a Bachelor of Commerce from the University of Alberta, is a Chartered Accountant and is a Fellow of the Canadian Institute of Chartered Accountants. He serves on and has served on the boards of several public

companies and other organizations, including as Chairman of the Alberta Chapter of the Institute of Corporate Directors, and on the audit committees of certain of those boards. Mr. Schaefer has also held several executive positions with public companies. He is currently Chair of the Audit Committee and of the audit committees of two other public companies.

Mr. Benson earned a Bachelor of Accounting from the University of Witwatersrand (South Africa) and was a member of the South African Society of Chartered Accountants. Mr. Benson is the President and Chief Executive Officer of Laidlaw International, Inc. In prior years, he has held several executive positions including one as President and Chief Executive Officer of Canadian Airlines International Ltd. and has served on other public company boards.

Mr. Burney earned a Bachelor of Arts (Honours) and Master of Arts from Queen's University. He is currently a senior strategic advisor at Ogilvy Renault LLP. Mr. Burney previously served as President and Chief Executive Officer of CAE Inc. and as Chairman and Chief Executive Officer of Bell Canada International Inc. Mr. Burney is the lead director at Shell Canada Limited and the Chairman of CanWest Global Communications Corp. He has served on one other organization's audit committee.

Mme. Gauthier earned a Bachelor of Arts from the Collège Jésus-Marie de Sillery, a Bachelor of Laws from Laval University and a Master of Laws in Business Law (Intellectual Property) from Laval-University. She has served on the boards of several public companies and other organizations and on the audit committees of certain of those boards.

Mr. Joskow earned a Bachelor of Arts with Distinction in Economics from Cornell University, a Masters of Philosophy in Economics from Yale University, and Ph.D. in Economics from Yale University. He is currently a Professor, Department of Economics, Massachusetts Institute of Technology. He has served on the boards of several public companies and other organizations and on the audit committees of certain of those boards.

Mr. MacNaughton earned a Bachelor of Arts in Economics from the University of Western Ontario. Mr. MacNaughton is currently the Chairman of Canadian Trading and Quotation System Inc. In prior years, he has held several executive positions including founding President and Chief Executive Officer of the Canadian Pension Plan Investment Board and President of Nesbitt Burns Inc. He is currently the Chair of an audit committee of one other public company.

The Charter of the Audit Committee can be found in Schedule "B" of this AIF and on TransCanada's website under the Corporate Governance Board Committees page, at the link specified above under the heading "Corporate Governance".

#### ***Pre-Approval Policies and Procedures***

TransCanada's Audit Committee has adopted a pre-approval policy with respect to permitted non-audit services. Under the policy, the Audit Committee has granted pre-approval for specified non-audit services. For engagements of \$25,000 or less which are not within the annual pre-approved limit, approval by the Audit Committee is not required, and for engagements between \$25,000 and \$100,000, approval of the Audit Committee Chair is required, and the Audit Committee is to be informed of the engagement at the next scheduled Audit Committee meeting. For all engagements of \$100,000 or more, pre-approval of the Audit Committee is required. In all cases, regardless of the dollar amount involved, where there is a potential for conflict of interest involving the external auditor to arise on an engagement, the Audit Committee Chair must pre-approve the assignment.

To date, TransCanada has not approved any non-audit services on the basis of the de-minimis exemptions. All non-audit services have been pre-approved by the Audit Committee in accordance with the pre-approval policy described above.

**External Auditor Service Fees**

The aggregate fees for external auditor services rendered by the External Auditor for the TransCanada group of companies for the 2006 and 2005 fiscal years, are shown in the table below:

<b>Fee Category</b>	<b>2006</b>	<b>2005</b>	<b>Description of Fee Category</b>
	(millions of dollars)		
Audit Fees	<b>4.94</b>	3.15	Aggregate fees for audit services rendered by TransCanada's External Auditor for the audit of TransCanada's annual financial statements or services provided in connection with statutory and regulatory filings or engagements, the review of interim consolidated financial statements and information contained in various prospectuses and other offering documents.
Audit Related Fees	<b>0.07</b>	0.11	Aggregate fees for assurance and related services rendered by TransCanada's External Auditor that are reasonably related to performance of the audit or review of TransCanada's financial statements and are not reported as Audit Fees. The nature of services comprising these fees related to the audit of the financial statements of TransCanada's various certain plans.
Tax Fees	<b>0.22</b>	0.12	Aggregate fees rendered by TransCanada's External Auditor for primarily tax compliance and tax advice. The nature of these services consisted of: tax compliance including the review of Canadian and U.S. income tax returns; and tax items and tax services related to domestic and international taxation including income tax, capital tax and Goods and Services Tax.
All Other Fees	<b>0.07</b>	0.14	Aggregate fees for products and services other than those reported in this table above rendered by TransCanada's External Auditor. The nature of these services consisted of advice with respect to TransCanada's compliance with SOX.
Total	<b>5.30</b>	3.52	

**Other Board Committees**

In addition to the Audit Committee, TransCanada has three other Board committees: the Governance Committee, the Health, Safety and Environment Committee and the Human Resources Committee. Mr. Jackson, the Chair of the Board, sits on each of Board's committees as a non-voting member. The voting members of each of these committees, as of Year End, are identified below:

<b>Governance Committee</b>		<b>Health, Safety &amp; Environment Committee</b>		<b>Human Resources Committee</b>	
Chair:	W.K. Dobson	Chair:	E.L. Draper	Chair:	K.L. Hawkins
Members:	D.H. Burney P.L. Joskow D.P. O'Brien H.G. Schaefer	Members:	P. Gauthier K.L. Hawkins D.M.G. Stewart J.A. MacNaughton	Members:	W.K. Dobson E.L. Draper D.P. O'Brien

22 TRANSCANADA CORPORATION

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The charters of the Governance Committee, the Health, Safety & Environment Committee and the Human Resources Committee can be found on TransCanada's website under the Corporate Governance Board Committees page at the link specified below.

Further information about TransCanada's Board committees and corporate governance can be found on TransCanada's website located at: [http://www.transcanada.com/company/board\\_committees.html](http://www.transcanada.com/company/board_committees.html).

### Conflicts of Interest

Directors and officers of TransCanada and its subsidiaries are required to disclose the existence of existing or potential conflicts in accordance with TransCanada policies governing directors and officers and in accordance with the *Canada Business Corporations Act*. Although some of the directors sit on boards or may be otherwise associated with companies that ship natural gas on TransCanada's pipeline systems, TransCanada as a common carrier in Canada cannot, under its tariff, deny transportation service to a credit-worthy shipper. Further, due to the specialized nature of the industry, TransCanada believes that it is important for its Board to be composed of qualified and knowledgeable directors, so some of them must come from oil and gas producers and shippers; the Governance Committee closely monitors relationships among directors to ensure that business associations do not affect the Board's performance. In a circumstance where a director declares an interest in any material contract or material transaction being considered at a meeting, the director generally absents himself or herself from the meeting during the consideration of the matter, and does not vote on the matter.

### ADDITIONAL INFORMATION

1. Additional information in relation to TransCanada may be found under TransCanada's profile on SEDAR at [www.sedar.com](http://www.sedar.com).
2. Additional information including directors' and officers' remuneration and indebtedness, principal holders of TransCanada's securities and securities authorized for issuance under equity compensation plans (all where applicable), is contained in TransCanada's Proxy Circular for its most recent annual meeting of shareholders that involved the election of directors and can be obtained upon request from the Corporate Secretary of TransCanada.
3. Additional financial information is provided in TransCanada's audited consolidated financial statements and MD&A for its most recently completed financial year.

**GLOSSARY**

ACES	Accelerated Clean Energy Supply
AIF	Annual Information Form of TransCanada Corporation dated February 22, 2007
Alberta System	A natural gas transmission system throughout the province of Alberta
Annual Report	TransCanada's Annual Report to Shareholders for the year ended, December 31, 2006
ANR	American Natural Resources Company and ANR Storage Company
ANR Purchase and Sale Agreement	An agreement between TransCanada and El Paso Corporation, dated December 22, 2006, whereby TransCanada agreed to acquire ANR from El Paso Corporation
ANR System	A natural gas transmission system which extends approximately 17,000 km from producing fields in Louisiana, Oklahoma, Texas and the Gulf of Mexico to markets in Wisconsin, Michigan, Illinois, Ohio and Indiana
B.C. and Foothills Systems	A natural gas pipeline system in southeastern B.C., southern Alberta and southwestern Saskatchewan
Bcf	Billion cubic feet
Bécancour Plant	A power plant near Trois-Rivières, Québec
Board	TransCanada's Board of Directors
Bruce A	Bruce Power A L.P.
Bruce B	Bruce Power L.P.
Cacouna Energy Project	The Cacouna Energy LNG facility in Cacouna, Québec
Canadian Mainline	A natural gas pipeline system running from the Alberta border east to delivery points in eastern Canada and along the U.S. border
Cartier Wind Energy Project	Six wind energy projects by Hydro-Québec Distribution representing a total of 740 MW in the Gaspé region of Québec
CSA	Canadian Securities Administrators
EUB	Alberta Energy and Utilities Board
External Auditor	KPMG LLP
FERC	Federal Energy Regulatory Commission (USA)
Gas Transmission Northwest System	A natural gas transmission system running from northwestern Idaho, through Washington and Oregon to the California border
Grandview Plant	A power plant in Saint John, New Brunswick
Great Lakes	Great Lakes Gas Transmission Limited Partnership
Great Lakes System	A natural gas pipeline system in the north central U.S., roughly parallel to the Canada-U.S. Border
GUA	Gas Utilities Act
HS&E	Health, Safety and Environment
Iroquois System	A natural gas pipeline system in New York and Connecticut
LNG	Liquefied Natural Gas
MD&A	TransCanada's Management's Discussion and Analysis dated February 22, 2007
MW	Megawatts
NBPL	Northern Border Pipeline
NBPL System	A natural gas transmission system located in the upper midwestern portion of the United States
NEB	National Energy Board
Northern Border Pipeline	Northern Border Pipeline Company
North Baja System	A natural gas pipeline in southern California
NYSE	New York Stock Exchange
PEC	Portlands Energy Centre
Portland System	A natural gas pipeline that runs through Maine and New Hampshire into Massachusetts
Power LP	TransCanada Power, L.P.
PPA	Power Purchase Agreement
Proxy Circular	TransCanada's Management Proxy Circular dated February 22, 2007
SEC	U.S. Securities and Exchange Commission
Shell	Shell US Gas & Power LLC
SOX	U.S. <i>Sarbanes-Oxley Act of 2002</i>
Tcf	Trillion cubic feet
TCPL	TransCanada PipeLines Limited
TQM	Trans Québec & Maritimes Pipeline Inc.
TQM System	A natural gas pipeline system in southeastern Québec
TransCanada	TransCanada Corporation
TSX	Toronto Stock Exchange
Tuscarora	Tuscarora Gas Transmission Company
Tuscarora System	A natural gas pipeline that runs from Oregon through northeast California to Reno, Nevada
Year End	December 31, 2006

**SCHEDULE "A"****METRIC CONVERSION TABLE**

The conversion factors set out below are approximate factors. To convert from Metric to Imperial multiply by the factor indicated. To convert from Imperial to Metric divide by the factor indicated.

<b>Metric</b>	<b>Imperial</b>	<b>Factor</b>
Kilometres	Miles	0.62
Millimetres	Inches	0.04
Gigajoules	Million British thermal units	0.95
Cubic metres*	Cubic feet	35.3
Kilopascals	Pounds per square inch	0.15
Degrees Celsius	Degrees Fahrenheit	to convert to Fahrenheit multiply by 1.8, then add 32 degrees; to convert to Celsius subtract 32 degrees, then divide by 1.8

\*

The conversion is based on natural gas at a base pressure of 101.325 kilopascals and at a base temperature of 15 degrees Celsius.

TRANSCANADA CORPORATION A-1

**SCHEDULE "B"**  
**CHARTER OF THE AUDIT COMMITTEE**

**1. Purpose**

The Audit Committee shall assist the Board of Directors (the "Board") in overseeing and monitoring, among other things, the:

Company's financial accounting and reporting process;

integrity of the financial statements;

Company's internal control over financial reporting;

external financial audit process;

compliance by the Company with legal and regulatory requirements; and

independence and performance of the Company's internal and external auditors.

To fulfill its purpose, the Audit Committee has been delegated certain authorities by the Board of Directors that it may exercise on behalf of the Board.

**2. Roles and Responsibilities**

***I.***

***Appointment of the Company's External Auditors***

Subject to confirmation by the external auditors of their compliance with Canadian and U.S. regulatory registration requirements, the Audit Committee shall recommend to the Board the appointment of the external auditors, such appointment to be confirmed by the Company's shareholders at each annual meeting. The Audit Committee shall also recommend to the Board the compensation to be paid to the external auditors for audit services and shall pre-approve the retention of the external auditors for any permitted non-audit service and the fees for such service. The Audit Committee shall also be directly responsible for the oversight of the work of the external auditor (including resolution of disagreements between management and the external auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work. The external auditor shall report directly to the Audit Committee.

The Audit Committee shall also receive periodic reports from the external auditors regarding the auditors' independence, discuss such reports with the auditors, consider whether the provision of non-audit services is compatible with maintaining the auditors' independence and the Audit Committee shall take appropriate action to satisfy itself of the independence of the external auditors.

***II.***

***Oversight in Respect of Financial Disclosure***

The Audit Committee, to the extent it deems it necessary or appropriate, shall:

(a)

review, discuss with management and the external auditors and recommend to the Board for approval, the Company's audited annual financial statements, annual information form including management discussion and analysis, all financial statements in prospectuses and other offering memoranda, financial statements required by regulatory authorities, all prospectuses and all documents which may be incorporated by reference into a prospectus, including without limitation, the annual proxy circular, but excluding any pricing supplements issued under a medium term note prospectus supplement of the Company;



- (b) review, discuss with management and the external auditors and recommend to the Board for approval the release to the public of the Company's interim reports, including the financial statements, management discussion and analysis and press releases on quarterly financial results;

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- (c) review and discuss with management and external auditors the use of "pro forma" or "adjusted" non-GAAP information and the applicable reconciliation;
- (d) review and discuss with management and external auditors financial information and earnings guidance provided to analysts and rating agencies; provided, however, that such discussion may be done generally (consisting of discussing the types of information to be disclosed and the types of presentations to be made). The Audit Committee need not discuss in advance each instance in which the Company may provide earnings guidance or presentations to rating agencies;
- (e) review with management and the external auditors major issues regarding accounting and auditing principles and practices, including any significant changes in the Company's selection or application of accounting principles, as well as major issues as to the adequacy of the Company's internal controls and any special audit steps adopted in light of material control deficiencies that could significantly affect the Company's financial statements;
- (f) review and discuss quarterly reports from the external auditors on:
  - (i) all critical accounting policies and practices to be used;
  - (ii) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the external auditor;
  - (iii) other material written communications between the external auditor and management, such as any management letter or schedule of unadjusted differences;
- (g) review with management and the external auditors the effect of regulatory and accounting initiatives as well as off-balance sheet structures on the Company's financial statements;
- (h) review with management, the external auditors and, if necessary, legal counsel, any litigation, claim or contingency, including tax assessments, that could have a material effect upon the financial position of the Company, and the manner in which these matters have been disclosed in the financial statements;
- (i) review disclosures made to the Audit Committee by the Company's CEO and CFO during their certification process for the periodic reports filed with securities regulators about any significant deficiencies in the design or operation of internal controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls;
- (j) discuss with management the Company's material financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company's risk assessment and risk management policies.

### **III.**

#### ***Oversight in Respect of Legal and Regulatory Matters***

- (a) review with the Company's General Counsel legal matters that may have a material impact on the financial statements, the Company's compliance policies and any material reports or inquiries received from regulators or governmental agencies.

### **IV.**

#### ***Oversight in Respect of Internal Audit***

- (a)

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review the audit plans of the internal auditors of the Company including the degree of coordination between such plan and that of the external auditors and the extent to which the planned audit scope can be relied upon to detect weaknesses in internal control, fraud or other illegal acts;

- (b) review the significant findings prepared by the internal auditing department and recommendations issued by the Company or by any external party relating to internal audit issues, together with management's response thereto;
- (c) review compliance with the Company's policies and avoidance of conflicts of interest;

**B-2** TRANSCANADA CORPORATION

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- (d) review the adequacy of the resources of the internal auditor to ensure the objectivity and independence of the internal audit function, including reports from the internal audit department on its audit process with associates and affiliates;
- (e) ensure the internal auditor has access to the Chair of the Audit Committee and of the Board and to the Chief Executive Officer and meet separately with the internal auditor to review with him any problems or difficulties he may have encountered and specifically:
  - (i) any difficulties which were encountered in the course of the audit work, including restrictions on the scope of activities or access to required information, and any disagreements with management;
  - (ii) any changes required in the planned scope of the internal audit; and
  - (iii) the internal audit department responsibilities, budget and staffing;and to report to the Board on such meetings;
- (f) bi-annually review officers' expenses and aircraft usage reports.

### V.

#### *Insight in Respect of the External Auditors*

- (a) review the annual post-audit or management letter from the external auditors and management's response and follow-up in respect of any identified weakness, inquire regularly of management and the external auditors of any significant issues between them and how they have been resolved, and intervene in the resolution if required;
- (b) review the quarterly unaudited financial statements with the external auditors and receive and review the review engagement reports of external auditors on unaudited financial statements of the Company;
- (c) receive and review annually the external auditors' formal written statement of independence delineating all relationships between itself and the Company;
- (d) meet separately with the external auditors to review with them any problems or difficulties the external auditors may have encountered and specifically:
  - (i) any difficulties which were encountered in the course of the audit work, including any restrictions on the scope of activities or access to required information, and any disagreements with management; and
  - (ii) any changes required in the planned scope of the audit; and to report to the Board on such meetings;
- (e) review with the external auditors the adequacy and appropriateness of the accounting policies used in preparation of the financial statements;
- (f) meet with the external auditors prior to the audit to review the planning and staffing of the audit;
- (g)

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receive and review annually the external auditors' written report on their own internal quality control procedures; any material issues raised by the most recent internal quality control review, or peer review, of the external auditors, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, and any steps taken to deal with such issues;

(h)

review and evaluate the external auditors, including the lead partner of the external auditor team;

(i)

ensure the rotation of the lead (or coordinating) audit partner having primary responsibility for the audit and the audit partner responsible for reviewing the audit as required by law.

TRANSCANADA CORPORATION **B-3**

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**VI.**

***Oversight in Respect of Audit and Non-Audit Services***

- (a) pre-approve all audit services (which may entail providing comfort letters in connection with securities underwritings) and all permitted non-audit services, other than non-audit services where:
  - (i) the aggregate amount of all such non-audit services provided to the Company constitutes not more than 5% of the total fees paid by the Company and its subsidiaries to the external auditor during the fiscal year in which the non-audit services are provided;
  - (ii) such services were not recognized by the Company at the time of the engagement to be non-audit services; and
  - (iii) such services are promptly brought to the attention of the Audit Committee and approved prior to the completion of the audit by the Audit Committee or by one or more members of the Audit Committee to whom authority to grant such approvals has been delegated by the Audit Committee;
- (b) approval by the Audit Committee of a non-audit service to be performed by the external auditor shall be disclosed as required under securities laws and regulations;
- (c) the Audit Committee may delegate to one or more designated members of the Audit Committee the authority to grant pre-approvals required by this subsection. The decisions of any member to whom authority is delegated to pre-approve an activity shall be presented to the Audit Committee at its first scheduled meeting following such pre-approval;
- (d) if the Audit Committee approves an audit service within the scope of the engagement of the external auditor, such audit service shall be deemed to have been pre-approved for purposes of this subsection.

**VII.**

***Oversight in Respect of Certain Policies***

- (a) review and recommend to the Board for approval policy changes and program initiatives deemed advisable by management or the Audit Committee with respect to the Company's codes of business conduct and ethics;
- (b) obtain reports from management, the Company's senior internal auditing executive and the external auditors and report to the Board on the status and adequacy of the Company's efforts to ensure its businesses are conducted and its facilities are operated in an ethical, legally compliant and socially responsible manner, in accordance with the Company's codes of business conduct and ethics;
- (c) establish a non-traceable, confidential and anonymous system by which callers may ask for advice or report any ethical or financial concern, ensure that procedures for the receipt, retention and treatment of complaints in respect of accounting, internal controls and auditing matters are in place, and receive reports on such matters as necessary;
- (d) annually review and assess the adequacy of the Company's public disclosure policy;
- (e) review and approve the Company's hiring policies for employees or former employees of the external auditors (recognizing the Sarbanes-Oxley Act of 2002 does not permit the CEO, controller, CFO or chief accounting officer to have participated in the Company's audit as an employee of the external auditors' during the preceding one-year period) and monitor the Company's adherence to the policy.

**VIII.**

***Oversight in Respect of Financial Aspects of the Company's Pension Plans, specifically:***

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- (a) provide advice to the Human Resources Committee on any proposed changes in the Company's pension plans in respect of any significant effect such changes may have on pension financial matters;
- (b) review and consider financial and investment reports and the funded status relating to the Company's pension plans and recommend to the Board on pension contributions;
- (c) receive, review and report to the Board on the actuarial valuation and funding requirements for the Company's pension plans;

**B-4** TRANSCANADA CORPORATION

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- (d) review and approve annually the Statement of Investment Policies and Procedures ("SIP&P");
- (e) approve the appointment or termination of auditors and investment managers.

**IX.**

***Oversight in Respect of Internal Administration***

- (a) review annually the reports of the Company's representatives on certain audit committees of subsidiaries and affiliates of the Company and any significant issues and auditor recommendations concerning such subsidiaries and affiliates;
- (b) review the succession plans in respect of the Chief Financial Officer, the Vice President, Risk Management and the Director, Internal Audit;
- (c) review and approve guidelines for the Company's hiring of employees or former employees of the external auditors who were engaged on the Company's account.

**X.**

***Oversight Function***

While the Audit Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Audit Committee to plan or conduct audits or to determine that the Company's financial statements and disclosures are complete and accurate or are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibilities of management and the external auditors. The Audit Committee, its Chair and any of its members who have accounting or related financial management experience or expertise, are members of the Board, appointed to the Audit Committee to provide broad oversight of the financial disclosure, financial risk and control related activities of the Company, and are specifically not accountable nor responsible for the day to day operation of such activities. Although designation of a member or members as an "audit committee financial expert" is based on that individual's education and experience, which that individual will bring to bear in carrying out his or her duties on the Audit Committee, designation as an "audit committee financial expert" does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the Audit Committee and Board in the absence of such designation. Rather, the role of any audit committee financial expert, like the role of all Audit Committee members, is to oversee the process and not to certify or guarantee the internal or external audit of the Company's financial information or public disclosure.

**3. Composition of Audit Committee**

The Audit Committee shall consist of three or more Directors, a majority of whom are resident Canadians (as defined in the Canada Business Corporations Act), and all of whom are unrelated and/or independent for the purposes of applicable Canadian and United States securities law and applicable rules of any stock exchange on which the Company's shares are listed. Each member of the Audit Committee shall be financially literate and at least one member shall have accounting or related financial management expertise (as those terms are defined from time to time under the requirements or guidelines for audit committee service under securities laws and the applicable rules of any stock exchange on which the Company's securities are listed for trading or, if it is not so defined as that term is interpreted by the Board in its business judgment).

**4. Appointment of Audit Committee Members**

The members of the Audit Committee shall be appointed by the Board from time to time, on the recommendation of the Governance Committee and shall hold office until the next annual meeting of shareholders or until their successors are earlier appointed or until they cease to be Directors of the Company.



**5. Vacancies**

Where a vacancy occurs at any time in the membership of the Audit Committee, it may be filled by the Board on the recommendation of the Governance Committee.

**6. Audit Committee Chair**

The Board shall appoint a Chair of the Audit Committee who shall:

- (a) review and approve the agenda for each meeting of the Audit Committee and as appropriate, consult with members of management;
- (b) preside over meetings of the Audit Committee;
- (c) report to the Board on the activities of the Audit Committee relative to its recommendations, resolutions, actions and concerns; and
- (d) meet as necessary with the internal and external auditors.

**7. Absence of Audit Committee Chair**

If the Chair of the Audit Committee is not present at any meeting of the Audit Committee, one of the other members of the Audit Committee present at the meeting shall be chosen by the Audit Committee to preside at the meeting.

**8. Secretary of Audit Committee**

The Corporate Secretary shall act as Secretary to the Audit Committee.

**9. Meetings**

The Chair, or any two members of the Audit Committee, or the internal auditor, or the external auditors, may call a meeting of the Audit Committee. The Audit Committee shall meet at least quarterly. The Audit Committee shall meet periodically with management, the internal auditors and the external auditors in separate executive sessions.

**10. Quorum**

A majority of the members of the Audit Committee, present in person or by telephone or other telecommunication device that permit all persons participating in the meeting to speak to each other, shall constitute a quorum.

**11. Notice of Meetings**

Notice of the time and place of every meeting shall be given in writing or facsimile communication to each member of the Audit Committee at least 24 hours prior to the time fixed for such meeting; provided, however, that a member may in any manner waive a notice of a meeting. Attendance of a member at a meeting is a waiver of notice of the meeting, except where a member attends a meeting for the express purpose of objecting to the transaction of any business on the grounds that the meeting is not lawfully called.

**12. Attendance of Company Officers and Employees at Meeting**

At the invitation of the Chair of the Audit Committee, one or more officers or employees of the Company may attend any meeting of the Audit Committee.

**13. Procedure, Records and Reporting**

The Audit Committee shall fix its own procedure at meetings, keep records of its proceedings and report to the Board when the Audit Committee may deem appropriate but not later than the next meeting of the Board.

**14. Review of Charter and Evaluation of Audit Committee**

The Audit Committee shall review its Charter annually or otherwise, as it deems appropriate, and if necessary propose changes to the Governance Committee and the Board. The Audit Committee shall annually review the Audit Committee's own performance.

**15. Outside Experts and Advisors**

The Audit Committee is authorized, when deemed necessary or desirable, to retain independent counsel, outside experts and other advisors, at the Company's expense, to advise the Audit Committee or its members independently on any matter.

**16. Reliance**

Absent actual knowledge to the contrary (which shall be promptly reported to the Board), each member of the Audit Committee shall be entitled to rely on (i) the integrity of those persons or organizations within and outside the Company from which it receives information, (ii) the accuracy of the financial and other information provided to the Audit Committee by such persons or organizations and (iii) representations made by Management and the external auditors, as to any information technology, internal audit and other non-audit services provided by the external auditors to the Company and its subsidiaries.

TRANSCANADA CORPORATION B-7

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## Financial Highlights

<i>Year ended December 31</i> <i>(millions of dollars)</i>	<b>2006</b>	2005	2004	2003	2002
<b>Income</b>					
Net income					
Continuing operations	<b>1,051</b>	1,209	980	801	747
Discontinued operations	<b>28</b>		52	50	
	<b>1,079</b>	1,209	1,032	851	747
<b>Cash Flow</b>					
Funds generated from operations	<b>2,378</b>	1,951	1,703	1,822	1,843
(Increase)/decrease in operating working capital	<b>(303)</b>	(49)	29	93	92
Net cash provided by operations	<b>2,075</b>	1,902	1,732	1,915	1,935
Capital expenditures and acquisitions	<b>2,042</b>	2,071	2,046	965	851
<b>Balance Sheet</b>					
Total assets	<b>25,909</b>	24,113	22,422	20,887	20,555
Long-term debt	<b>10,887</b>	9,640	9,749	9,516	8,899
Common shareholders' equity	<b>7,701</b>	7,206	6,565	6,091	5,747
<i>Common Share Statistics</i>					
<i>Year ended December 31</i>	<b>2006</b>	2005	2004	2003	2002
Net income per share – Basic					
Continuing operations	<b>\$2.15</b>	\$2.49	\$2.02	\$1.66	\$1.56
Discontinued operations	<b>0.06</b>		0.11	0.10	
	<b>\$2.21</b>	\$2.49	\$2.13	\$1.76	\$1.56
Net income per share – Diluted					
Continuing operations	<b>\$2.14</b>	\$2.47	\$2.01	\$1.66	\$1.55
Discontinued operations	<b>0.06</b>		0.11	0.10	
	<b>\$2.20</b>	\$2.47	\$2.12	\$1.76	\$1.55
Dividends declared per share	<b>\$1.28</b>	\$1.22	\$1.16	\$1.08	\$1.00
Common shares outstanding (millions)					
Average for the year	<b>488.0</b>	486.2	484.1	481.5	478.3
End of year	<b>489.0</b>	487.2	484.9	483.2	479.5





## Chairman's Message

At TransCanada, doing business with integrity, respect and a deeply ingrained sense of responsibility to all stakeholders is critical to the company's ongoing success.

2006 marked another strong year for TransCanada, the outcome of both the continued diligent, prudent execution of the company's strategy, and a focus on building and maintaining strong relationships with stakeholders. The accomplishments of 2006 demonstrated our company's ability to identify and act on strategic opportunities, and provided further evidence of TransCanada's financial strength. Based on these achievements, and our solid foundation for future growth, the Board increased the dividend in January 2007 for the seventh consecutive year.

TransCanada's Board plays a significant role in providing leadership, setting direction and deciding strategy. Ultimately, directors are accountable for the overall stewardship and governance of the company. While corporate governance may no longer dominate news headlines, it remains one of TransCanada's highest priorities.

In January 2007, we were proud to see TransCanada named as a member of the Global 100 Most Sustainable Companies in the world, recognizing TransCanada's ability to manage the environmental, social and governance risks and opportunities it faces. This acknowledgement also reinforces the company's continued inclusion in the Dow Jones Sustainability Index achieved for a fifth year in a row. TransCanada's Board continues to be independently ranked as one of the top corporate boards in Canada.

TransCanada's 2007 annual and special meeting will mark the last meeting for Harry Schaefer, F.C.A. who will retire from the Board after 20 years as a director. Mr. Schaefer has served most recently as Vice-Chairman of the Board and Chair of the Audit Committee. Mr. Schaefer is an experienced and talented director and a leading voice for corporate governance in Canada. On behalf of the Board and management of TransCanada, I thank him for his commitment and dedication.

Subsequent to the 2006 Annual Meeting of Shareholders, TransCanada welcomed John MacNaughton, C.M. to the Board. As the former President and Chief Executive Officer of the Canada Pension Plan Investment Board, Mr. MacNaughton contributes significant financial acumen and expertise earned through years of experience in the investment industry.

Looking forward, the Board is pleased to approve the nomination of W. Thomas Stephens, Chairman and Chief Executive Officer, Boise Cascade LLC, to the Board at our annual meeting in April. Mr. Stephens served previously as a director, stepping down in 2005 for business reasons. We welcome Mr. Stephens' return.

Along with the Board, I thank the management and employees of TransCanada for their enthusiasm, passion and dedication to realizing the company's objectives.

On behalf of the Board of Directors,

**S. Barry Jackson**  
Chair

**2** CHAIRMAN'S MESSAGE

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**Letter  
to  
Shareholders**

As we begin 2007, TransCanada is set to significantly expand its continental natural gas pipeline and storage operations through the acquisition of American Natural Resources Company, ANR Storage Company (together, ANR) and an additional interest in Great Lakes Gas Transmission Limited Partnership (Great Lakes).

The ANR announcement marked a strong finish to an excellent year for TransCanada. In addition to the ANR transaction, we continued to build our portfolio of high-quality power generation assets and established a substantial natural gas storage business in Western Canada. By continuing along the strategic growth path we embarked on seven years ago, we've made significant progress towards our objective of being the leading North American energy infrastructure company.

Our efforts are focused on three key objectives: maximizing the profitability and value of our existing assets; implementing new projects and initiatives; and continually cultivating a high-quality portfolio of future growth opportunities.

**Maximizing profitability and value**

TransCanada's net income for the year ended December 31, 2006 was \$1.079 billion or \$2.21 per share. Excluding net income from discontinued operations of \$28 million or \$0.06 per share, net income from continuing operations (net earnings) was \$1.051 billion or \$2.15 per share, compared to \$1.209 billion or \$2.49 per share in 2005. Our 2006 and 2005 results were impacted by a number of significant items, which are highlighted in Management's Discussion and Analysis on page 74 of TransCanada's 2006 Annual Report. Net earnings excluding these significant items<sup>(1)</sup> increased nine per cent in 2006 to \$925 million or \$1.90 per share, from \$849 million or \$1.75 per share in 2005.

Funds generated from operations grew to approximately \$2.4 billion in 2006, an increase of 22 per cent over 2005. This strong underlying cash flow enabled us to make significant capital investments in our pipelines and energy businesses. In 2006, we invested approximately \$2 billion in growth initiatives.

Our performance in 2006 builds on our track record of delivering steady growth in earnings and cash flow. Over the past seven years, TransCanada has:

Grown net earnings, excluding significant items, at a compound average annual growth rate of 8.4 per cent from \$1.08 per share in 1999 to \$1.90 per share in 2006;

Grown funds generated from operations at a compound average annual growth rate of 12.5 per cent from \$1 billion in 1999 to \$2.4 billion in 2006; and

Invested approximately \$11 billion in our core businesses.

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<sup>(1)</sup> "Net earnings excluding significant items" does not have any standardized meaning prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other issuers.

Our strong 2006 financial performance enabled our Board of Directors to increase the quarterly dividend on the company's common shares in January 2007 by six per cent to \$0.34 per share. On an annualized basis, this equates to \$1.36 per share. This is the seventh year in a row the Board has increased the dividend.

Our strong financial performance has resulted in significant returns for our shareholders. In 2006, TransCanada generated a total shareholder return of approximately 15 per cent. The compound average annual total shareholder return over the past seven years is approximately 24 per cent.

### **Implementing new projects and initiatives, and Cultivating a portfolio of future growth opportunities**

North America is faced with two critical challenges: a fundamental shortage of energy supply from existing sources, and a lack of critical infrastructure to connect new supply to where it is needed. While we have seen some progress toward addressing these challenges, the fact remains that energy demand continues to grow at a faster rate than available supply.

This situation creates tremendous opportunity for TransCanada. With more than 50 years of experience in planning, constructing and operating large-scale energy infrastructure, we are well positioned to play a key role in connecting new sources of supply with growing demand in our preferred North American markets.

In 2006, we continued to invest in our North American natural gas transmission, natural gas storage and power businesses. We also continued to pursue new and complementary opportunities in oil pipelines and liquefied natural gas (LNG). These projects and initiatives will allow TransCanada to continue to strengthen its position as a leading North American energy infrastructure company and deliver significant value to our shareholders in the future.

### **In Pipelines Expanding our continental footprint**

**ANR acquisition** In February 2007, we completed our acquisition of ANR and an additional interest in Great Lakes for approximately US\$3.4 billion, including US\$488 million of assumed debt. The acquisition of ANR represents a unique opportunity to acquire regulated pipeline and storage assets that are a strong fit with our existing North American footprint. ANR is one of the largest interstate natural gas pipeline systems in the United States providing transportation, storage and various capacity related services to a variety of customers in both the U.S. and Canada. With this acquisition, our wholly owned natural gas pipeline network extends more than 59,000 kilometres (36,500 miles), offering our customers unparalleled connections from traditional and emerging supply basins.

In a separate transaction, TC PipeLines, LP acquired the remaining 46.45 per cent interest in Great Lakes for US\$962 million, including US\$212 million of assumed debt. TransCanada owns approximately 32 per cent of TC PipeLines, LP and is the general partner.

In February 2007, TransCanada issued \$1.5 billion in Subscription Receipts to help finance the ANR acquisition. The Subscription Receipts converted to common shares on a one-to-one basis on closing of the acquisition. Our decision to issue new equity is aligned with our commitment to maintain a strong financial position and TransCanada PipeLines Limited's 'A' credit ratings.

**Canadian Mainline and Alberta System expansions** We continue to invest in our existing pipeline systems in response to our customers' needs to connect supply in Alberta and meet market demand in the East. Our highly competitive gas transmission network is capturing the majority of new gas connections in Western Canada. Our customers see real value in the size, scale and reach of our systems.

**Tamazunchale** The 130-kilometre Tamazunchale Pipeline went into commercial service in December 2006. We are exploring additional opportunities in the Mexican energy market as the government advances its initiative to promote the use of natural gas for regional development, particularly as a fuel for much needed power generation.

**Northern Border and Tuscarora** Over the past year, through TC PipeLines, LP, we have increased our interests in Northern Border Pipeline Company, the largest natural gas pipeline connecting Western Canadian supply with growing U.S. Midwest markets, and Tuscarora Gas Transmission, meeting the growing demands of the northern Nevada market. TransCanada will operate these pipelines in 2007.

**Keystone** TransCanada's Keystone Pipeline is an innovative and cost competitive proposal to add much needed new oil pipeline capacity from Alberta to key refining centres in the U.S. Midwest. Shippers have demonstrated strong support for the proposed pipeline. In January 2006, we announced binding contracts for 340,000 barrels per day with an average duration of 18 years.

A key feature of the 2,960-kilometre Keystone Pipeline is the proposal to convert a section of TransCanada's Canadian Mainline from natural gas to oil transmission. We marked a critical milestone in the project in February 2007 when the National Energy Board (NEB) approved this conversion. Subject to further NEB and U.S. regulatory approvals, construction of the Keystone Pipeline is expected to begin in early 2008, with commercial operations scheduled to commence in the fourth quarter of 2009.

**Northern pipelines** Over the longer term, we remain a key player in projects to bring northern natural gas to market. On the Mackenzie Gas Project, the project coventurers expect to file an updated cost estimate and schedule with regulators in the first quarter of 2007. The project continues to move through the regulatory process.

In Alaska, it continues to be our objective to see a natural gas pipeline project develop within Alaska on terms that Alaskans find satisfactory. We look forward to working with the State of Alaska and the Alaska producers to develop commercial arrangements for the movement of Alaska gas through Canada, taking advantage of the Northern Pipeline Act, our existing Yukon right-of-way and spare capacity in our extensive North American natural gas pipeline network.

**In Energy Building a solid platform for long-term growth**

**Bécancour Power Plant** In September 2006, our 550-megawatt (MW) Bécancour cogeneration plant went into commercial service. We are proud to have completed this significant project on time and under budget.

**Cartier Wind** In November 2006, the 110-MW Baie-des-Sables wind farm was completed and placed into service. This is the first of six phases of the Cartier Wind project, of which TransCanada owns 62 per cent. Phase two is expected to go into commercial service in the third quarter of 2007.

**Edson Gas Storage** In December 2006, we commenced commercial operations at our new Edson natural gas storage facility. TransCanada now has interests in approximately 130 billion cubic feet (Bcf) of natural gas storage capacity in Alberta, or approximately one-third of the capacity in the province.

**Bruce Power** The Bruce Power restart and refurbishment project continues to progress as expected. To date, the partners have invested approximately \$1.1 billion in the project that will ultimately see another 1,500 MW of generating capacity returned to the Ontario power grid.

**Portlands Energy Centre and Halton Hills Generating Station** We are also proceeding with construction on the Portlands Energy Centre (PEC) with our partner, Ontario Power Generation, and completing the environmental permitting process for the Halton Hills Generating Station. We anticipate beginning construction on Halton Hills later in 2007. PEC is expected to begin delivering electricity to the Ontario grid by the summer of 2008, with full operations beginning in 2009. Halton Hills is expected to be operating in the second quarter of 2010.

These two plants will add significant incremental generating capacity in the Ontario power market and, along with our Bécancour plant, will be fuelled by natural gas.

**Cacouna and Broadwater LNG projects** With North American natural gas supply from traditional basins expected to essentially remain flat over the next decade, new sources of supply are needed to meet the growing demand for natural gas to fuel power generation and meet industrial and residential heating needs. Our two LNG proposals, Cacouna Energy, near Gros-Cacouna, Quebec, and Broadwater Energy, in the New York waters of Long Island Sound, are designed to connect 1.5 billion cubic feet per day of natural gas directly to the areas where it is needed most, helping meet local needs while at the same time moderating energy prices and minimizing environmental impacts.

Both LNG projects require additional regulatory approvals before construction can proceed and we will continue to work with our partners to advance through the regulatory process in 2007.

**Continued growth, enduring value**

Our accomplishments in 2006 give us confidence that TransCanada is well on its way to becoming North America's leading energy infrastructure company. Over the next five years we expect to capitalize on increased demand for natural gas and power by continuing to invest in our natural gas transmission, natural gas storage and power generation businesses. In addition to these businesses, we are now positioned to make substantial investments in crude oil pipelines and LNG. We have identified and developed a portfolio of attractive projects that will allow us to invest more than \$4 billion over the next three years alone. With the ANR acquisition, our total capital program is expected to exceed \$8 billion over that same time period.





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In closing, I would note that TransCanada's strength and enduring value is evident in our high-quality physical assets, our financial position and our people. The TransCanada team is exceptionally skilled, knowledgeable and energetic, and it is their efforts that have made our company a success. Our strong and highly motivated team is our real competitive advantage, and I am confident that we will sustain and build on that advantage in the years ahead. As always, our success will be measured in the value we create for our shareholders.

**Hal Kvisle** President and Chief Executive Officer

LETTER TO SHAREHOLDERS [7](#)

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**TABLE OF CONTENTS**

<hr/>	
<b>CONSOLIDATED FINANCIAL REVIEW</b>	
Selected Three-Year Consolidated Financial Data	10
Highlights	11
Segment Results-at-a-Glance	12
Results of Operations	12
<hr/>	
<b>SUBSEQUENT EVENTS</b>	14
<hr/>	
<b>FORWARD-LOOKING INFORMATION</b>	15
<hr/>	
<b>NON-GAAP MEASURES</b>	15
<hr/>	
<b>TRANSCANADA OVERVIEW</b>	15
<hr/>	
<b>TRANSCANADA'S STRATEGY</b>	
Pipelines	16
Energy	18
Operational Excellence	19
Competitive Strength and Enduring Value	20
<hr/>	
<b>OUTLOOK</b>	20
<hr/>	
<b>PIPELINES</b>	
Highlights	24
Results-at-a-Glance	25
Financial Analysis	26
Opportunities and Developments	28
Business Risks	33
Other	35
Outlook	35
Natural Gas Throughput Volumes	37
<hr/>	
<b>ENERGY</b>	
Highlights	40
Results-at-a-Glance	41
Power Plants – Nominal Generating Capacity and Fuel Type	42
Financial Analysis	42
Opportunities and Developments	52
Business Risks	53
Outlook	54
<hr/>	
<b>CORPORATE</b>	
Results-at-a-Glance	55
<hr/>	
<b>DISCONTINUED OPERATIONS</b>	56
<hr/>	
<b>LIQUIDITY AND CAPITAL RESOURCES</b>	
Summarized Cash Flow	56
Highlights	56
<hr/>	
<b>8 MANAGEMENT'S DISCUSSION AND ANALYSIS</b>	
<hr/>	

---

<b>CONTRACTUAL OBLIGATIONS</b>	
Contractual Obligations	59
Principal Repayments	59
Interest Payments	60
Purchase Obligations	60
<b>FINANCIAL AND OTHER INSTRUMENTS</b>	62
<b>RISKS AND RISK MANAGEMENT</b>	67
<b>CONTROLS AND PROCEDURES</b>	69
<b>SIGNIFICANT ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES</b>	70
<b>ACCOUNTING CHANGES</b>	72
<b>SELECTED QUARTERLY CONSOLIDATED FINANCIAL DATA</b>	73
<b>FOURTH QUARTER 2006 HIGHLIGHTS</b>	75
<b>SHARE INFORMATION</b>	76
<b>OTHER INFORMATION</b>	76
<b>GLOSSARY OF TERMS</b>	77

MANAGEMENT'S DISCUSSION AND ANALYSIS [9](#)

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*The Management's Discussion and Analysis (MD&A) dated February 22, 2007 should be read in conjunction with the audited Consolidated Financial Statements of TransCanada Corporation (TransCanada or the Company) and the notes thereto for the year ended December 31, 2006. This MD&A covers TransCanada's financial position and operations as at and for the year ended December 31, 2006. TransCanada's February 22, 2007 acquisition of American Natural Resources Company, and ANR Storage Company (collectively ANR), additional interests in Great Lakes Gas Transmission Partnership (Great Lakes) and related events, are summarized in the "Subsequent Events" section of this MD&A. Amounts are stated in Canadian dollars unless otherwise indicated. Abbreviations and acronyms used in this MD&A are identified in the Glossary of Terms in the Company's 2006 Annual Report.*

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## CONSOLIDATED FINANCIAL REVIEW

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### SELECTED THREE YEAR CONSOLIDATED FINANCIAL DATA<sup>(1)</sup>

(millions of dollars except per share amounts)

	2006	2005	2004
<b>Balance Sheet</b>			
Total assets	25,909	24,113	22,422
Total long-term liabilities	14,464	13,012	12,403
<b>Income Statement</b>			
Revenues	7,520	6,124	5,497
Net income			
Continuing operations	1,051	1,209	980
Discontinued operations	28		52
Total net income	1,079	1,209	1,032
<b>Per Common Share Data</b>			
Net income Basic			
Continuing operations	\$2.15	\$2.49	\$2.02
Discontinued operations	0.06		0.11
	\$2.21	\$2.49	\$2.13
Net income Diluted			
Continuing operations	\$2.14	\$2.47	\$2.01
Discontinued operations	0.06		0.11
	\$2.20	\$2.47	\$2.12
Dividends declared	\$1.28	\$1.22	\$1.16

(1) The selected three-year consolidated financial data is based on the Company's financial statements which are prepared in accordance with Canadian generally accepted accounting principles (GAAP). Certain comparative figures have been reclassified to conform with the current year's presentation.

## HIGHLIGHTS

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### Balance Sheet

In 2006, TransCanada's shareholders' equity increased by \$0.5 billion to \$7.7 billion.

### Net Income

In 2006, net income was \$1,079 million or \$2.21 per share compared to \$1,209 million or \$2.49 per share in 2005.

### Net Earnings

In 2006, TransCanada's net income from continuing operations (net earnings) was \$1,051 million or \$2.15 per share compared to \$1,209 million or \$2.49 per share in 2005.

Excluding gains on sales of assets, TransCanada's net earnings increased \$186 million in 2006 to \$1,038 million or \$2.12 per share compared to \$852 million or \$1.75 per share in 2005.

### Investing Activities

In 2006, TransCanada invested approximately \$2.0 billion in its Pipelines and Energy businesses.

In February 2007, the Company closed the acquisition of ANR and an additional 3.55 per cent interest in Great Lakes for approximately US\$3.4 billion, subject to certain post-closing adjustments, including approximately US\$488 million of assumed long-term debt.

In February 2007, TC PipeLines, LP (PipeLines LP) closed its acquisition of a 46.45 per cent interest in Great Lakes for approximately US\$962 million, subject to certain post-closing adjustments, including approximately US\$212 million of assumed long-term debt.

### Financing Activities

In 2006, TransCanada issued \$2.1 billion of long-term debt.

In January 2007, the Company filed a short form shelf prospectus in Canada and the U.S. to allow for the offering of up to \$3.0 billion of common shares, preferred shares and/or subscription receipts.

In February 2007, the Company sold 39,470,000 subscription receipts at a price of \$38.00 each. The gross proceeds of approximately \$1.5 billion were used to partially finance the ANR acquisition. TransCanada granted the underwriters of the subscription receipts offering an option to purchase an additional 5,920,500 common shares at a price of \$38.00 at any time up to and including March 16, 2007.

In February 2007, the Company entered into agreements for a US\$2.2 billion one-year bridge loan facility and, through a wholly owned subsidiary, for a new US\$1.0 billion credit facility. The Company utilized \$1.5 billion and US\$1.8 billion from these and existing facilities to partially finance the ANR acquisition as well as additional interests in PipeLines LP, described below. A portion of these advances were repaid on February 23, 2007 with proceeds from the subscription receipt

offering.

In February 2007, PipeLines LP increased the size of its syndicated revolving credit and term loan agreement to US\$950 million. Draws of US\$126 million under this agreement were used to partially finance PipeLines LP's Great Lakes acquisition.

In February 2007, PipeLines LP completed a private placement offering of 17,356,086 common units at a price of US\$34.57 per unit. TransCanada acquired 50 per cent of the units for US\$300 million and invested an additional approximately US\$12 million to maintain its general partner interest, increasing its total ownership to 32.1 per cent. The total private placement resulted in gross proceeds of approximately US\$612 million which were used to partially finance PipeLines LP's Great Lakes acquisition.

## Dividend

On January 29, 2007, the Board of Directors of TransCanada increased the quarterly dividend on the Company's outstanding common shares for the quarter ending March 31, 2007 by six per cent to \$0.34 per share from \$0.32 per share. This is the seventh consecutive annual increase in the common share dividend.

In January 2007, TransCanada's Board of Directors authorized the issue of common shares from treasury at a two per cent discount under the Company's Dividend Reinvestment and Share Purchase Plan (DRP), beginning with the dividend payable April 30, 2007 to shareholders of record at March 30, 2007.

**SEGMENT RESULTS-AT-A-GLANCE***Year ended December 31 (millions of dollars)*

	2006	2005	2004
<b>Pipelines Net Earnings</b>			
Excluding gains	547	630	577
Gain on sale of Northern Border Partners, L.P. interest	13		
Gain on sale of PipeLines LP units		49	
Gain on sale of Millennium			7
	<b>560</b>	679	584
<b>Energy Net Earnings</b>			
Excluding gains	452	258	211
Gain on sale of Paiton Energy		115	
Gains related to Power LP		193	187
	<b>452</b>	566	398
<b>Corporate</b>	<b>39</b>	(36)	(2)
<b>Net Income</b>			
Continuing Operations <sup>(1)</sup>	1,051	1,209	980
Discontinued Operations	28		52
	<b>1,079</b>	1,209	1,032
<b>Net Income Per Share</b>			
Continuing Operations <sup>(2)</sup>	\$2.15	\$2.49	\$2.02
Discontinued Operations	0.06		0.11
Basic	<b>\$2.21</b>	\$2.49	\$2.13
<b><sup>(1)</sup>Net Income from Continuing Operations:</b>			
Excluding gains	1,038	852	786
Gains as noted above	13	357	194
	<b>1,051</b>	1,209	980
<b><sup>(2)</sup>Net Income Per Share from Continuing Operations:</b>			
Excluding gains	\$2.12	\$1.75	\$1.62
Gains as noted above	0.03	0.74	0.40
	<b>\$2.15</b>	\$2.49	\$2.02

**RESULTS OF OPERATIONS**

Effective June 1, 2006, TransCanada revised the composition and names of its reportable business segments to Pipelines and Energy. The financial reporting of these segments was aligned to reflect the internal organizational structure of the Company. Pipelines principally comprises the Company's pipelines in Canada, the U.S. and Mexico. Energy includes the Company's power operations, natural gas storage business and

liquefied natural gas (LNG) projects in Canada and the U.S. The segmented information has been retroactively reclassified to reflect the changes in reportable segments. These changes had no impact on consolidated net income.

**12** MANAGEMENT'S DISCUSSION AND ANALYSIS

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Net income for the year ended December 31, 2006 was \$1,079 million or \$2.21 per share compared to \$1,209 million or \$2.49 per share for 2005 and \$1,032 million or \$2.13 per share for 2004. This includes net income from discontinued operations of \$28 million or \$0.06 per share in 2006, reflecting bankruptcy settlements with Mirant Corporation and certain of its subsidiaries (Mirant) related to TransCanada's Gas Marketing business divested in 2001. Income from discontinued operations of \$52 million or \$0.11 per share in 2004 reflects income recognized on initially deferred gains relating to Mirant.

Net earnings for the year ended December 31, 2006 were \$1,051 million or \$2.15 per share compared to \$1,209 million or \$2.49 per share in 2005 and \$980 million or \$2.02 per share in 2004. Net earnings for 2006 included after-tax gains of \$13 million from the sale of TransCanada's general partner interest in Northern Border Partners, L.P. Net earnings for 2005 included after-tax gains of \$193 million on the sale of the Company's interest in TransCanada Power, L.P. (Power LP), \$115 million on the sale of the Company's interest in P.T. Paiton Energy Company (Paiton Energy) and \$49 million on the sale of PipeLines LP units.

Excluding gains of \$13 million in 2006 and \$357 million in 2005, net earnings in 2006 were \$1,038 million or \$2.12 per share, an increase of \$186 million or \$0.37 per share compared to 2005. This increase was mainly due to higher net earnings in Energy and Corporate, partially offset by decreased net earnings in Pipelines.

Excluding the gains on sale of the Northern Border Partners, L.P. interest in 2006 and the PipeLines LP units in 2005, net earnings in the Pipelines business decreased \$83 million in 2006 compared to 2005. The decrease was primarily due to lower net earnings from the Canadian Mainline and the Alberta System as a result of lower approved rates of return on common equity (ROE) and lower average investment bases in 2006 compared to 2005. In addition, the Company's Other Pipelines businesses and the Gas Transmission Northwest System and the North Baja system (collectively GTN) experienced lower earnings in 2006.

Excluding the gain on the sale of Paiton Energy and gains related to the Company's investment in Power LP in 2005, Energy's net earnings for 2006 increased \$194 million compared to 2005 as a result of higher operating income from each of its existing businesses as well as a \$23-million favourable impact on future income taxes arising from reductions in Canadian federal and provincial income tax rates in 2006. These increases were partially offset by a loss of operating income associated with the sale of Power LP in 2005.

The increase in Corporate's net earnings in 2006 of \$75 million compared to 2005 was primarily due to \$72 million of positive income tax adjustments in 2006.

Net earnings increased \$229 million or \$0.47 per share in 2005 compared to 2004. The increase was primarily due to the inclusion of gains of \$357 million or \$0.74 per share in 2005 compared to gains of \$194 million or \$0.40 per share in 2004. Excluding gains, Pipeline's net earnings increased due to the inclusion of a full year of earnings from GTN in 2005 and the positive impact on earnings of a National Energy Board (NEB) decision to increase the Canadian Mainline's common equity component in its deemed capital structure. This was partially offset by the Canadian Mainline's lower average investment base, lower earnings related to operating cost savings, a decrease in the approved ROE and lower net earnings from the Company's Other Pipelines' businesses in 2005. Energy's net earnings, excluding gains, increased in 2005, compared to 2004, primarily due to higher operating income from Bruce Power A L.P. (Bruce A) and Bruce Power L.P. (Bruce B) (collectively Bruce Power), and Eastern Power Operations. A lower contribution from Western Power Operations and higher general administrative, support costs and other also reduced Energy's net earnings in 2005 compared to 2004. Corporate's net expenses increased in 2005 compared to 2004, primarily due to increased net interest expense on higher average long-term debt and commercial paper balances in 2005.

## SUBSEQUENT EVENTS

### *ANR Acquisition*

On February 22, 2007, TransCanada closed the acquisition of ANR and an additional 3.55 per cent interest in Great Lakes from El Paso Corporation for approximately US\$3.4 billion, subject to certain post-closing adjustments, including approximately US\$488 million of assumed long-term debt. The acquisition of ANR added approximately 17,000 kilometres (km) of natural gas transmission pipeline with a peak-day capacity of 6.8 Bcf/d. ANR also owns and operates natural gas storage facilities with a total capacity of approximately 230 Bcf. The acquisition was financed with a combination of proceeds from the Company's recent equity offering, cash on hand and funds drawn on existing and newly established loan facilities, discussed below.

In January 2007, TransCanada filed a final short form shelf prospectus with securities regulators in Canada and the U.S. to allow for the offering of up to \$3.0 billion of common shares, preferred shares and/or subscription receipts in Canada and the U.S. until February 2009. The nature, size and timing of any financings will be dependent on TransCanada's assessment of its requirements for funding and general market conditions.

On February 6, 2007, TransCanada entered into an agreement with a syndicate of underwriters under which the underwriters agreed to purchase 39,470,000 subscription receipts from TransCanada and sell them to the public at a price of \$38.00 each. The offering closed on February 14, 2007, resulting in gross proceeds to TransCanada of approximately \$1.5 billion which were used towards financing the acquisition of ANR. TransCanada also granted the underwriters of the subscription receipts offering an option to purchase an additional 5,920,500 common shares at \$38.00 per common share at any time up to and including March 16, 2007. Upon closing of the ANR acquisition, the subscription receipts were exchanged on a one-to-one basis for common shares of TransCanada without any further action of, or payment from, the holder.

In February 2007, the Company executed an agreement with a syndicate of banks for a US\$2.2 billion, one-year bridge loan facility. The facility is committed and unsecured. The Company utilized \$1.5 billion and US\$700 million from this facility to partially finance the ANR acquisition of which \$1.5 billion and US\$20 million were subsequently repaid from the proceeds of the \$1.5 billion subscription receipts offering and cash on hand, respectively.

In February 2007, the Company, through a wholly owned subsidiary, executed an agreement with a syndicate of banks to establish a new US\$1.0 billion credit facility, consisting of a US\$700 million five-year term loan and a US\$300 million five-year extendible revolving facility. This facility is committed and unsecured. The Company utilized US\$1.0 billion from this facility and an additional US\$100 million from an existing demand line to partially finance the ANR acquisition as well as additional investments in PipeLines LP, described below.

### *Great Lakes Acquisition*

On February 22, 2007, PipeLines LP closed its acquisition of a 46.45 per cent interest in Great Lakes from El Paso Corporation for approximately US\$962 million, which included approximately US\$212 million of assumed long-term debt, subject to certain post-closing adjustments. At December 31, 2006, TransCanada had a 13.4 per cent interest in PipeLines LP.

In February 2007, PipeLines LP increased the size of its syndicated revolving credit and term loan agreement from US\$410 million to US\$950 million. Incremental draws of US\$126 million received under this agreement were used to partially finance PipeLines LP's Great Lakes acquisition.

On February 22, 2007, PipeLines LP completed a private placement offering of 17,356,086 common units at a price of US\$34.57 per unit, of which 50 per cent of the units were acquired by TransCanada for US\$300 million. TransCanada also invested an additional approximately US\$12 million to maintain its general partnership ownership interest in PipeLines LP. As a result of TransCanada's additional investments in PipeLines LP, its ownership in PipeLines LP increased to 32.1 per cent. The total private placement resulted in gross proceeds to PipeLines LP of US\$612 million, which were used to partially finance its Great Lakes acquisition. As a result of TransCanada's increased ownership in PipeLines LP, TransCanada's effective ownership in Tuscarora Gas Transmission Company (Tuscarora), Northern Border Pipeline

Company (Northern Border) and Great Lakes increased to 32.5 per cent (including one per cent held directly) 16.1 per cent and 68.5 per cent (including 53.55 per cent held directly), respectively.

## **FORWARD-LOOKING INFORMATION**

*Certain information in this MD&A includes forward-looking statements. All forward-looking statements are based on TransCanada's beliefs and assumptions based on information available at the time such statements were made. Factors which could cause actual results or events to differ materially from current expectations include, among other things, the ability of TransCanada to successfully implement its strategic initiatives and whether such strategic initiatives will yield the expected benefits, the availability and price of energy commodities, regulatory decisions, changes in environmental and other laws and regulations, competitive factors in the pipeline and energy industry sectors, construction and completion of capital projects, access to capital markets, interest and currency exchange rates, technological developments and the current economic condition in North America. By its nature, such forward-looking information is subject to various risks and uncertainties, which could cause TransCanada's actual results and experience to differ materially from the anticipated results or other expectations expressed. Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date of this MD&A or as otherwise stated. TransCanada undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required by law.*

## **NON-GAAP MEASURES**

The Company uses the measures "funds generated from operations" and "operating income" in this MD&A. These measures do not have any standardized meaning in GAAP and are therefore considered to be non-GAAP measures. These measures may not be comparable to similar measures presented by other entities. These measures have been used to provide readers with additional information on the Company's liquidity and its ability to generate funds to finance its operations.

Funds generated from operations is comprised of net cash provided by operations before changes in operating working capital. A reconciliation of funds generated from operations to net cash provided by operations is presented in the Summarized Cash Flow table in this MD&A. Operating income is used in the Energy segment and is comprised of revenues plus income from equity investments less operating expenses as shown on the consolidated income statement. Refer to the Energy section in this MD&A for a reconciliation of operating income to net earnings.

## **TRANSCANADA OVERVIEW**

TransCanada is a leading North American energy infrastructure company with a strong focus on natural gas transmission and power generation opportunities located in regions in which it has significant competitive advantages. Natural gas transmission and power are complementary businesses for TransCanada. They are driven by similar supply and demand fundamentals, they are both capital-intensive businesses, and they use similar technology and operating practices. They are also businesses with significant long-term growth prospects.

North American natural gas demand is expected to increase primarily due to a growing demand for electricity. Experts predict that demand for electricity will increase at an average annual rate of approximately two per cent over the next ten years, primarily due to a growing population and an increase in gross domestic product. A large part of that demand growth is expected to be met by higher utilization of existing natural gas-fired generating plants.

Nuclear facilities have played, and will continue to play, a significant role in supplying North American power. Coal-fired plants remain the largest source of electric power in North America and coal reserves are significant. However, the long lead times required to complete new coal and nuclear projects may impede the development and completion of new coal or nuclear generation over the next five to ten years. As a result, North America is expected to continue to rely on

natural gas-fired generation to satisfy its growing electricity needs in the near term. This is expected to lead to a significant increase in natural gas consumption. Natural gas demand in North America, including Mexico, is expected to grow to approximately 89 billion cubic feet per day (Bcf/d) by 2016, an increase of 14 Bcf/d when compared to 2006. New natural gas-fired power generation is expected to account for approximately 9 Bcf/d of that growth.

While growing demand will provide a number of opportunities, the natural gas industry also faces a number of challenges. North America has entered a period when it will no longer be able to rely solely on traditional sources of natural gas supply to meet its growing needs. Natural gas supply is limited and this is likely to continue until major investments are made in the infrastructure required to bring new supply to market. Looking forward, production from North America's traditional basins is expected to essentially remain flat over the next decade. An increase in production in the U.S. Rockies is expected to offset declines in other basins, including the Gulf of Mexico. This outlook for traditional basins means that northern gas and offshore LNG will be required to fill the shortfall between supply and demand. TransCanada is well positioned in North America to serve growing power generation demand in the near term and to bring these new natural gas supplies to market in the medium to long term.

## **TRANSCANADA'S STRATEGY**

TransCanada's strong position in North America is the direct result of successfully executing its corporate strategy which was first adopted in 2000. While the plan has evolved over time in response to actual and anticipated changes in the business environment, it fundamentally remains the same. Today, TransCanada's corporate strategy consists of the following six components:

- maximize the profitability and long-term value of existing pipelines;
- grow the North American pipeline business, internally and through acquisitions;
- maximize the profitability and long-term value of existing power and other energy assets;
- grow the North American energy business, internally and through acquisitions;
- drive for operational excellence in all aspects of the business; and
- maximize TransCanada's competitive strength and enduring value.

## **Pipelines**

### *Strategy*

The Company's strategy in Pipelines is focused on both growing its North American natural gas transmission network and maximizing the profitability and long-term value of its existing pipeline assets. In order to grow the Pipelines segment, TransCanada is focusing on expanding and extending its existing systems to connect new supply to growing markets, increasing its ownership in partially owned entities, acquiring or constructing pipelines that provide TransCanada with a significant regional presence, expanding into the oil transmission business and, in the long term, connecting new sources of supply in the form of northern gas and LNG.

Over the past 50 years, TransCanada has developed significant expertise in large-diameter, cold-weather natural gas pipeline design, construction, operation and maintenance. It has also developed significant expertise in the design, optimization and operation of large gas turbine compressor stations. Today, TransCanada operates one of the largest, most sophisticated, remote-controlled pipeline networks in the world with a solid reputation for safety and reliability.

In addition to growing the North American Pipelines business, the Company continues to place a priority on maximizing the profitability and long-term value of its wholly owned pipelines. Efforts in this area are focused on achieving a fair return on invested capital and streamlining and harmonizing processes and tariff provisions for and among TransCanada's regulated pipelines. Further, the Company works collaboratively with its customers to develop and implement new services. TransCanada also provides services to many of its partially owned pipeline systems.



*Existing Pipelines*

TransCanada's natural gas transmission assets link the Western Canada Sedimentary Basin (WCSB) with premium North American markets. With approximately 42,000 km of pipeline (at December 31, 2006), the Company's network of wholly owned pipeline assets is one of the largest in North America.

In 2006, the wholly owned Alberta System gathered 67 per cent of the natural gas produced in western Canada or 17 per cent of total North American production. TransCanada exports natural gas from the WCSB to Eastern Canada and the U.S. West, Midwest and Northeast through four wholly owned pipeline systems:

Canadian Mainline;

Gas Transmission Northwest System;

Foothills; and

BC System.

In addition, the Company transports natural gas in Alberta through the TransCanada Pipeline Ventures Limited Partnership (Ventures LP) System.

In December 2006, TransCanada began transporting natural gas in Mexico through its Tamazunchale pipeline.

TransCanada also exports gas from the WCSB to eastern Canada as well as the U.S. West, Midwest and Northeast through six partially owned pipeline systems:

Great Lakes;

Trans Québec & Maritimes System (TQM);

Iroquois Gas Transmission System (Iroquois);

Portland Natural Gas Transmission System (Portland);

Northern Border; and

Tuscarora.

*Northern Development*

In 2006, TransCanada continued to pursue the Mackenzie Delta and Alaska North Slope projects. When the Mackenzie Gas Pipeline (MGP) project and the Alaska Highway Pipeline project are constructed and connected to TransCanada's existing infrastructure, they would represent additional growth opportunities for TransCanada and enhance the long-term viability and value of the Company's existing Pipelines business, especially the wholly owned pipelines currently transporting WCSB natural gas.

*Mexico*

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In addition to the Tamazunchale pipeline, TransCanada continues to explore other pipeline and energy infrastructure opportunities in Mexico.

### *ANR and Great Lakes*

On February 22, 2007, TransCanada closed its acquisition of ANR and an additional 3.55 per cent interest in Great Lakes. In addition, PipeLines LP closed its acquisition of a 46.45 per cent interest in Great Lakes.

### *Regulatory*

In 2006, TransCanada's principal regulatory activities included a negotiated settlement with respect to 2006 Canadian Mainline tolls; filing a rate case with the Federal Energy Regulatory Commission (FERC) for new Gas Transmission Northwest System rates; filing an application with the NEB to integrate the BC System into the Foothills Zone 8 facilities (received NEB approval in February 2007); filing an application with the NEB seeking approval to transfer approximately 860 km of the Canadian Mainline's existing natural gas pipeline to oil service; filing an application with the NEB to construct and operate approximately 370 km of new oil pipeline, terminal facilities and pump stations; and filing

MANAGEMENT'S DISCUSSION AND ANALYSIS [17](#)

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applications that sought approval to transfer a portion of the Canadian Mainline's assets to Keystone and to reduce the Canadian Mainline's rate base by the net book value (NBV) of the transferred assets (received NEB approval in February 2007).

## Energy

### *Strategy*

TransCanada's strategy for growth and value creation in the Energy business has five key elements:

focusing on markets where TransCanada has a competitive advantage;

developing low-risk, greenfield generation projects, underpinned by long-term input and sales contracts with quality counterparties;

acquiring low-cost, base-load power generation. The Company believes that being a low-cost provider and/or having long-term sales contracts is critical to being successful in volatile power markets;

exploiting TransCanada's proven strong project management skills; and

optimizing the profitability and reliability of the existing asset portfolio by operating the facilities as efficiently and cost-effectively as possible.

TransCanada's ability to successfully execute its strategy is related to a broad understanding of North American energy markets and a deep understanding of its core markets in Alberta, Ontario, Québec, and the northeastern U.S. In addition, the Company actively participates in deregulated and deregulating markets and has the ability to structure transactions and manage risk, which is critical to mitigating volatility in natural gas and power markets.

### *Existing Assets*

TransCanada has built a substantial energy business over the past decade and has achieved a significant presence in power generation across Canada and the U.S. More recently, TransCanada has developed its natural gas storage business through investments in Alberta.

The power plants and power supply that TransCanada owns, operates and/or controls, including projects under construction, represent approximately 7,700 megawatts (MW) of power generation capacity in Canada and the U.S. TransCanada's portfolio of power supply is diversified: 33 per cent natural gas; 32 per cent nuclear; 22 per cent coal; seven per cent hydro and six per cent wind. TransCanada's power assets are primarily low-cost, base load generation and/or backed by secure, long-term power sales agreements. The Company's power assets are concentrated in two main regions: Western Power Operations in Alberta and Eastern Power Operations in the eastern Canada and New England markets.

Energy's natural gas storage assets are all located in Alberta. TransCanada owns or controls more than 130 billion cubic feet (Bcf) or approximately one third of the natural gas storage

capacity in the province. TransCanada believes the market fundamentals for natural gas storage will remain strong into the future. In 2006, TransCanada continued to add to its diverse portfolio of existing quality energy assets as follows:

### *Bécancour*

Construction of the Bécancour cogeneration plant was completed and placed commercially in service in September 2006. The project was completed on time and under budget and is the largest greenfield power plant built by TransCanada to date.



*Portlands Energy*

In September 2006, Portlands Energy Centre L.P. (Portlands Energy) announced that it had signed a 20-year Accelerated Clean Energy Supply (ACES) contract with the Ontario Power Authority (OPA) to construct a natural gas generation plant to be located in downtown Toronto, Ontario.

*Cartier Wind*

In November 2006, the Baie-des-Sables wind farm went into commercial operation and is currently one of the largest wind farms in Canada, providing 110 MW of power to the Hydro-Québec grid.

*Halton Hills*

In November 2006, TransCanada announced that it had been awarded a contract to build, own and operate a natural gas-fired power plant near the town of Halton Hills, Ontario.

*Bruce Power*

Throughout 2006, work continued on the Bruce A capital project, consisting of the restart and refurbishment of the currently idle Units 1 and 2, extension of the operating life of Unit 3 by replacing its steam generators and fuel channels when required, and replacement of the steam generators on Unit 4.

*Edson Gas Storage*

Construction of the Edson natural gas storage facility was substantially completed and placed into service on December 31, 2006.

*Broadwater and Cacouna LNG Facilities*

TransCanada continues to pursue these two LNG proposals.

**Operational Excellence**

TransCanada maintains a high level of pipeline operating performance, as measured by the minimal disruptions for the Canadian Mainline, the Alberta System and GTN.

In 2006, TransCanada developed a technology program involving techniques to reduce the cost and environmental impact of constructing new pipeline. The program, which negates the need for large volumes of water, was applied to a segment of TransCanada's pipeline construction. The technology was accepted by the NEB which is expected to encourage further development by TransCanada and to promote wide-scale use.

Through its annual Customer Satisfaction Survey, TransCanada received feedback from customers served by its Canadian pipelines. The survey, conducted by Ipsos Reid in the fall of 2006, found that TransCanada maintained high levels of overall customer satisfaction. TransCanada's call centre, transactional systems and staff obtained the highest satisfaction levels. This reflects TransCanada's commitment to operational excellence in the provision of reliable and high-quality service to customers.

The Company was very productive in 2006 with respect to collaborative efforts with customers. The Mainline Tolls Task Force, the Alberta System Tolls, Tariff, Facilities and Procedures Committee, and the BC System and Foothills Shippers group produced a number of resolutions in 2006. These resolutions included new services, service enhancements, process improvements, a Canadian Mainline tolls settlement and the proposed integration of the BC System into the Foothills system, which was approved by the NEB in February 2007. Productive collaborative processes can result in significant costs savings for both TransCanada and the industry by avoiding costs associated with regulatory proceedings.

In Energy, TransCanada continued its commitment in 2006 to provide safe, low-cost operations and maintenance of all assets to ensure the highest possible reliability and availability. For power plants directly operated by TransCanada, the weighted average plant availability in 2006 was 93 per cent compared to 87 per cent in 2005.

In 2007, TransCanada will continue to focus efforts on efficiencies, operational reliability, the environment and safety. Greenhouse gas emissions management programs will continue to receive attention and further efforts will be undertaken to improve contractor safety.

### **Competitive Strength and Enduring Value**

TransCanada's strategy includes:

developing excellence in value-creating strategy, analysis and investment execution;

appropriate financial capacity and flexibility, allowing TransCanada to build large scale infrastructure projects and act quickly on quality opportunities when they arise;

using project development and project management skills, combined with strong facility construction and operational abilities;

maintaining high standards in corporate governance practices;

developing and sustaining its relationships and reputation with key stakeholders; and

creating sustainable organizational strengths.

At December 31, 2006, TransCanada had approximately 2,350 employees who have expertise in gas transmission and power operations, project management, depth of market and industry knowledge, and financial acumen.

### **OUTLOOK**

Since 2000, TransCanada has followed a long-term approach of growing its Pipelines and Energy businesses in a diligent and disciplined manner. In 2007 and beyond, the Company's net earnings and cash flow, combined with a strong balance sheet, are expected to continue to provide the financial flexibility for TransCanada to pursue opportunities and create additional long-term value for its shareholders.

In 2007, the Company will continue to implement its Pipelines strategy, including:

integrating ANR into TransCanada's existing Pipelines business;

becoming the operator of Great Lakes in conjunction with the acquisition of an additional 3.55 per cent interest in Great Lakes, bringing its direct total ownership to 53.55 per cent, with PipeLines LP owning the remaining interest;

engaging in discussions with Alberta System stakeholders following the conclusion of the current three-year settlement that expires at the end of 2007;

proceeding with the Gas Transmission Northwest System rate case, which is scheduled to be in negotiations and answering discovery until the hearing phase begins on October 31, 2007;

advancing development of the Keystone Pipeline;

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working with the MGP owners and the Aboriginal Pipeline Group (APG), including participating in regulatory proceedings as may be required, to advance the MGP project;

working with project stakeholders and the State of Alaska to further advance the proposed Alaska Highway Pipeline project;

developing transportation solutions for new market and supply growth opportunities that lead to potential expansions of the Alberta System;

becoming the operator of Northern Border; and

working with joint venture partners of partially owned pipeline systems to develop additional supply and market options for system customers.

### 20 MANAGEMENT'S DISCUSSION AND ANALYSIS

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TransCanada will continue to grow its Energy business in 2007. As in prior years, this growth is expected to come from a mix of greenfield developments, new acquisitions and organic growth within its existing assets and markets. In particular, in 2007, TransCanada expects to:

work with Bruce A and its partners on the restart and refurbishment of the Bruce A units;

complete construction of the second of six Cartier Wind projects in third quarter 2007 and begin construction of the third Cartier Wind facility;

continue construction of the Portlands Energy project;

initiate construction of the Halton Hills project;

advance development of the Cacouna Energy project (Cacouna) and Broadwater Energy project (Broadwater) LNG facilities; and

pursue additional greenfield projects and acquisition opportunities in TransCanada's key markets.

Although the following discussion reflects management's expectations for 2007, as discussed throughout this MD&A, a number of risk factors and developments may positively or negatively affect the actual results for 2007, as discussed throughout this MD&A, including the section entitled "Forward-Looking Information".

With the closing of the acquisition of ANR and Great Lakes, and the Company's increased ownership in PipeLines LP, TransCanada expects higher net earnings from Pipelines in 2007 compared to 2006. The combined effect of an expected decline in the average investment base of each of the Canadian Mainline and the Alberta System, and a decline in each of their formula-based regulated ROEs, is expected to decrease net earnings on these systems compared to 2006. Excluding any potential positive impact from a decision or settlement on the current rate case filing for the Gas Transmission Northwest System, reduced firm contract volumes on this system are expected to have a slightly negative impact on the results compared to 2006. In addition, Pipelines' 2006 net earnings included a \$13 million gain on the sale of Northern Border Partners, L.P. interest, which will not occur in 2007. In 2007, TransCanada is expecting a positive impact from a full year of earnings from the Tamazunchale pipeline.

In Energy, net earnings in 2007 are expected to approximate or be slightly lower than 2006 net earnings due to the non-recurring \$23-million future tax benefit in 2006 arising from reductions in federal and provincial income tax rates. Operating income is expected to be relatively consistent with 2006, although this is very dependent on commodity prices in each region as well as other factors such as hydrology and storage spreads. TransCanada's operating income from its investment in Bruce B can be significantly impacted by the effect, on uncontracted output, of changes in spot market prices for power. Excluding any changes in spot market prices for 2007 compared to 2006, Bruce Power's operating income is expected to decline in 2007 compared to 2006, reflecting lower projected generation volumes and higher operating costs resulting from an increase in planned outages in 2007. Western Power Operations' operating income in 2007 is expected to approximate 2006. Although TransCanada has sold forward significant output from its Alberta power purchase agreements (PPA) and power plants, Western Power Operations' operating income in 2007 can be significantly impacted by changes in the spot market price of power and market heat rates in Alberta. Eastern Power Operations' operating income is expected to increase in 2007 primarily due to a full year of operations for both the Bécancour natural gas-fired cogeneration facility and the first of six wind farms of the Cartier Wind project as well as the positive impact of the New England Power Pool (NEPOOL) forward capacity payments received by Ocean State Power (OSP) and TC Hydro commencing December 1, 2006. Gas Storage's operating income is expected to increase in 2007 over 2006 primarily due to the placing into service of the Edson facility at the end of 2006, partially offset by expected lower storage spreads.

Corporate's net expenses are expected to be higher in 2007 compared to 2006 primarily due to the income tax refunds and positive income tax adjustments realized in 2006 that are not expected to recur in 2007. Financing costs associated with the purchase of ANR are expected to increase net expenses in Corporate in 2007.

**CANADIAN MAINLINE** TransCanada's 100 per cent owned, 14,957 km natural gas transmission system in Canada 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** TransCanada's 100 per cent owned natural gas transmission system in Alberta gathers natural gas for use within the province and delivers it to provincial boundary points for connection with the Canadian Mainline, BC System, Foothills and other pipelines. The 23,498 km system is one of the largest carriers of natural gas in North America.

**GAS TRANSMISSION NORTHWEST SYSTEM** TransCanada's 100 per cent owned natural gas transmission system extends 2,174 km and links the BC System and Foothills with Pacific Gas and Electric Company's California Gas Transmission System, with Williams' Northwest Pipeline in Washington and Oregon, and with Tuscarora.

**FOOTHILLS** TransCanada's 100 per cent owned, 1,040 km natural gas 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.

**BC SYSTEM** TransCanada's 100 per cent owned natural gas transmission system extends 201 km from Alberta's western border through British Columbia (B.C.) to connect with the Gas Transmission Northwest System at the U.S. border, serving markets in B.C. as well as the Pacific Northwest, California and Nevada.

**NORTH BAJA** TransCanada's 100 per cent owned natural gas transmission system extends 129 km from southwestern Arizona at Ehrenberg to a point near Ogilby, California on the California/Mexico border and connects with the Gasoducto Bajanorte pipeline system in Mexico.

**VENTURES LP** Ventures LP, which is 100 per cent owned by TransCanada, owns a 121 km pipeline and related facilities which supply natural gas to the oil sands region of northern Alberta, and a 27 km pipeline which supplies natural gas to a petrochemical complex at Joffre, Alberta.

**TAMAZUNCHALE** TransCanada's 100 per cent owned, 130 km natural gas pipeline in east central Mexico extends from the facilities of Pemex Gas near Naranjos, Veracruz to an electricity generation station near Tamazunchale, San Luis Potosi. This pipeline went into service on December 1, 2006.

**ANR** On February 22, 2007, TransCanada acquired 100 per cent of the ANR natural gas transmission system which extends approximately 17,000 km from producing fields in Louisiana, Oklahoma, Texas and the Gulf of Mexico to markets in Wisconsin, Michigan, Illinois, Ohio and Indiana. This pipeline also connects with other pipelines to give access to supply from western Canada, the Rocky Mountain region and a variety of markets in the midwestern and northeastern U.S. ANR also owns and operates underground natural gas storage facilities in Michigan with a total capacity of approximately 230 Bcf.

**TUSCARORA** Tuscarora is owned or controlled 99 per cent by PipeLines LP and is a 491 km pipeline system transporting natural gas from the Gas Transmission Northwest System at Malin, Oregon to Wadsworth, Nevada with delivery points in northeastern California and northwestern Nevada. TransCanada operates Tuscarora and, at February 22, 2007, effectively owns or controls an aggregate 32.8 per cent interest in Tuscarora, of which 31.8 per cent is held indirectly through TransCanada's 32.1 per cent ownership interest in PipeLines LP and the remaining one percent is owned directly.

**NORTHERN BORDER** Northern Border is 50 per cent owned by PipeLines LP and is a 2,250 km natural gas pipeline system which serves the U.S. Midwest from a connection with Foothills near Monchy, Saskatchewan. In April 2007, TransCanada expects to become the operator of Northern Border. At February 22, 2007, the Company effectively owns approximately 16.1 per cent of Northern Border through its 32.1 per cent ownership interest in PipeLines LP.

**GREAT LAKES** Great Lakes is a 3,404 km pipeline system that connects with the Canadian Mainline at Emerson, Manitoba and serves markets in central Canada and the midwestern U.S. Effective February 22, 2007, TransCanada owns 53.55 per cent of Great Lakes and PipeLines LP owns the remaining 46.45 per cent. TransCanada's effective ownership of Great Lakes is 68.5 per cent of which 14.9 per cent is held indirectly through its 32.1 per cent ownership in PipeLines LP. TransCanada is the operator of Great Lakes.

**IROQUOIS** Iroquois connects with the Canadian Mainline near Waddington, New York and delivers natural gas to customers in the northeastern U.S. TransCanada has a 44.5 per cent ownership interest in this 666 km pipeline system.

**TQM** TQM is a 572 km natural gas pipeline system which connects with the Canadian Mainline and transports natural gas from Montréal to Québec City and to the Portland system. TransCanada holds a 50 per cent ownership interest in TQM and is the operator.

**PORTLAND** Portland is a 474 km pipeline that connects with TQM near East Hereford, Québec and delivers natural gas to customers in the northeastern U.S. TransCanada has a 61.7 per cent ownership interest in Portland and operates this pipeline.

**TRANSGAS** TransGas is a 344 km natural gas pipeline system which runs from Mariquita in the central region of Colombia to Cali in the southwest of Colombia. TransCanada holds a 46.5 per cent ownership interest in this pipeline.

**GAS PACIFICO** Gas Pacifico is a 540 km natural gas pipeline extending from Loma de la Lata, Argentina to Concepción, Chile. TransCanada holds a 30 per cent ownership interest in Gas Pacifico.

**INNERGY** INNERGY is an industrial natural gas marketing company based in Concepción, Chile that markets natural gas transported on Gas Pacifico. TransCanada holds a 30 per cent ownership interest in INNERGY.



## HIGHLIGHTS

### *Net Earnings*

Net earnings from Pipelines decreased \$119 million to \$560 million in 2006 compared to \$679 million in 2005, primarily due to a \$49-million gain on the sale of PipeLines LP units in 2005 (\$13-million gain on the sale of the interest in Northern Border Partners, L.P., in 2006), lower net earnings from the Canadian Mainline and the Alberta System as a result of a lower ROE and lower average investment bases in 2006, compared to 2005, and a \$13-million Mainline adjustment in 2005 related to a 2004 regulatory decision.

### *ANR and Great Lakes Acquisition*

On February 22, 2007, TransCanada acquired ANR and an additional 3.55 per cent interest in Great Lakes.

### *Canadian Mainline*

The NEB approved a negotiated settlement of 2006 Mainline tolls which included a deemed common equity ratio of 36 per cent and incentives for managing costs through fixing certain components of the revenue requirement.

### *Alberta System*

The Alberta System continues to operate under the terms of the 2005-2007 Revenue Requirement Settlement approved by the Alberta Energy and Utilities Board (EUB) in 2005. The settlement includes a deemed common equity ratio of 35 per cent.

### *Gas Transmission Northwest System*

In June 2006, Gas Transmission Northwest System filed a rate case with the FERC. The comprehensive filing requests a number of tariff changes, including increased rates for transportation services.

### *Keystone*

TransCanada filed two applications with the NEB in 2006. In the first application, TransCanada applied to transfer a portion of its Canadian Mainline assets to Keystone and to reduce the Canadian Mainline's rate base by the NBV of the transferred assets. Approval was received from the NEB on this application in February 2007. In the second application, TransCanada applied to construct and operate new oil pipeline facilities.

### *Foothills and BC System*

In February 2007, TransCanada received approval from the NEB to integrate the BC System into Foothills in southern B.C.

### *North Baja*

In February 2006, TransCanada filed an application with the FERC to expand North Baja to accommodate bi-directional natural gas flow and to construct new pipeline and metering facilities. In October 2006, the FERC issued a preliminary approval of the application except for environmental issues which will be the subject of a future order.

### *PipeLines LP*



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In April 2006, PipeLines LP acquired an additional 20 per cent partnership interest in Northern Border.

In December 2006, PipeLines LP acquired an additional 49 per cent controlling general partner interest in Tuscarora, with the option to purchase Sierra Pacific Resources' remaining one per cent interest in Tuscarora in approximately one year.

On February 22, 2007, PipeLines LP acquired a 46.45 per cent interest in Great Lakes.

TransCanada became the operator of Tuscarora in December 2006 and Great Lakes in February 2007, and expects to begin operating Northern Border in April 2007.

In February 2007, PipeLines LP completed a private placement offering of 17,356,086 units at a price of US\$34.57 per unit. TransCanada acquired 50 per cent of the units for US\$300 million, increasing its total ownership to 32.1 per cent. TransCanada also invested an additional approximately US\$12 million to maintain its general partnership interest in PipeLines LP. The total private placement resulted in gross proceeds of approximately US\$612 million which were used to partially finance the acquisition of the 46.45 per cent interest in Great Lakes.

### [24](#) MANAGEMENT'S DISCUSSION AND ANALYSIS

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*Other Pipelines*

TransCanada sold its 17.5 per cent general partner interest in Northern Border Partners, L.P. for an after-tax gain of approximately \$13 million.

TransCanada continued its efforts to progress the proposed Alaska Highway Pipeline.

TransCanada continued to fund the APG participation in the MGP project.

In December 2006, TransCanada commenced commercial operations of the Tamazunchale pipeline in east-central Mexico.

**PIPELINES RESULTS-AT-A-GLANCE**

*Year ended December 31 (millions of dollars)*

	2006	2005	2004
<b>Wholly Owned Pipelines</b>			
Canadian Mainline	239	283	272
Alberta System	136	150	150
GTN <sup>(1)</sup>	64	71	14
Foothills	21	21	22
BC System	6	6	7
	<b>466</b>	531	465
<b>Other Pipelines</b>			
Great Lakes	44	46	55
Iroquois	15	17	17
PipeLines LP <sup>(2)</sup>	4	9	16
Portland	13	11	10
Ventures LP	12	12	15
TQM	7	7	8
Tamazunchale <sup>(3)</sup>	2		
TransGas	11	11	11
Gas Pacifico/INNERGY <sup>(4)</sup>	8	6	4
Northern Development	(5)	(4)	(6)
General, administrative, support costs and other	(30)	(16)	(18)
	<b>81</b>	99	112
Gain on sale of Northern Border Partners, L.P. interest	13		
Gain on sale of PipeLines LP units		49	
Gain on sale of Millennium			7
	<b>94</b>	148	119
Net earnings	<b>560</b>	679	584

(1) TransCanada acquired GTN in November 2004. Amounts in this table reflect TransCanada's 100 per cent ownership interest in GTN's net earnings from the acquisition date.

(2)

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During 2005, TransCanada decreased its ownership interest in PipeLines LP to 13.4 per cent from 33.4 per cent.

- (3) The Tamazunchale pipeline went into service December 1, 2006.
- (4) Gasoducto del Pacifico S.A./INNERGY Holdings S.A.

In 2006, net earnings from the Pipelines business were \$560 million compared to \$679 million and \$584 million in 2005 and 2004, respectively. Excluding the \$49-million after-tax gain on the sale of PipeLines LP units in 2005 and the \$13-million after-tax gain on the sale of TransCanada's general partner interest in Northern Border Partners, L.P. in 2006, Pipelines' net earnings for the year ended December 31, 2006 decreased \$83 million compared to the same period in 2005. This decrease was primarily due to lower net earnings from the Canadian Mainline, the Alberta System, GTN and Other Pipelines.

MANAGEMENT'S DISCUSSION AND ANALYSIS [25](#)

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The overall increase of \$95 million in 2005 Pipelines net earnings compared to 2004 was mainly due to a full year of GTN net earnings, the \$49-million gain related to PipeLines LP and higher Canadian Mainline net earnings in 2005 as a result of an April 2005 NEB decision that resulted in a positive \$13-million adjustment related to 2004, partially offset by lower net earnings from Other Pipelines. Lower 2005 net earnings from Other Pipelines were primarily due to decreased earnings from Great Lakes, PipeLines LP and Ventures LP.

## PIPELINES FINANCIAL ANALYSIS

### *Canadian Mainline*

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

In April 2006, the NEB approved TransCanada's application for a negotiated settlement of the 2006 Canadian Mainline tolls as filed. The settlement resulted in a revenue requirement of approximately \$1.8 billion for 2006. The settlement also established the Canadian Mainline's fixed OM&A costs for 2006 at \$174 million with variances between actual OM&A costs in 2006 and those agreed to in the settlement accruing to TransCanada. The majority of the other cost elements of the 2006 revenue requirement were to be treated on a flow-through basis. The settlement also provided TransCanada with an opportunity to realize modest additional net earnings through performance-based incentive arrangements. These incentive arrangements were focused on certain cost management activities and the management of fuel, and provided mutual benefits to both TransCanada and its customers. Further, the settlement included an ROE of 8.88 per cent as determined for 2006 under the NEB's return adjustment formula, on a deemed common equity ratio of 36 per cent.

Net earnings of \$239 million in 2006 were \$44 million lower than 2005 net earnings of \$283 million. The decrease was primarily due to a combination of a lower ROE and a lower average investment base in 2006 compared to 2005. In addition, 2005 net earnings included a positive adjustment of \$13 million related to 2004 as a result of the NEB's decision in April 2005 on the Canadian Mainline's 2004 Tolls and Tariff Application (Phase II) which included an increase in the deemed common equity ratio to 36 per cent from 33 per cent for 2005 that was also effective for 2004. The 2006 NEB-approved Canadian Mainline tolls settlement that TransCanada reached with its customers and other interested parties included an ROE of 8.88 per cent, which was determined for 2006 under the NEB's return adjustment formula on a deemed common equity ratio of 36 per cent. The NEB-approved ROE for 2005 was 9.46 per cent.

The Canadian Mainline generated net earnings of \$283 million in 2005, an increase of \$11 million over 2004 earnings. The increase in net earnings was primarily due to the NEB's decision on the 2004 Tolls and Tariff Application (Phase II). The Phase II decision resulted in a \$35-million (\$22 million related to 2005 and \$13 million related to 2004) increase to the Canadian Mainline's 2005 net earnings compared to 2004. However, this earnings increase was partially offset by the combination of a lower average investment base, lower cost savings and a lower approved ROE in 2005. The NEB-approved ROE decreased to 9.46 per cent in 2005 from 9.56 per cent in 2004.

*Alberta System*

The Alberta System is regulated by the EUB primarily under the provisions of the *Gas Utilities Act (Alberta)* (GUA) and the *Pipeline Act (Alberta)*. Under the GUA, the Alberta System's rates, tolls and other charges, and terms and conditions of service are subject to approval by the EUB.

The Alberta System is currently operating under the 2005-2007 Revenue Requirement Settlement. The settlement was reached in 2005 with shippers and other interested parties regarding the annual revenue requirements of its Alberta System for the years 2005, 2006 and 2007. The settlement was approved by the EUB in June 2005 and encompassed all elements of the Alberta System revenue requirement, including operating, maintenance and administration (OM&A) costs, ROE, depreciation and income and municipal taxes.

The Alberta System settlement fixed OM&A costs at \$193 million for 2005, \$201 million for 2006, and \$207 million for 2007. In each year, any variance between actual OM&A and other fixed costs, and those agreed to in the settlement accrues to TransCanada. The majority of other cost elements of the 2005, 2006 and 2007 revenue requirements are treated on a flow-through basis.

The ROE will be calculated annually during the term of the settlement using the EUB formula for the purpose of establishing the annual generic rate of return for Alberta utilities on deemed common equity of 35 per cent. In addition, depreciation costs are determined using the depreciation rates and methodology that the Company proposed to the EUB in its 2004 General Rate Application (GRA).

Net earnings of \$136 million in 2006 were \$14 million lower compared to 2005. The decrease was primarily due to a lower investment base and a lower approved rate of return in 2006. Net earnings in 2005 and 2006 reflect an ROE of 9.50 and 8.93 per cent, respectively, as prescribed by the EUB, on deemed common equity of 35 per cent.

Net earnings of \$150 million in 2005 were unchanged from 2004 due to the negative impacts of a lower investment base and a lower approved rate of return in 2005 being offset by the positive impact of higher allowed operating costs in 2005 compared to 2004 as a result of cost disallowances in the EUB's decision on Phase 1 of the 2004 GRA. Net earnings in 2004 reflect an ROE of 9.60 as prescribed by the EUB, on deemed common equity of 35 per cent.

*GTN*

GTN is regulated by the FERC, which has authority to regulate rates for natural gas transportation in interstate commerce. Both of GTN's systems, the Gas Transmission Northwest System and North Baja, operate under fixed rate models, under which maximum and minimum rates for various service types have been ordered by the FERC. GTN is permitted to discount or negotiate these rates on a non-discriminatory basis. In 2006, the Gas Transmission Northwest System operated under a rate case that was filed in 1994 and settled and approved by the FERC in 1996. In June 2006, the Gas Transmission Northwest System filed a new rate case with the FERC. North Baja's rates were established in the FERC's initial order in 2002 certifying construction and operation of the system. The net earnings of GTN are impacted by variations in contracted levels, volumes delivered and prices charged under the various service types that are provided, as well as by variations in the costs of providing services.

Net earnings for the year ended December 31, 2006 were \$64 million, a \$7-million decrease from the same period in 2005. This decrease was primarily due to lower transportation revenues, higher operating costs, the impact of a weaker

U.S. dollar and a provision for non-payment of contract transportation revenue from a subsidiary of Calpine Corporation that filed for bankruptcy protection. These negative factors were partially offset by an \$18-million bankruptcy settlement (\$29 million pre-tax) in first quarter 2006 with Mirant, a former shipper on the Gas Transmission Northwest System. Net earnings for November and December 2004 were \$14 million.

#### *Other Pipelines*

TransCanada's direct and indirect investments in various natural gas pipelines are included in Other Pipelines. It also includes TransCanada's project development activities related to its pursuit of new pipelines and gas and oil transmission related opportunities throughout North America.

TransCanada's net earnings from Other Pipelines in 2006 were \$94 million compared to \$148 million and \$119 million in 2005 and 2004, respectively. Excluding the gains on sale of Northern Border Partners, L.P. in 2006 and PipeLines LP units in 2005, net earnings for 2006 were \$18 million lower compared to 2005. The decrease was primarily due to higher project development and support costs associated with growing the Pipelines business, reduced ownership in PipeLines LP, a weaker U.S. dollar and bankruptcy settlements received by Iroquois in 2005, partially offset by increased net earnings from Portland due to a bankruptcy settlement received in 2006.

Excluding the gains on sale of PipeLines LP units in 2005 and the Millennium Pipeline project (Millennium) in 2004, net earnings in 2005 were \$13 million lower than 2004. The decrease was primarily due to lower net earnings from Great Lakes as a result of lower short-term revenues and higher operating and maintenance costs, and lower earnings from PipeLines LP as a result of the reduced ownership. Results were also negatively impacted by a weaker U.S. dollar in 2005.

## **PIPELINES OPPORTUNITIES AND DEVELOPMENTS**

#### *ANR and Great Lakes Acquisition*

On February 22, 2007, TransCanada closed its acquisition of ANR and an additional 3.55 per cent interest in Great Lakes from El Paso Corporation for approximately US\$3.4 billion, subject to certain post-closing adjustments, including approximately US\$488 million of assumed long-term debt. This transaction will significantly expand the Company's continental natural gas pipeline and storage operations.

ANR operates one of the largest interstate natural gas pipeline systems in the U.S., providing transportation, storage, and various capacity-related services to a variety of customers in both the U.S. and Canada. The system consists of approximately 17,000 km of pipeline with a peak-day capacity of 6.8 Bcf/d. It transports natural gas from producing fields in Louisiana, Oklahoma, Texas and the Gulf of Mexico to markets in Wisconsin, Michigan, Illinois, Ohio and Indiana. The pipeline system also connects with numerous other pipelines providing customers with access to diverse sources of supply from western Canada and the Rocky Mountain region and access to a variety of end-user markets in the midwestern and northeastern U.S.

ANR also owns and operates numerous underground natural gas storage facilities in Michigan with a total capacity of approximately 230 Bcf. Its facilities offer customers a high level of service flexibility allowing them to meet peak-day delivery requirements and to capture the value resulting from changing supply and demand dynamics. As part of the acquisition, TransCanada will also obtain certain natural gas supplies contained within production and storage reservoirs in Michigan.

#### *Great Lakes*

On February 22, 2007, PipeLines LP closed its acquisition of a 46.45 per cent interest in Great Lakes from El Paso Corporation for approximately US\$962 million, subject to certain post-closing adjustments, including approximately US\$212 million of assumed long-term debt. Great Lakes owns and operates a 3,402 km interstate natural gas pipeline system with a design capacity of 2.5 Bcf/d. TransCanada is the general partner of and holds a 32.1 per cent interest in PipeLines LP.

*Canadian Mainline*

In May 2006, TransCanada filed for approval of two Canadian Mainline services designed to meet the growing needs of natural gas-fired power generators in Ontario. These services are designed to ensure that shippers can access transportation on as little as 15 minutes notice so they can better match the timing of their natural gas transportation needs with the timing of their power generation requirements. The application was the subject of an oral public hearing in September 2006 and, in December 2006, the NEB approved implementation of the services with minor modifications.

In December 2006, TransCanada applied to the NEB for approval of a new receipt point at Gros Cacouna on the Canadian Mainline. The Company is also seeking affirmation of the tolling methodology that will apply to service from that point. The new receipt point would accommodate receipts of regassified LNG at Gros Cacouna, bringing a new source of supply to the Canadian Mainline to serve markets in eastern Canada and the U.S. Northeast. The NEB has established a procedure to deal with the Gros Cacouna, Québec receipt point application which includes an oral hearing expected to begin in April 2007.

*Alberta System*

On February 21, 2006, the EUB issued its decision on the 2005 GRA Phase II. The EUB approved the 2005 rate design as applied for. With this decision, TransCanada was able to finalize the 2005 and 2006 Alberta System tolls on March 14, 2006. The 2006 final tolls were effective April 1, 2006. TransCanada had been charging interim tolls since January 1, 2006 with the EUB's approval.

TransCanada filed for a Review and Variance on the Ventures LP's Transportation by Others (TBO) costs following the EUB decision on the 2004 GRA Phase I. At the time, the EUB denied certain costs associated with the Ventures LP's new TBO contract that was replacing the old TBO contract. In its decision on November 28, 2006, (Decision 2006-069), the EUB allowed for the recovery of approximately \$1 million of costs due to the timing of the termination and commencement of the TBO contracts.

On November 30, 2006, the EUB finalized the 2007 generic ROE formula results. For 2007, the Alberta System's ROE will be 8.51 per cent; down from 8.93 per cent in 2006.

On December 20, 2006, the EUB approved TransCanada's application to charge interim tolls for transportation service, effective January 1, 2007. Final tolls for 2007 will be determined in first quarter 2007 upon updating of the flow-through cost components of the revenue requirement to reflect actual costs and revenues from the prior year.

*GTN*

In June 2006, TransCanada filed a rate case with the FERC for its Gas Transmission Northwest System. The rate case filing was primarily driven by decreased revenues due to contract non-renewals and shipper defaults. The comprehensive filing requested a number of tariff changes including an increase in rates for transportation services that became effective January 1, 2007, subject to refund. The proposed rates include an ROE of 14.5 per cent, a common equity ratio of 62.99 per cent and a depreciation rate for the transmission plant of 2.76 per cent. The rates in effect prior to the January 2007 rate increase were based on the last rate case filed in 1994.

In January 2007, TransCanada received a procedural order from the FERC establishing a timeline for the system's rate case proceeding. The hearing into this rate case is scheduled to commence on October 31, 2007.

*BC System and Foothills*

TransCanada filed applications with the NEB in early December 2005 for approval of 2006 tolls for Foothills and the BC System, reflecting an agreement with the Canadian Association of Petroleum Producers (CAPP) and other stakeholders to increase the deemed equity component of the capital structure of each system to 36 per cent from 30 per cent. On December 21, 2005, the NEB approved Foothills' application as filed. On February 22, 2006, the NEB finalized the BC System's 2006 tolls as filed.

In March 2006, TransCanada initiated discussions with shippers on the BC System to integrate the BC System with Foothills. The discussions culminated in a settlement agreement (Integration Settlement) between Foothills and CAPP.

The Integration Settlement amended an existing settlement for Foothills and includes a sharing mechanism for anticipated cost savings through increased administrative efficiencies arising out of the integration of the two systems. TransCanada filed Foothills and BC System's integration application and related approvals with the NEB on December 21, 2006. In February 2007, the NEB approved the application as filed.

#### *Tamazunchale*

In December 2006, TransCanada commenced commercial operations of the Tamazunchale pipeline. The 36 inch, 130 km pipeline in central Mexico extends from the facilities of Pemex Gas near Naranjos, Veracruz and transports natural gas under a 26-year contract with the Comisión Federal de Electricidad to an electricity generation station near Tamazunchale, San Luis Potosi.

The pipeline is designed to transport initial volumes of 170 million cubic feet per day (mmcf/d). Under the contract, the capacity of the Tamazunchale pipeline is expected to be expanded, beginning in 2009, to approximately 430 mmcf/d to meet the needs of two additional proposed power plants near Tamazunchale.

#### *North Baja*

On February 7, 2006, North Baja Pipelines LLC (North Baja) filed an application with the FERC to expand and modify its existing system to facilitate the importation of up to 2.7 Bcf/d of regassified LNG from Mexico into the California and Arizona markets. Specifically, North Baja proposes to modify its existing system to accommodate bi-directional natural gas flow, to construct a new meter station and a 36 inch pipeline to interconnect with Southern California Gas Company, to construct approximately 74 km of lateral facilities to serve electric generation facilities, and to loop its entire approximately 129 km existing system with a combination of 42 inch and 48 inch diameter pipeline. In addition to its FERC certificate of public convenience and necessity, which includes a determination on environmental issues, the project will need various permits and leases from the U.S. Bureau of Land Management, the California State Lands Commission and other agencies. On October 6, 2006, the FERC issued a preliminary determination approving all aspects of North Baja's proposal other than those related to environmental issues, which will be the subject of a future order.

#### *Keystone Pipeline*

In November 2005, TransCanada, ConocoPhillips Company and ConocoPhillips Pipe Line Company (CPPL) signed a Memorandum of Understanding which commits ConocoPhillips Company to ship crude oil on the proposed Keystone Pipeline, and gives CPPL the right to acquire up to a 50 per cent ownership interest in the pipeline. On January 31, 2006, TransCanada announced it has secured firm, long-term contracts totalling 340,000 barrels per day with durations averaging 18 years. The commitments were obtained through the successful completion of a binding Open Season held during fourth quarter 2005. With these commitments from shippers, TransCanada proceeded with regulatory filings for approval of the project.

At an estimated cost of approximately US\$2.1 billion, the Keystone Pipeline is intended to transport approximately 435,000 barrels per day of crude oil from Hardisty, Alberta, to Patoka, Illinois through a 2,960 km pipeline system. The pipeline can be expanded to 590,000 barrels per day with additional pump stations. In addition to approximately 1,730 km of new pipeline construction in the U.S., the Canadian portion of the proposed project includes the construction of approximately 370 km of new pipeline and the conversion of approximately 860 km of TransCanada's existing pipeline facilities from natural gas to crude oil transmission. At December 31, 2006, the Company had capitalized \$39 million related to Keystone.

In 2006, TransCanada and TransCanada's wholly owned subsidiary, TransCanada Keystone Pipeline GP Ltd. (Keystone), filed two regulatory applications with the NEB for the Canadian leg of the Keystone Pipeline. In June 2006, TransCanada filed the first application with the NEB seeking approval to transfer a portion of its Canadian Mainline natural gas transmission facilities to Keystone for use as part of the Keystone Pipeline. As part of the transfer application, TransCanada sought approval to reduce the Canadian Mainline's rate base by the NBV of the transferred facilities and to add the NBV of these facilities to the Keystone Pipeline rate base. Public hearings on the transfer application were completed in mid-November 2006. Approval was received from the NEB in February 2007.



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In the second application, TransCanada sought approval to construct and operate new facilities in Canada including approximately 370 km of new oil pipeline, terminal facilities at Hardisty, Alberta and required pump stations. TransCanada is also seeking approval of the tolls and tariff for the pipeline. A decision on this application is anticipated from the NEB in fourth quarter 2007.

In April 2006, TransCanada filed an application with the U.S. Department of State for a Presidential Permit authorizing the construction, operation and maintenance of the U.S. portion of the Keystone Pipeline. In September 2006, the Department of State issued a formal notice of the application as well as a Notice of Intent to prepare an Environmental Impact Statement for the project.

In June 2006, TransCanada filed a petition with the Illinois Commerce Commission for a certificate authorizing the pipeline and granting authority to exercise eminent domain. The matter is expected to go to hearing in March 2007.

Shippers have also expressed interest in a proposed extension of the Keystone Pipeline to Cushing, Oklahoma. Through an Open Season, which will close at the end of first quarter 2007, binding commitments are being solicited to support the Cushing Extension, which would expand the Keystone Pipeline from a capacity of approximately 435,000 barrels per day to 590,000 barrels per day, and see the construction of a 468 km, 36 inch extension of the U.S. portion of the pipeline to Cushing. The expansion and extension would enable Keystone to provide access for increasing western Canadian crude supply to two key markets and transportation hubs at Patoka and Cushing. The expected capital cost is US\$700 million and the targeted in-service date is fourth quarter 2010.

The Heartland extension is a proposed 190 km pipeline from Hardisty which would connect Keystone to the Fort Saskatchewan area. This extension would increase the Keystone Pipeline's market supply reach and provide incremental transportation service between Alberta's two major crude oil centres. The expected capital cost is approximately US\$300 million. Discussions are under way with shippers to gauge the level of interest with an anticipation of moving forward with commercial arrangements later in 2007. The targeted in-service date of the Heartland extension is 2010/2011.

TransCanada is in the business of connecting energy supplies to markets and it views the Keystone opportunity as another way of providing a valuable service to its customers. Converting one of the Company's natural gas pipeline assets for oil transportation is an innovative, cost-competitive way to meet the need for pipeline expansions to accommodate anticipated growth in Canadian crude oil production during the next decade.

### *Mackenzie Gas Pipeline Project*

The MGP is a 1,200 km natural gas pipeline proposed to be constructed from near Inuvik, Northwest Territories to the northern border of Alberta, where it would then connect to the Alberta System. In June 2006, TransCanada submitted an application to the EUB for approval of the Dickens-Vardie facilities, a \$212-million capital project required to provide the Alberta System interconnection facilities for Mackenzie gas volumes.

Throughout 2006, the MGP proponents participated in public hearings convened by the NEB and by a Joint Review Panel (JRP) constituted to assess socio-economic and environmental aspects of the project. These latter hearings are expected to conclude in second quarter 2007, with the JRP's report ultimately being submitted into the NEB review process. Concurrently, the project proponents have been reassessing the capital cost estimate and construction schedule for the MGP, in light of overall industry cost escalations and labour shortages. A revised capital estimate for the project is expected to be filed with the NEB in first quarter 2007.

Apart from the Alberta System interconnection facilities, TransCanada's involvement with the MGP is derived from a 2003 agreement with the APG and the MGP by which TransCanada agreed to finance the APG's one-third share of the pipeline's pre-development costs associated with the project. These costs are currently forecasted to be approximately \$145 million by the end of 2007. Cumulative advances made by TransCanada in this respect totalled \$118 million at December 31, 2006 and are included in Other Assets. These amounts constitute a loan to the APG, which becomes repayable only after the date upon which the pipeline commences commercial operations. The total amount of the loan

is expected to ultimately form part of the rate base of the pipeline, and the loan will subsequently be repaid from the APG's share of available future 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, the recovery of the advances is dependent upon a successful outcome of the project.

Under the terms of certain MGP agreements, TransCanada holds an option to acquire up to five per cent equity ownership in the pipeline at the time of the decision to construct. 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 pipeline owners and the APG sharing the balance.

#### *Alaska Highway Pipeline Project*

In 2006, TransCanada continued its discussions with Alaska North Slope producers and the State of Alaska regarding the Alaskan portion of the proposed Alaska Highway Pipeline Project. In early 2006, Alaska's State administration reached a preliminary agreement with ConocoPhillips Alaska Inc., BP Exploration (Alaska) Inc. and ExxonMobil Alaska Production Inc. for the pipeline project. However, the State Legislature did not ratify that agreement. Alaska's new Governor, elected in November 2006, has indicated the new administration intends to introduce a different process for the pipeline project in 2007.

Foothills Pipe Lines Ltd. (Foothills) holds the priority right to build, own and operate the first pipeline through Canada for the transportation of Alaskan gas. This right was granted under the *Northern Pipeline Act of Canada* (NPA), following a lengthy competitive hearing before the NEB in the late 1970s, which resulted in a decision in favour of Foothills. The NPA creates a single window regulatory regime that is uniquely available to Foothills. It has been used by Foothills to construct facilities in Alberta, B.C. and Saskatchewan, which constitute a prebuild for the Alaska Highway Pipeline Project, and to expand those facilities five times, the latest of which was in 1998. Continued development under the NPA should ensure the earliest in-service date for the project.

#### *Western Supply and Markets*

The primary driver for infrastructure projects for the Alberta System is the development of natural gas supply and market demand in the various regions served by the Alberta System. In 2006, natural gas prices were lower than in 2005 which resulted in some slowdown in natural gas drilling activity levels. Nevertheless, activity remains strong which has resulted in supply growth in some regions of western Canada and an increased requirement for new transmission infrastructure. The primary source of supply growth has been deeper conventional drilling in western Alberta, northeastern B.C. and coalbed methane development in central Alberta.

TransCanada will continue to focus on the cost effective and timely connection of new gas production volumes so that customers can promptly access markets. As well, service flexibility will continue to be a focus to ensure TransCanada remains competitive.

TransCanada received approval from the EUB in April 2006 to construct new natural gas transmission facilities to serve the firm intra-Alberta delivery contract requirements of oil sand developers in the Fort McKay area. These facilities include 127 km of pipeline and three metering facilities at an estimated capital cost of \$125 million. In addition to the proposed Fort McKay facilities, TransCanada constructed additional metering facilities to serve approximately 200 mmcf/d of firm intra-Alberta delivery contracts.

#### *Eastern Supply and Markets*

Historically, TransCanada's eastern pipeline system has been supplied by long-haul flows from western Canada and by volumes received from storage fields and interconnecting pipelines in southwestern Ontario. In the future, the eastern pipeline system may also be supplied by LNG deliveries from proposed regassification facilities in Québec and the northeastern U.S.

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Power generation continues to be the primary driver for incremental gas demand in eastern Canada and the northeastern U.S. Power projects that require significant volumes of natural gas continue to be developed, supporting utilization of the eastern pipeline system. Aligned with these power project developments, TransCanada received NEB approval in 2006 for two new services targeted at attracting incremental demand for natural gas transportation on the Canadian Mainline system.

In addition, TransCanada completed construction of three NEB-approved facilities on its Canadian Mainline system in 2006. This included the Stittsville and Deux Rivières loops of approximately 38 km of 42 inch pipe with a capital cost of approximately \$113 million, and the Les Cèdres loop of approximately 21 km of 36 inch pipe with a capital cost of \$56 million.

### **PIPELINES BUSINESS RISKS**

#### *Competition*

TransCanada faces competition at both the supply end and the market end of its systems. The competition is a result of other pipelines accessing the increasingly mature WCSB as well as markets served by TransCanada's pipelines. In addition, the continued expiration of long-term firm transportation (FT) contracts has resulted in significant reductions in long-term firm contracted capacity on the Canadian Mainline, the Alberta System, the BC System and the Gas Transmission Northwest System, and shifts to short-term firm contracts.

TransCanada's primary source of natural gas supply is the WCSB. As of December 2005, the WCSB had 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, additional reserves have continually been discovered to maintain the reserves-to-production ratio at close to nine years. Natural gas prices in the future are expected to be higher than long-term historical averages due to a tighter supply/demand balance, which should stimulate exploration and production in the WCSB. However, the WCSB's natural gas supply is expected to remain essentially flat. With the expansion of capacity on TransCanada's wholly and partially owned pipelines over the past decade and the competition provided by other pipelines combined with significant growth in natural gas demand in Alberta, TransCanada anticipates there will be excess pipeline capacity out of the WCSB for the foreseeable future.

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. The Alberta System has faced, and will continue to face, increasing competition from other pipelines. An emerging competitive issue for the Alberta System is the existence and access to natural gas liquids (NGLs) contained in the gas that is transported by the pipeline. The current extraction convention in Alberta allocates a heat content value to the receipt point shippers at the overall Alberta System average gas composition. This averaging is becoming a significant issue for northern gas producers whose gas is generally rich in NGL content as they seek to extract the full value of the NGLs. Alberta's petrochemical industry is also very interested in the issue as it relies on NGLs as their feedstock. The EUB is aware of the current extraction convention inequities and has indicated that they will commission a process to address these concerns.

The Canadian Mainline is TransCanada's cross-continental natural gas pipeline serving midwestern and eastern markets in Canada and the U.S. The demand for natural gas in TransCanada's key eastern markets is expected to continue to increase, particularly to meet the expected growth in natural gas-fired power generation. Although there are opportunities to increase market share in Canadian 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 pipeline and supply options. Eastern Canadian markets that historically received Canadian supplies only from TransCanada are now capable of receiving supplies from new pipelines into the region that can source western and Atlantic Canadian, and U.S. supplies.

Over the last few years, the Canadian Mainline has experienced reductions in long-haul FT contracts. This has been partially offset by increases in short-haul contracts. While decreases in throughput do not directly impact the Canadian Mainline earnings, such decreases will impact the competitiveness of its tolls. Over the course of 2005 and into early

2006, strong prices in eastern Canada and the northeastern U.S. resulted in higher than anticipated flows on the Canadian Mainline. Moderating prices in these markets in the latter part of 2006 have reduced flows toward expected levels. Looking forward, in the short to medium term, there is limited opportunity to further reduce per unit tolls by increasing long-haul volumes on the Canadian Mainline.

The Gas Transmission Northwest System must compete with other pipelines to access natural gas supplies as well as to access markets. Transportation service capacity on the Gas Transmission Northwest System provides customers with access to supplies of natural gas primarily from the WCSB and serves markets in the Pacific Northwest, California and Nevada. These three markets may also access supplies from other competing basins in addition to supplies from the WCSB. Historically, natural gas supplies from the WCSB have been competitively priced in relation to natural gas supplies from the other supply regions serving these markets. The Gas Transmission Northwest System experienced significant contract non-renewals in 2005 and 2006 as natural gas transported from the WCSB on the Gas Transmission Northwest System competes for the California and Nevada markets against supplies from the Rocky Mountain and southwestern U.S. supply basins. In the Pacific Northwest market, natural gas transported on the Gas Transmission Northwest System competes against the Rocky Mountain natural gas supply as well as additional western Canadian supply transported by other pipelines.

In October 2006, the Gas Transmission Northwest System's largest customer, Pacific Gas & Electric Company (PG&E), extended its contract to October 31, 2008. In 2006, PG&E accounted for approximately 22 per cent of the Gas Transmission Northwest System's revenue. By October 31, 2007, PG&E will inform TransCanada whether it elects to either extend the contract beyond November 2008, utilize the contract's right of first refusal process or terminate the contract.

Transportation service on North Baja provides access to natural gas supplies primarily from both the Permian Basin, located in western Texas and southeastern New Mexico, and the San Juan Basin, primarily located in northwestern New Mexico and Colorado. North Baja delivers gas to the Gasoducto Bajanorte Pipeline at the California/Mexico border, which transports the gas to markets in northern Baja California, Mexico. While there are currently no direct competitors to deliver natural gas to North Baja's downstream markets, the pipeline may compete with fuel oil, which is an alternative to natural gas in the operation of some electric generation plants in the North Baja region.

#### *Counterparty Risk*

The risk of counterparty default is always present. In December 2005, Calpine Corporation and certain of its subsidiaries (Calpine) filed for bankruptcy protection in both Canada and the U.S. Calpine repudiated its transportation contracts on certain of TransCanada's Canadian pipelines effective January 1, 2007 as allowed under a Companies' Creditors Arrangement Act Order. Given that TransCanada considers itself prudent in having obtained the maximum financial assurances allowable under the respective Canadian tariffs, TransCanada will make an application to the regulator for recovery under the current regulatory model for any lost revenue, net of assurances and any revenues from the defaulted capacity. Should Calpine be successful in rejecting its contracts on certain of TransCanada's U.S. pipelines, the unmitigated annual after-tax exposure of the contract obligations is estimated at \$10 million for the Gas Transmission Northwest System. Mitigating factors exist which may reduce this exposure including recontracting the capacity where possible and recovery from bankruptcy proceedings. The potential impact of such mitigating factors and the resulting net exposure are unknown at this time.

#### *Regulatory Financial Risk*

Regulatory decisions continue to have a significant impact on the financial returns for existing and future investments in TransCanada's Canadian wholly owned pipelines. TransCanada remains concerned that the approved financial returns fail to be competitive with returns from assets of similar risk and will discourage additional investment in existing Canadian natural gas transmission systems. In recent years, TransCanada applied for an ROE of 11 per cent on 40 per cent deemed common equity for both the Canadian Mainline and the Alberta System to the NEB and the EUB, respectively. The outcome of these proceedings resulted in the Canadian Mainline's current 36 per cent deemed equity thickness and the Alberta System's 35 per cent deemed equity thickness. Additionally, the NEB reaffirmed its ROE

formula, while the EUB set a generic ROE which largely aligns with the NEB's formula. In 2006, the NEB's ROE formula declined to 8.88 per cent from the 2005 ROE of 9.46 per cent and the EUB's generic ROE declined to 8.93 per cent from 9.50 per cent in 2005. In 2007, the Canadian Mainline and the Alberta System's ROEs continued to decline, dropping to 8.46 percent and 8.51 per cent, respectively.

#### *Throughput Risk*

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

## **PIPELINES OTHER**

#### *Safety*

TransCanada worked closely with regulators, customers and communities during 2006 to ensure the continued safety of employees and the public. In 2006, TransCanada experienced two small diameter pipeline line-breaks located in remote areas of northern Alberta. The breaks released sweet natural gas and resulted in minimal impact with no injuries or property damage. Under the approved regulatory models in Canada, expenditures for pipeline integrity on the NEB and the EUB regulated pipelines are treated on a flow-through basis and, as a result, have no impact on TransCanada's earnings. The Company expects to spend approximately \$100 million in 2007 for pipeline integrity on its wholly owned pipelines, which approximates the amount spent in 2006. TransCanada continues to use a rigorous risk management system that focuses spending on issues and areas that have the largest impact on maintaining or improving the reliability and safety of the pipeline system. TransCanada utilizes a comprehensive management system of policies, programs and procedures to ensure the occupational safety of employees and contractors.

#### *Environment*

In 2006, TransCanada continued to address environmental issues associated with its historical operations through proactive environmental monitoring, sampling and site remediation programs. Environmental site assessments were completed on the assets of the BC System, the Alberta System and the Canadian Mainline. The building containment integrity improvement program also continued at compressor station sites across the Canadian Mainline. Additionally, the demolition and clean up of four mainline compressor plants was carried out in 2006. TransCanada will continue to actively invest in improving its environmental protection practices in 2007 and the future.

For information on management of risks with respect to the Pipelines business, refer to the "Risks and Risk Management" section of this MD&A.

## **PIPELINES OUTLOOK**

As demand for natural gas continues to grow across North America, TransCanada's Pipelines business will continue to play a critical role in the reliable transportation of natural gas. For 2007, the business will continue to focus on the reliable delivery of natural gas to growing markets, connecting new supply, progressing development of new infrastructure to connect natural gas from the north, LNG in the east, and development of the Keystone Pipeline.

It is expected that producers will continue to explore and develop new fields, particularly in northeastern B.C. and the west central foothills regions of Alberta. There will also be significant activity aimed at unconventional resources such as coalbed methane although activity is expected to decline from last year's level. New facilities will be required to move this incremental supply from the location of the resource. New customer requests to serve markets in eastern Canada and the U.S. will require expansion of certain facilities on the Canadian Mainline for 2007 and 2008. This will include the addition of 18 MW of compression and a 7 km looping project. The estimated capital cost for these projects is \$63 million.

It is expected that incremental supply from LNG will serve growing North American markets in the mid to long term. As a result, TransCanada will take prudent steps to further understand the potential commercial and operational implications of connecting LNG facilities to those systems affected.

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

#### *Earnings*

With the closing of the acquisition of ANR and Great Lakes, and the Company's increased ownership in PipeLines LP, TransCanada expects higher net earnings from Pipelines in 2007 compared to 2006. TransCanada's earnings from its Canadian Wholly Owned Pipelines are primarily determined by the average investment base, ROE, deemed common equity and opportunity for incentive earnings. In the short to medium term, the Company expects a modest level of investment in these mature assets and, therefore, anticipates a continued net decline in the average investment base due to depreciation. Accordingly, without an increase in ROE, deemed common equity or incentive opportunities, future earnings from the Canadian Wholly Owned Pipelines are anticipated to decrease. However, these mature assets will continue to generate strong cash flows that can be redeployed to other projects offering higher returns. Under the current regulatory model, earnings from the Canadian Wholly Owned Pipelines are not affected by short-term fluctuations in the commodity price of natural gas, changes in throughput volumes or changes in contract levels. In addition, the Tamazunchale pipeline will provide an increase in 2007 earnings as a result of its first full year of operations.

In November 2006, the NEB established the 2007 ROE for the Canadian Mainline at 8.46 per cent compared to 8.88 per cent in 2006. In addition, the 2007 average investment base is expected to continue to decline. These two factors are expected to lower earnings on the Canadian Mainline in 2007, relative to 2006, barring any offsetting factors.

Alberta System's earnings will be negatively influenced in 2007 by the decrease in the EUB's generic ROE to 8.51 per cent in 2007 from 8.93 per cent in 2006, and the anticipated decrease in the average investment base. The three-year revenue requirement settlement reached in 2005 does provide the opportunity for limited incentive earnings as the settlement contains some at-risk components. There is a possibility that the at-risk OM&A cost components of the settlement will have a negative impact on the Alberta System's earnings in 2007.

In 2007, reduced firm contract volumes on the Gas Transmission Northwest System, partially due to the bankruptcy of Calpine, are expected to have a negative impact on the Gas Transmission Northwest System's earnings compared to 2006. It is uncertain what impact the rate case proceeding may have on the system's financial results. Net earnings, excluding gains, from Other Pipelines are expected to be relatively consistent with 2006.

#### *Capital Expenditures*

Total capital spending for the Wholly Owned Pipelines during 2006 was \$434 million. Overall capital spending for the Wholly Owned Pipelines in 2007 is expected to be approximately \$400 million, excluding any capital expenditures for ANR.

**NATURAL GAS THROUGHPUT VOLUMES***(Bcf)*

	<b>2006</b>	2005	2004
Canadian Mainline <sup>(1)</sup>	<b>2,955</b>	2,997	2,621
Alberta System <sup>(2)</sup>	<b>4,051</b>	3,999	3,909
Gas Transmission Northwest System <sup>(3)</sup>	<b>790</b>	777	181
Foothills	<b>1,051</b>	1,051	1,139
BC System	<b>351</b>	321	360
North Baja <sup>(3)</sup>	<b>95</b>	84	13
Great Lakes	<b>816</b>	850	801
Northern Border	<b>799</b>	808	845
Iroquois	<b>384</b>	394	356
TQM	<b>158</b>	166	159
Ventures LP	<b>179</b>	138	136
Portland	<b>52</b>	62	50
Tuscarora	<b>28</b>	25	25
Gas Pacifico	<b>52</b>	34	28
TransGas	<b>22</b>	19	18
Tamazunchale <sup>(4)</sup>			

(1) Canadian Mainline deliveries originating at the Alberta border and in Saskatchewan in 2006 were 2,224 Bcf (2005 2,215 Bcf; 2004 2,017 Bcf).

(2) Field receipt volumes for the Alberta System in 2006 were 4,160 Bcf (2005 4,034 Bcf; 2004 3,952 Bcf).

(3) TransCanada acquired GTN on November 1, 2004. The delivery volumes for 2004 represent November and December 2004 throughput for GTN.

(4) The Tamazunchale pipeline went into service December 1, 2006.

**BEAR CREEK** An 80 MW natural gas-fired cogeneration plant located near Grande Prairie, Alberta.

**MACKAY RIVER** A 165 MW natural gas-fired cogeneration plant located near Fort McMurray, Alberta.

**REDWATER** A 40 MW natural gas-fired cogeneration plant located near Redwater, Alberta.

**SUNDANCE A&B** The Sundance power facility in Alberta is the largest coal-fired electrical generating facility in Western Canada. TransCanada owns the 560 MW Sundance A PPA, which expires in 2017. TransCanada effectively owns 50 per cent of the 706 MW Sundance B PPA, which expires in 2020.

**SHEERNESS** The Sheerness plant consists of two 390 MW coal-fired thermal power generating units. TransCanada owns the 756 MW Sheerness PPA, which expires in 2020.

**CARSELAND** An 80 MW natural gas-fired cogeneration plant located near Carseland, Alberta.

**38** MANAGEMENT'S DISCUSSION AND ANALYSIS

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**CANCARB** The 27 MW Cancarb facility at Medicine Hat, Alberta is fuelled by waste heat from TransCanada's adjacent thermal carbon black facility.

**BRUCE POWER** TransCanada owns 31.6 per cent of Bruce B, consisting of operating Units 5 to 8 with approximately 3,200 MW of generating capacity. In addition, TransCanada owns 48.7 per cent of Bruce A, consisting of operating Units 3 and 4 with approximately 1,500 MW of generating capacity and currently idle Units 1 and 2 with approximately 1,500 MW of generating capacity, which are currently being refurbished and are expected to restart in late 2009 or early 2010.

**HALTON HILLS** The 683 MW natural gas-fired power plant near the town of Halton Hills, Ontario is under development and is expected to be placed in service in second quarter 2010.

**PORTLANDS ENERGY** The 550 MW high efficiency, combined cycle natural gas generation power plant located in downtown Toronto is 50 percent owned by TransCanada and is under construction. The plant is expected to be operational in simple-cycle mode, delivering 340 MW of electricity to the City of Toronto beginning June 2008. It is anticipated to be fully commissioned in its full combined-cycle mode, delivering 550 MW of power in second quarter 2009.

**BÉCANCOUR** Construction of the 550 MW Bécancour natural gas-fired cogeneration power plant located near Trois-Rivières, Québec was completed and the plant placed into service in September 2006. The entire power output will be supplied to Hydro-Québec under a 20-year power purchase contract. Steam is also sold to industrial customers for use in commercial processes.

**CARTIER WIND** Construction of the 740 MW Cartier Wind project, 62 per cent owned by TransCanada, continued in 2006. The first of six wind projects, Baie-des-Sables, with a generation capacity of 110 MW, was placed into service in November 2006. Planning and construction on the remaining five projects will continue, subject to future appropriations and approvals.

**GRANDVIEW** A 90 MW natural gas-fired cogeneration power plant located in Saint John, New Brunswick was commissioned and placed into service in January 2005. Under a 20-year tolling arrangement, 100 per cent of the plant's heat and electricity output is sold to Irving Oil.

**TC HYDRO** TransCanada's hydroelectric facilities on the Connecticut and Deerfield Rivers consist of 13 stations and associated dams and reservoirs with a total generating capacity of 567 MW and are located in New Hampshire, Vermont and Massachusetts.

**OSP** The OSP plant is a 560 MW natural gas-fired, combined-cycle facility in Rhode Island.

**EDSON** Edson is an underground natural gas storage facility connected to the Alberta System located near Edson, Alberta. The central processing system is capable of maximum injection and withdrawal rates of 725 mmcf/d of natural gas. Edson has a working natural gas storage capacity of approximately 50 Bcf. Construction of the Edson facility was substantially completed in third quarter 2006 and the facility was placed into service on December 31, 2006.

**CROSSALTA** CrossAlta is an underground natural gas storage facility connected to the Alberta System and is located near Crossfield, Alberta. CrossAlta has a working natural gas capacity of 50 Bcf with a maximum deliverability capability of 400 mmcf/d. TransCanada holds a 60 per cent ownership in CrossAlta.

**CACOUNA** Cacouna, a joint venture with Petro-Canada, is a proposed LNG project in Québec at Gros Cacouna harbour on the St. Lawrence River, capable of receiving, storing and regassifying imported LNG with an average send-out capacity of approximately 500 mmcf/d of natural gas.

**BROADWATER** Broadwater, a joint venture with Shell US Gas & Power LLC, is a proposed LNG project located offshore of New York State in Long Island Sound, capable of receiving, storing and regassifying imported LNG with an average send-out capacity of approximately 1 Bcf/d of natural gas.

## HIGHLIGHTS

### *Net Earnings*

Energy's net earnings in 2006 were \$452 million compared to \$566 million in 2005.

Excluding gains related to Power LP and Paiton Energy in 2005, Energy's net earnings in 2006 increased \$194 million to \$452 million compared to \$258 million in 2005, primarily due to increased operating income from Western Power Operations.

### *Expanding Asset Base*

At December 31, 2006, approximately 2,100 MW of new power plants were under construction, with an anticipated total capital cost of more than \$3.2 billion.

Since 1999, TransCanada's Power business has grown its nominal generating capacity by approximately 5,200 MW (including 2,100 MW under construction), representing an investment of more than \$4 billion to the end of 2006. TransCanada has committed an additional \$1.9 billion to complete the assets under construction.

### *Power*

In September 2006, the Bécancour cogeneration plant was commissioned and placed into service.

Construction on the Portlands Energy project commenced in September 2006.

In November 2006, construction on the Baie-des-Sables Cartier Wind project was completed and placed into service.

In November 2006, TransCanada was awarded a contract to build, own and operate a natural gas-fired power plant near the town of Halton Hills, Ontario.

In 2006, construction continued on the Bruce A restart and refurbishment project, which includes restart of the currently idle Units 1 and 2, and replacement of the steam generators on Unit 4.

2006 included the first full year of earnings from the Sheerness PPA, acquired in December 2005 from the Alberta Balancing Pool.

### *Natural Gas Storage*

Construction of the Edson natural gas storage facility was substantially completed in third quarter 2006 and was placed into service on December 31, 2006.

### *Plant Availability*

Weighted average power plant availability was 93 per cent in 2006, excluding Bruce Power, compared to 87 per cent in 2005.

Including Bruce Power, weighted average power plant availability was 91 per cent in 2006, compared to 84 per cent in 2005.



**ENERGY RESULTS-AT-A-GLANCE***Year ended December 31 (millions of dollars)*

	2006	2005	2004
Bruce Power	235	195	130
Western Power Operations	297	123	138
Eastern Power Operations	187	137	108
Natural Gas Storage	93	32	27
Power LP Investment		29	29
General, administrative, support costs and other	(144)	(129)	(127)
Operating income	668	387	305
Financial charges	(23)	(11)	(13)
Interest income and other	5	5	14
Income taxes	(198)	(123)	(95)
	452	258	211
Gain on sale of Paiton Energy		115	
Gains related to Power LP		193	187
Net earnings	452	566	398

Energy's net earnings in 2006 were \$452 million compared to \$566 million in 2005. In 2005, TransCanada sold its approximate 11 per cent interest in Paiton Energy to subsidiaries of the Tokyo Electric Power Company for gross proceeds of US\$103 million (\$122 million) resulting in an after-tax gain of \$115 million. In August 2005, TransCanada sold its ownership interest in Power LP to EPCOR Utilities Inc. (EPCOR) for net proceeds of \$523 million resulting in an after-tax gain of \$193 million. Excluding the Paiton Energy and Power LP-related gains in 2005, Energy's net earnings in 2006 of \$452 million increased \$194 million compared to \$258 million in 2005. The increase was primarily due to higher contributions from each of its existing businesses and a \$23-million favourable impact on future income taxes arising from reductions

in Canadian federal and provincial corporate income tax rates enacted in 2006. Partially offsetting these increases was the loss of operating income associated with the sale of the Power LP interest in 2005 and reduced earnings in 2006 due to the effect of a weaker U.S. dollar on earnings from Energy's U.S. operations.

Included in 2004 net earnings was an after-tax gain of \$187 million comprising a \$15-million after-tax gain on the sale of TransCanada's Curtis Palmer and ManChief power facilities to Power LP as well as \$172 million of after-tax dilution gains.

Excluding the gain on the sale of Paiton Energy in 2005 and Power LP-related gains in 2005 and 2004, Energy's net earnings for the year ended December 31, 2005 of \$258 million increased \$47 million compared to \$211 million in 2004. The increase was primarily due to higher operating income from Bruce Power and Eastern Power Operations, partially offset by a reduced contribution from Western Power Operations and lower interest income and other.

**POWER PLANTS NOMINAL GENERATING CAPACITY AND FUEL TYPE**

	MW	Fuel Type
<b>Bruce Power<sup>(1)</sup></b>	2,474	Nuclear
<b>Western Power Operations</b>		
Sheerness <sup>(2)</sup>	756	Coal
Sundance A <sup>(3)</sup>	560	Coal
Sundance B <sup>(3)</sup>	353	Coal
MacKay River	165	Natural gas
Carseland	80	Natural gas
Bear Creek	80	Natural gas
Redwater	40	Natural gas
Cancarb	27	Natural gas
	2,061	
<b>Eastern Power Operations</b>		
Halton Hills <sup>(4)</sup>	683	Natural gas
TC Hydro <sup>(5)</sup>	567	Hydro
OSP	560	Natural gas
Bécancour <sup>(6)</sup>	550	Natural gas
Cartier Wind <sup>(7)</sup>	458	Wind
Portlands Energy <sup>(8)</sup>	275	Natural gas
Grandview <sup>(9)</sup>	90	Natural gas
	3,183	
<b>Total Nominal Generating Capacity</b>	<b>7,718</b>	

(1) Represents TransCanada's 48.7 per cent proportionate interest in Bruce A and 31.6 per cent proportionate interest in Bruce B. Bruce A consists of four 750 MW reactors. Bruce A Unit 3 was returned to service in first quarter 2004. Bruce A Units 1 and 2 are currently being refurbished and are expected to restart in late 2009 or early 2010. Bruce B consists of four reactors which are currently in operation, with a combined capacity of approximately 3,200 MW.

(2) TransCanada directly acquires 756 MW from Sheerness through a long-term PPA.

(3) TransCanada directly or indirectly acquires 560 MW from Sundance A and 353 MW from Sundance B through long-term PPAs, which represents 100 per cent of the Sundance A and 50 per cent of the Sundance B power plant output, respectively.

(4) Currently in development.

(5) Acquired in second quarter 2005.

(6) Placed in service in third quarter 2006.

(7) First of six wind farms placed in service in fourth quarter 2006. Represents TransCanada's 62 per cent share of the total 740 MW project.

(8) Currently under construction. Represents TransCanada's 50 per cent share of this 550 MW facility.

(9) Placed in service in first quarter 2005.

## ENERGY FINANCIAL ANALYSIS

### *Bruce Power*

On October 31, 2005, Bruce Power and the OPA completed a long-term agreement whereby Bruce A will restart and refurbish the currently idle Units 1 and 2, extend the operating life of Unit 3 by replacing its steam generators and fuel channels when required and replace the steam generators on Unit 4. As a result of an agreement between Bruce Power and the OPA, and Cameco Corporation's (Cameco) decision not to participate in the restart and refurbishment program,

## 42 MANAGEMENT'S DISCUSSION AND ANALYSIS

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the Bruce A partnership was formed by TransCanada and BPC Generation Infrastructure Trust (BPC), with each owning a 48.7 per cent (2005 47.9 per cent) interest in Bruce A at December 31, 2006. TransCanada and BPC each incurred a net cash outlay of approximately \$100 million in 2005 to acquire Cameco's interest. The remaining 2.6 per cent is owned by the Power Worker's Union Trust No. 1 and The Society of Energy Professionals Trust. The Bruce A partnership subleases the Bruce A facilities, which comprises Units 1 to 4, from Bruce B. TransCanada continues to own 31.6 per cent of Bruce B, which consists of Units 5 to 8.

Upon reorganization, both Bruce A and Bruce B became jointly controlled entities and TransCanada proportionately consolidated these investments on a prospective basis from October 31, 2005. The following Bruce Power financial results reflect the operations of the full six-unit operation for all periods.

**Bruce Power Results-at-a-Glance<sup>(1)</sup>**

*Year ended December 31 (millions of dollars)*

	2006	2005	2004
<b>Bruce Power (100 per cent basis)</b>			
Revenues			
Power	1,861	1,907	1,563
Other <sup>(2)</sup>	71	35	20
	<b>1,932</b>	1,942	1,583
Operating expenses			
Operations and maintenance	(912)	(871)	(793)
Fuel	(96)	(77)	(68)
Supplemental rent	(170)	(164)	(156)
Depreciation and amortization	(134)	(198)	(161)
	<b>(1,312)</b>	(1,310)	(1,178)
Revenues, net of operating expenses	620	632	405
Financial charges under equity accounting <sup>(3)</sup>		(58)	(67)
	<b>620</b>	574	338
TransCanada's proportionate share	228	188	107
Adjustments	7	7	23
TransCanada's operating income from Bruce Power <sup>(3)</sup>	<b>235</b>	195	130
<b>Bruce Power Other Information</b>			
Plant availability	88%	80%	82%
Sales volumes (GWh) <sup>(4)</sup>			
Bruce Power 100 per cent	36,470	32,900	33,600
TransCanada's proportionate share	13,317	10,732	10,608
Results per MWh <sup>(5)</sup>			
Bruce A revenues	\$58		
Bruce B revenues	\$48		
Combined Bruce Power revenues	\$51	\$58	\$47
Combined Bruce Power fuel	\$3	\$2	\$2
Combined Bruce Power total operating expenses <sup>(6)</sup>	\$35	\$40	\$35
Percentage of output sold to spot market	35%	49%	52%

(1) All information in this table includes adjustments to eliminate the effects of inter-partnership transactions between Bruce A and Bruce B.

(2)

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Includes fuel cost recoveries for Bruce A of \$30 million for 2006 (\$4 million from November 1 to December 31, 2005).

MANAGEMENT'S DISCUSSION AND ANALYSIS [43](#)

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- (3) TransCanada's consolidated equity income in 2005 includes \$168 million which represents TransCanada's 31.6 per cent share of Bruce Power earnings for the ten months ended October 31, 2005.
- (4) Gigawatt hours.
- (5) Megawatt hours.
- (6) Net of fuel cost recoveries.

TransCanada's operating income from its combined investment in Bruce Power for 2006 was \$235 million compared to \$195 million for 2005. The increase of \$40 million was primarily due to an increased ownership interest in the Bruce A facilities and higher sales volumes resulting from increased plant availability, partially offset by lower overall realized prices.

Combined Bruce Power prices achieved during 2006 (excluding other revenues) were \$51 per MWh compared to \$58 per MWh in 2005, reflecting lower prices on uncontracted volumes sold into the spot market. Bruce Power's combined operating expenses (net of fuel cost recoveries) decreased to \$35 per MWh for 2006 from \$40 per MWh in 2005 primarily due to increased output and higher fuel cost recoveries in 2006.

The Bruce units ran at a combined average availability of 88 per cent in 2006, compared to an 80 per cent average availability during 2005. The higher availability in 2006 was the result of 114 fewer days of planned maintenance outages as well as 65 fewer forced outage days in 2006 compared to 2005.

TransCanada's operating income from its combined investment in Bruce Power for 2005 was \$195 million compared to \$130 million for the same period in 2004. This increase was primarily due to higher realized prices in 2005, partially offset by higher maintenance costs, higher depreciation and lower capitalization of labour and other in-house costs following the restart of Unit 3 in first quarter 2004.

Adjustments to TransCanada's combined interest in Bruce Power's income before income taxes for 2005 were lower than in 2004 primarily due to a lower amortization of the purchase price allocated to the fair value of sales contracts in place at the time of acquisition.

Income from Bruce B is directly impacted by fluctuations in wholesale spot market prices for electricity. Income from both Bruce A and Bruce B units is impacted by overall plant availability, which in turn, is impacted by scheduled and unscheduled maintenance. To reduce its exposure to spot market prices, as at December 31, 2006, Bruce B entered into fixed price sales contracts to sell forward approximately 6,900 GWh for 2007 and 2,900 GWh for 2008. As a result of the contract with the OPA, all of the output from Bruce A was sold at a fixed price of \$58.63 per MWh (\$57.37 to March 31, 2006), before recovery of fuel costs from the OPA. Under the terms of the arrangement between Bruce A and the OPA, effective October 31, 2005, Bruce A receives a contract price for power generated, whereby the price is adjusted for inflation annually on April 1. Post refurbishment, prices are adjusted for any capital cost variances associated with the restart and refurbishment projects. Bruce A contract prices will not vary with changes in the wholesale price of power in the Ontario market. As part of this contract, sales from the Bruce B Units 5 to 8 are subject to a floor price of \$45.99 per MWh (\$45.00 to March 31, 2006), adjusted annually for inflation on April 1. Payments received pursuant to the Bruce B floor price mechanism may be subject to a recapture payment dependent on annual spot prices over the term of the contract. Bruce B net earnings to December 31, 2006 included no amounts received pursuant to this floor mechanism.

The overall plant availability percentage in 2007 is expected to be in the low 90s for the four Bruce B units and the mid 70s for the two operating Bruce A units. Two planned outages are scheduled for Bruce A Unit 3 with the first outage expected to last one month in second quarter 2007 and a second outage expected to last approximately two months beginning in late third quarter 2007. A one month outage of Bruce A Unit 4 is expected to commence in first quarter 2007. The only planned maintenance outage for 2007 for Bruce B is an approximately two and a half month outage for Unit 6 that began in January 2007 and is expected to be completed in early second quarter 2007.

#### 44 MANAGEMENT'S DISCUSSION AND ANALYSIS

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The Bruce partners have agreed that all excess cash from both Bruce A and Bruce B will be distributed on a monthly basis and that separate cash calls will be made for major capital projects, including the Bruce A restart and refurbishment project.

The project to restart and refurbish Bruce A Units 1 and 2 was initiated in 2005. Substantial work on the project began in 2006 after Bruce received formal acceptance of its environmental assessment from the Canadian Nuclear Safety Commission in July 2006. Bruce Power has separated Units 1 and 2 from the operating reactors in Units 3 and 4. At the end of December 2006, eight replacement steam generators had been delivered and preparations made for the installation in early 2007. Work on manufacturing the Unit 4 steam generators also occurred during the year.

Bruce Power's capital program for the restart and refurbishment project is expected to total approximately \$4.25 billion and TransCanada's approximately \$2.125 billion share will be financed through capital contributions to 2011. A capital cost risk-and reward-sharing schedule with the OPA is in place for spending below or in excess of the \$4.25 billion base case estimate. The first unit is expected to be online in late 2009, subject to approval by the Canadian Nuclear Safety Commission. Restarting Units 1 and 2, which have a capacity of approximately 1,500 MW, will boost the Bruce facilities' overall output to more than 6,200 MW. As at December 31, 2006, Bruce A had incurred \$1.092 billion in costs with respect to the restart and refurbishment project.

#### *Western Power Operations*

As at December 31, 2006, Western Power Operations directly controlled approximately 2,100 MW of power supply in Alberta from its three long-term PPAs and five natural gas-fired cogeneration facilities. The Western Power Operations power supply portfolio comprises approximately 1,700 MW of low-cost, base-load coal-fired generation supply and approximately 400 MW of natural gas-fired cogeneration assets. This supply portfolio is among the lowest-cost, most competitive generation in the Alberta market area. The three long-term PPAs include the December 31, 2005 acquisition of the remaining rights and obligations of the 756 MW Sheerness PPA in addition to the Sundance A and Sundance B PPAs acquired in 2001 and 2002, respectively. The Sheerness PPA was acquired from the Alberta Balancing Pool for \$585 million on December 31, 2005 and has a remaining term of approximately 14 years. The PPAs entitle TransCanada to the output capacity of these coal facilities, ending in 2017 to 2020. The success of Western Power Operations is the direct result of its two integrated functions – marketing and plant operations.

The marketing function, based in Calgary, Alberta, purchases and resells electricity sourced from the PPAs, markets uncommitted generation volumes from the cogeneration facilities, and purchases and resells power and gas to maximize the value of the cogeneration facilities. The marketing function is integral to optimizing Energy's return from its portfolio of power supply and managing risks around uncontracted volumes. A portion of TransCanada's supply is held for sale in the spot market for operational reasons and is also dependent upon the availability of acceptable contract terms in the forward market. This approach to portfolio management assists in minimizing costs in situations where TransCanada would otherwise have to purchase power in the open market to fulfil its contractual obligations. In 2006, approximately 35 per cent of power sales volumes were sold into the spot market. To reduce exposure to spot market prices of uncontracted volumes, as at December 31, 2006, Western Power Operations entered into fixed price sales contracts to sell forward approximately 10,600 GWh for 2007 and 8,300 GWh for 2008.

Plant operations consist of five natural gas-fired cogeneration power plants located in Alberta with an approximate combined output capacity of 400 MW ranging from 27 MW to 165 MW per facility. A portion of the expected output is sold under long-term contracts and the remainder is subject to fluctuations in the price of power and gas. Market heat rate is an economic measure for natural gas-fired power plants determined by dividing the average price of power per MWh by the average price of natural gas per gigajoule (GJ) for a given period. To the extent power is not sold under long-term contracts and plant fuel gas has not been purchased under long-term contracts, the higher the market heat rate, the more profitable is a natural gas-fired generating facility. Market heat rates in Alberta increased in 2006 by more than 60 per cent as a result of a decrease in average spot market natural gas prices combined with an increase in power prices. Market heat rates averaged approximately 13.5 GJ/MWh in 2006 compared to approximately 8.3 GJ/MWh in 2005. The market heat rates are expected to return to more modest levels in 2007.

All plants in Western Power Operations operated with an average plant availability in 2006 of approximately 88 per cent compared to 85 per cent in 2005. Bear Creek returned to service in mid 2006 after experiencing an unplanned outage in 2005 resulting from technical difficulties with its gas turbine. Since its return to service, it has operated as expected.

### Western Power Operations Results-at-a-Glance

Year ended December 31 (millions of dollars)

	2006	2005	2004
Revenues			
Power	1,185	715	606
Other <sup>(1)</sup>	169	158	120
	<b>1,354</b>	873	726
Commodity purchases resold			
Power	(767)	(476)	(377)
Other <sup>(1)</sup>	(135)	(104)	(64)
	<b>(902)</b>	(580)	(441)
Plant operating costs and other	(135)	(149)	(125)
Depreciation	(20)	(21)	(22)
Operating income	<b>297</b>	123	138

<sup>(1)</sup> Includes Cancarb Thermax and natural gas sales.

### Western Power Operations Sales Volumes

Year ended December 31 (GWh)

	2006	2005	2004
<b>Supply</b>			
Generation	2,259	2,245	2,105
Purchased			
Sundance A & B and Sheerness PPAs	12,712	6,974	6,842
Other purchases	1,905	2,687	2,748
	<b>16,876</b>	11,906	11,695
<b>Contracted vs. Spot</b>			
Contracted	11,029	10,374	10,705
Spot	5,847	1,532	990
	<b>16,876</b>	11,906	11,695

Operating income in 2006 of \$297 million was \$174 million higher than the \$123 million earned in 2005. This increase was primarily due to incremental earnings from the December 31, 2005 acquisition of the 756 MW Sheerness PPA and increased margins from a combination of

higher overall realized power prices and higher market heat rates on uncontracted volumes of power sold. Revenues and commodity purchases resold increased in 2006 compared to 2005 primarily due to the acquisition of the Sheerness PPA, as well as higher realized power prices. Plant operating costs and other, which include fuel gas consumed in generation, decreased due to lower natural gas prices. Purchased power

[46](#) MANAGEMENT'S DISCUSSION AND ANALYSIS

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volumes in 2006 increased compared to 2005 primarily due to the acquisition of the Sheerness PPA. In 2006, approximately 35 per cent of power sales volumes were sold into the spot market compared to 13 per cent in 2005.

Operating income for 2005 was \$123 million or \$15 million lower compared to \$138 million earned in 2004. This decrease was primarily due to reduced margins in 2005 resulting from the lower market heat rates on uncontracted volumes of power generated, fee revenues earned in 2004 from Power LP and a lower contribution from Bear Creek. Revenues and commodity purchases resold increased in 2005, compared to 2004, primarily due to higher realized prices. Plant operating costs and other, which include fuel gas consumed in generation, increased due to higher operating and fuel usage costs at MacKay River resulting from a full year of operation and higher natural gas prices. Generation volumes in 2005 increased compared to 2004 primarily due to a full year of operations at MacKay River, partially offset by an unplanned outage at Bear Creek. TransCanada ceased to earn fees to manage and operate Power LP's plants with the sale of Power LP in August 2005. In 2005, approximately 13 per cent of power sales volumes were sold into the spot market compared to eight per cent in 2004.

#### *Eastern Power Operations*

Eastern Power Operations conducts its business primarily in the deregulated New England power market and in eastern Canada. In the New England market, Eastern Power Operations has established a successful marketing operation and in 2006, significantly increased its marketing presence. Growth in generation capacity in eastern Canada was also significant. The first of the six Cartier Wind wind farm projects, Baie-des-Sables, was placed in service in November 2006. The 550 MW Bécancour power plant near Trois Rivières, Québec began operations in September 2006. Including facilities that are under construction or in development, Eastern Power Operations owns approximately 3,200 MW of power generation capacity. To reduce exposure to spot market prices of uncontracted volumes, as at December 31, 2006, Eastern Power Operations had fixed price sales contracts to sell forward approximately 11,900 GWh for 2007 and 9,600 GWh for 2008.

Eastern Power Operations' success in the New England deregulated power markets is the direct result of a knowledgeable, region-specific marketing operation which is conducted through its wholly owned subsidiary, TransCanada Power Marketing Ltd. (TCPM), located in Westborough, Massachusetts. TCPM has firmly established itself as a leading energy provider and marketer in the region and is focused on selling power under short-and long-term contracts to wholesale, commercial and industrial customers while managing a portfolio of power supplies sourced from both its own generation and wholesale power purchases. TCPM is a full requirement electric service provider offering varied products and services to assist customers in managing their power supply and power prices in volatile deregulated power markets.

Eastern Power Operations' current operating power generation assets are TC Hydro, OSP, Bécancour, Grandview and the Baie-des-Sables wind farm. The TC Hydro assets include 13 hydroelectric stations housing 39 hydroelectric generating units on the Connecticut River System in New Hampshire and Vermont and the Deerfield River System in Massachusetts and Vermont. Water flows in 2006 through the hydro assets were above long-term averages as a result of higher precipitation in the areas surrounding the river systems. These higher than expected water flows were partially offset by lower than expected power prices in the market during 2006.

OSP is a 560 MW natural gas-fired plant located in Rhode Island, owned 100 per cent by TransCanada. In 2006, plant availability and utilization of the OSP facility improved compared to 2005. OSP realized lower overall natural gas fuel supply costs in 2006 compared to 2005 due to lower spot prices of natural gas as a result of a restructuring of its long-term gas supply contracts which took place in 2005.

Bécancour is a 550 MW natural gas-fired cogeneration plant located near Trois Rivières, Québec. After nearly three years of planning and construction, and an investment of approximately \$500 million, Bécancour was placed in service in September 2006. The facility is capable of generating approximately 4,500 GWh of power per year. Under long-term contracts, the facility will supply electricity to Hydro-Québec to help meet growing electricity demands and provide an important source of steam for industrial processes.

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Grandview is a 90 MW natural gas-fired cogeneration facility on the site of the Irving Oil Refinery (Irving) in Saint John, New Brunswick. Under a 20-year tolling arrangement which will expire in 2025, Irving supplies fuel for the plant and contracts for 100 per cent of the plant's heat and electricity output.

Eastern Power Operations' growing presence in eastern Canada is represented by the development of the Portlands Energy project and the Halton Hills power plant and construction in 2007 on the second and third of six proposed wind farms of the Cartier Wind project.

In November 2006, the Baie-des-Sable wind farm went into commercial operation and is currently one of the largest wind farms in Canada, providing up to 110 MW of power to the Hydro Québec grid. Baie-des-Sable is the first phase of a multi-phase, multi-year project called the Cartier Wind project that is owned 62 per cent by TransCanada. The other phases of Cartier Wind will continue, subject to future appropriations and approvals, through 2012 at six different locations in the Gaspé region of Québec and capacity is expected to total 740 MW when all phases are complete. Commitments are in place for the 100 MW Anse à Valteau phase and the 100 MW Carleton phase. Anse à Valteau is presently under construction and is expected to be placed into commercial service during third quarter 2007 and construction at Carleton will commence in late 2007 with expected commercial service to begin in fourth quarter 2008.

In September 2006, Portlands Energy, a 50/50 partnership between Ontario Power Generation and TransCanada, announced that it had signed a 20-year ACES contract with the OPA to construct a 550 MW high efficiency, combined-cycle natural gas generation plant to be located in downtown Toronto, Ontario. The capital cost of the Portlands Energy project is estimated to be approximately \$730 million and is expected to be operational in simple cycle mode, delivering 340 MW of electricity to the City of Toronto, beginning June 1, 2008. Upon the expected completion in second quarter 2009, the Company anticipates that this plant will provide up to 550 MW of power under the ACES contract.

In November 2006, TransCanada announced that it had been awarded a 20-year Greater Toronto Area (GTA) West Trafalgar Clean Energy Supply contract by the OPA to build, own and operate a 683 MW natural gas-fired power plant near the town of Halton Hills, Ontario. TransCanada expects to invest approximately \$670 million in the Halton Hills Generating Station, which is anticipated to be in service in second quarter 2010.

On June 15, 2006, the FERC approved a settlement agreement to implement a newly-designed Forward Capacity Market (FCM) for power generation in the New England power markets. The FCM design is intended to promote investment in new and existing power resources needed to meet the growing consumer demand and maintain a reliable power system. The settlement agreement provides for a multi-year transition period beginning in December 2006 and ending in 2010, whereby fixed payments, ranging from US\$3.05 to US\$4.10 per kilowatt-month, will be made to owners of existing installed capacity. These payments will be reduced in the event of facility-forced outages. Eastern Power Operations' 560 MW OSP plant and 567 MW TC Hydro generation facilities are eligible to receive payments during the transition period starting in December 2006. Under the new FCM design, Independent System Operator New England will project the needs of the power system three years in advance and then hold an annual auction to purchase power resources to satisfy a region's future needs. June 1, 2010 is identified as the first period for which suppliers would receive payments pursuant to the FCM auction mechanism.

### 48 MANAGEMENT'S DISCUSSION AND ANALYSIS

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**Eastern Power Operations Results-at-a-Glance<sup>(1)</sup>***Year ended December 31 (millions of dollars)*

	2006	2005	2004
Revenues			
Power	789	505	535
Other <sup>(2)</sup>	292	412	238
	<b>1,081</b>	917	773
Commodity purchases resold			
Power	(379)	(215)	(288)
Other <sup>(2)</sup>	(257)	(373)	(211)
	<b>(636)</b>	(588)	(499)
Plant operating costs and other	(226)	(167)	(146)
Depreciation	(32)	(25)	(20)
Operating income	<b>187</b>	137	108

(1) Curtis Palmer is included until April 30, 2004.

(2) Other includes natural gas.

**Eastern Power Operations Sales Volumes<sup>(1)</sup>***Year ended December 31 (GWh)*

	2006	2005	2004
<b>Supply</b>			
Generation	4,700	2,879	1,467
Purchased	3,091	2,627	4,731
	<b>7,791</b>	5,506	6,198
<b>Contracted vs. Spot</b>			
Contracted	7,374	4,919	6,055
Spot	417	587	143
	<b>7,791</b>	5,506	6,198

(1) Curtis Palmer is included until April 30, 2004.

Operating income for 2006 was \$187 million or \$50 million higher than the \$137 million earned in 2005. This increase is primarily due to incremental income from the full year of ownership of the TC Hydro assets, the placing into service of the 550 MW Bécancour cogeneration plant in September 2006, a \$10-million after-tax one-time restructuring payment in first quarter 2005 from OSP to its natural gas fuel suppliers,

and higher overall margins on power sales volumes in 2006. Partially offsetting these increases was the negative impact of a weaker U.S. dollar in 2006 compared to 2005.

Eastern Power Operations' revenues in 2006 were \$1,081 or \$164 million higher than the \$917 million earned in 2005. This is due to the placing into service of the Bécancour facility, increased sales volumes to commercial and industrial customers, and higher realized prices. Other revenue and other commodity purchases resold decreased year-over-year as a result of a reduction in the quantity of natural gas purchased and resold under the new natural gas supply contracts at OSP. Power commodity purchases resold were higher in 2006 due to the impact of higher purchased volumes,



combined with higher prices for purchased power. Purchased power volumes were higher in 2006 due to higher contracted sales volumes, partially offset by the increased power generation from the purchase of the TC Hydro assets as volumes generated from the TC Hydro assets reduced the requirement to purchase power to fulfil contractual sales obligations. Plant operating costs and other in 2006 were higher primarily due to the full year of operations of the TC Hydro assets as well as the placing into service of the Bécancour and Baie-des-Sables facilities.

Operating income for 2005 was \$137 million or \$29 million higher than the \$108 million earned in 2004. The incremental income from the acquisition of the TC Hydro assets and income from the Grandview cogeneration facility were the primary reasons for this increase. Partially offsetting these increases were the contract restructuring payment made by OSP in first quarter 2005, a \$10-million after-tax reduction in income as a result of the sale of Curtis Palmer to Power LP in April 2004, and a loss of operating income primarily associated with the expiration of certain long-term sales contracts in 2004.

*Power LP Divestiture*

On August 31, 2005, TransCanada sold all of its interest in Power LP to EPCOR for net proceeds of \$523 million resulting in an after-tax gain of \$193 million. This divestiture included approximately 14.5 million partnership units, representing approximately 30.6 per cent of the outstanding units, 100 per cent of the general partnership of Power LP, and management and operations agreements governing the ongoing operation of Power LP's generation assets. TransCanada's investment in Power LP generated operating income of \$29 million in each of 2005 and 2004.

*Plant Availability*

Weighted average power plant availability for all plants, excluding Bruce Power, was 93 per cent in 2006 compared to 87 per cent in 2005 and 96 per cent in 2004. Plant availability represents the percentage of time in the year that the plant is available to generate power, whether actually running or not, and is reduced by planned and unplanned outages. Western Power Operations' plant availability was impacted in 2006 and 2005 by an unplanned outage at Bear Creek, which returned to service in August 2006. An additional planned outage was taken in 2005 at the MacKay River facility, further decreasing the plant availability for Western Power Operations in 2005. Availability of 95 per cent was achieved in Eastern Power Operations in 2006. Availability was lower in 2005 as a result of OSP experiencing two significant outages.

**Weighted Average Plant Availability<sup>(1)</sup>**

*Year ended December 31*

	2006	2005	2004
Bruce Power <sup>(2)</sup>	<b>88%</b>	80%	82%
Western Power Operations <sup>(3)</sup>	<b>88%</b>	85%	95%
Eastern Power Operations <sup>(4)</sup>	<b>95%</b>	83%	95%
Power LP investment <sup>(5)</sup>		94%	97%
All plants, excluding Bruce Power investment	<b>93%</b>	87%	96%
All plants	<b>91%</b>	84%	90%

(1) Plant availability represents the percentage of time in the period that the plant is available to generate power, whether actually running or not and is reduced by planned and unplanned outages.

(2) Bruce A Unit 3 is included effective March 1, 2004.

(3) The Sheerness PPA is included in Western Power Operations, effective December 31, 2005.

(4) TC Hydro, Bécancour and Cartier Wind's Baie-des-Sables are included in Eastern Power Operations effective April 1, 2005, September 17, 2006 and November 21, 2006, respectively.

(5)

Power LP is included to August 31, 2005.

**50** MANAGEMENT'S DISCUSSION AND ANALYSIS

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*Natural Gas Storage*

With the completion of the 50 Bcf Edson storage facility, TransCanada became one of the largest natural gas storage providers in western Canada in 2006. TransCanada owns or controls 138 Bcf of natural gas storage capacity in Alberta, which includes a 60 per cent ownership interest in CrossAlta Gas Storage & Services Ltd. (CrossAlta), an independently operated 50 Bcf storage facility. TransCanada also has contracts for 38 Bcf in 2007 of long-term, Alberta-based storage capacity from a third party.

**Natural Gas Storage Capacity**

	Working Gas Storage Capacity (Bcf)	Maximum Injection/ Withdrawal Capacity (mmcf/d)
Edson	50	725
CrossAlta	50	480
Third Party Storage (for 2007)	38	630
	138	1,835

TransCanada believes the market fundamentals for natural gas storage are strong. The additional gas storage capacity will help balance seasonal and short-term supply and demand, and provide flexibility to the supply of natural gas to Alberta and North America. The increasing seasonal imbalance in North American natural gas supply and demand has increased gas price volatility and the demand for storage service.

Alberta-based storage will continue to serve market needs and could play an important role should northern gas be connected to North American markets. Energy's natural gas storage business operates independently from TransCanada's regulated natural gas transmission business.

TransCanada manages its exposure to seasonal gas price spreads by hedging storage capacity with a portfolio of third party storage contracts and gas purchases and sales. TransCanada offers a broad range of flexible injection and withdrawal storage alternatives specific to customer needs in multi-year contract terms. In addition to term gas storage contracts, TransCanada actively manages its storage assets with a combination of gas hedging activities and short-term third party contracts to take advantage of market opportunities and meet unique customer needs. Market volatility frequently creates arbitrage opportunities and TransCanada offers market centre solutions to capture these short-term price movements. Market centre products consist of short-term deliver-redeliver contracts, parking, peak-day supply and other related services.

The Edson storage operation is an underground natural gas storage facility consisting of a single depleted reservoir, the Viking D pool, a central processing facility and associated pipeline gathering system. The plant is located near Edson, Alberta. The Viking D pool produced approximately 71 Bcf of gas over its productive life from the 1980's to early 2004. The natural gas storage facility is expected to have a working natural gas capacity of approximately 50 Bcf, is connected to TransCanada's Alberta System and has a central processing system capable of maximum injection and withdrawal rates of 725 mmcf/d of natural gas. Construction of the Edson facility was substantially completed in 2006 and placed into service on December 31, 2006.

The CrossAlta storage facility is a 50 Bcf natural gas storage facility located near the town of Crossfield, Alberta. CrossAlta is a joint venture with BP Canada that has been in operation since 1994 and markets its own storage capacity and services. Gas is stored in a depleted gas reservoir that has been used to produce gas at this location since the 1960s. CrossAlta successfully completed a major expansion in the fall of 2005. The expansion increased total working natural gas capacity from 40 Bcf to 50 Bcf, with the potential to expand to 80 Bcf. The storage facility has a peak withdrawal capacity of 480 mmcf/d with the potential to expand to 1,000 mmcf/d.

The third-party natural gas storage capacity contracted by TransCanada is also located in Alberta. The capacity has increased annually from 18 Bcf in 2005 to 28 Bcf in 2006 and is expected to reach 38 Bcf in 2007. The contract expires in 2030, subject to mutual early termination rights in 2015.

Natural Gas Storage operating income of \$93 million for the year ended December 31, 2006 increased \$61 million and \$66 million, compared to 2005 and 2004, respectively. The increases were primarily due to higher contributions from CrossAlta as a result of increased capacity and higher natural gas storage spreads, and income from contracted third-party natural gas storage capacity. The Edson facility did not contribute to earnings in 2006 as the asset was placed into service on December 31, 2006.

#### *LNG Projects*

TransCanada continues to pursue two LNG proposals, the Broadwater and Cacouna projects. Broadwater, a joint venture with Shell US Gas & Power LLC (Shell), is a proposed LNG facility in the New York and Connecticut State waters in Long Island Sound. The Broadwater terminal would be capable of receiving, storing, and regassifying imported LNG with an average send-out capacity of approximately 1 Bcf/d of natural gas. TransCanada, on behalf of Broadwater, filed an application in January 2006 with the FERC for approval of the project. The U.S. Coast Guard issued a report which determined that the waterways associated with the project are suitable if additional measures are implemented to manage the safety and security risks associated with the project. Broadwater's application to the New York Department of State for a determination that the project is consistent with New York's coastal zone policies was deemed complete by the state in November 2006. Also in November, the FERC issued a Draft Environmental Impact Statement to fulfil the requirements of the *National Environmental Policy Act* and the FERC's implementing regulations. The Statement concludes that with strict adherence to federal and state permit requirements and regulations, Broadwater's proposed mitigation measures and the FERC's recommendations, the Broadwater project will not result in a significant impact on the environment. At December 31, 2006, the Company had capitalized \$31 million related to Broadwater.

Cacouna, a joint venture with Petro-Canada, is a proposed LNG project at the Gros Cacouna harbour on the St. Lawrence River in Québec. The proposed terminal would be capable of receiving, storing, and regassifying imported LNG with an average throughput capacity of approximately 500 mmcf/d of natural gas. A public hearing on the Cacouna facility was held in May and June 2006. In December 2006, the Québec government released the report of the Joint Commission on the Cacouna Energy project, which contained several recommendations and opinions but appears to be favourable to the project. TransCanada continues to work towards gaining regulatory approval and, if the necessary approvals are obtained, the facility is anticipated to be in service by 2010.

#### **ENERGY OPPORTUNITIES AND DEVELOPMENTS**

TransCanada is committed to growing its North American Energy business through acquisitions and development of greenfield opportunities in markets it knows and has a competitive advantage primarily western Canada, the northwestern U.S., eastern Canada and the northeastern U.S. The North American energy industry is expansive and will provide many opportunities for greenfield growth in power generation, power infrastructure projects and natural gas storage. In addition to greenfield growth opportunities, TransCanada will endeavour to pursue acquisitions resulting from industry and corporate restructurings and corporate bankruptcies. In addition to natural gas-fired facilities, Energy will focus on generation sourced from wind, hydro and nuclear. Its diverse power supply portfolio will continue to include low-cost, base-load facilities with low operating costs and high reliability, which may be underpinned by secure long-term contracts.

The Bécancour natural gas-fired cogeneration power plant and the first of six wind farms in the Cartier Wind project, both located in Québec, were placed in service in 2006. The remaining five Cartier Wind farms will continue, although certain phases of the project are subject to future appropriations and approvals. Construction began in 2006 on Portlands Energy's 550 MW, combined cycle natural gas generation plant in downtown Toronto. In 2006, TransCanada also announced that it had been awarded a 20-year GTA West Trafalgar Clean Energy Supply contract by the OPA to build, own and operate a 683 MW natural gas-fired power plant near the town of Halton Hills, Ontario which is

#### **52 MANAGEMENT'S DISCUSSION AND ANALYSIS**

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expected to be completed in 2010. The Bruce A restart and refurbishment continued in 2006 and Units 1 and 2 are expected to be restarted in late 2009 or early 2010.

Construction of the 50 Bcf Edson natural gas storage facility was substantially completed and the facility placed into service on December 31, 2006.

TransCanada is pursuing two LNG projects, Broadwater and Cacouna. Broadwater is a joint project with Shell to build a 1 Bcf/d LNG facility in the waters of the Long Island Sound. Cacouna is a joint venture with Petro-Canada to construct a 500 mmcf/d LNG facility at Gros Cacouna.

## **ENERGY BUSINESS RISKS**

### *Fluctuating Power and Natural Gas Market Prices*

TransCanada operates in competitive, generally deregulated power and natural gas markets in North America. Volatility in power and natural gas prices is caused by various market forces such as fluctuating supply and demand which are greatly affected by weather events. Energy's earnings from the sale of uncontracted volumes are subject to price volatility. Although Energy commits a significant portion of its supply to medium- to long-term sales contracts, it retains an amount of unsold supply in order to provide flexibility in managing the Company's portfolio of owned assets. The Company's risk management practices are described further in the section on Risk Management. See the "Uncontracted Volumes" section below.

### *Uncontracted Volumes*

Energy has certain uncontracted power sales volumes in Western and Eastern Power Operations and through its investment in Bruce Power. Sale of uncontracted power volumes into the spot market is subject to market price volatility which directly impacts earnings. Bruce B has a significant amount of uncontracted volumes sold into the wholesale power spot market while 100 per cent of the Bruce A output is sold to the OPA under fixed-price contract terms. The natural gas storage business is subject to fluctuating natural gas seasonal spreads generally determined by the differential in natural gas prices in the traditional summer injection and winter withdrawal seasons. As a result, the Company hedges capacity with a portfolio of contractual commitments with varying terms.

### *Plant Availability*

Maintaining plant availability is essential to the continued success of the Energy business. Plant operating risk is mitigated through a commitment to TransCanada's operational excellence strategy that provides low-cost, reliable operating performance at each of the Company's facilities. Unexpected plant outages and/or the duration of outages could result in lower plant output and sales revenue, reduced margins and increased maintenance costs. At certain times, unplanned outages may require power or natural gas purchases at market prices to enable TransCanada to meet its contractual obligations.

### *Weather*

Extreme temperature and weather events in North America and the Gulf of Mexico often create price volatility and demand for power and natural gas. These same events may also restrict the availability of power and natural gas. Seasonal changes in temperature can also affect the efficiency and output capability of natural gas-fired power plants. Variability in wind speeds may impact the earnings of the Cartier Wind assets in Québec.

### *Hydrology*

Energy's power business is subject to hydrology risk with its ownership of hydroelectric power generation facilities in the northeastern U.S. Weather changes, weather events, local river management and potential dam failures at these plants or upstream facilities pose potential risks to the Company.

*Execution and Capital Cost*

Energy's new construction program in Ontario and Québec, including its investment in Bruce Power, is subject to execution and capital cost risk. At Bruce Power, Bruce A's four unit restart and refurbishment program is also subject to a capital cost risk- and reward-sharing mechanism with the OPA.

*Asset Commissioning*

Recently constructed assets including Edson, Baie-des-Sables and Bécancour were all placed in service during 2006 and are in the first full year of operation in 2007. Although all of TransCanada's newly constructed assets go through rigorous acceptance testing prior to being placed in service, there is a risk that these assets may have lower than expected availability or performance, especially in the assets' first year of operations.

*Power Regulatory*

TransCanada operates in both regulated and deregulated power markets. As electricity markets evolve across North America, there is the potential for regulatory bodies to implement new rules that could negatively impact TransCanada as a generator and marketer of electricity. These may be in the form of market rule changes, price caps, emission controls, unfair cost allocations to generators or attempts to control the wholesale market by encouraging new plant construction. TransCanada continues to monitor regulatory issues and reform as well as participate in and lead discussions around these topics.

For information on management of risks with respect to the Energy business, refer to the "Risks and Risk Management" section of this MD&A.

**ENERGY OUTLOOK**

In Energy, net earnings in 2007 are expected to approximate or be slightly lower than 2006 net earnings due to the non-recurring \$23-million future tax benefit in 2006 arising from reductions in federal and provincial income tax rates. Operating income is expected to be relatively consistent with 2006, although this is very dependent on commodity prices in each region as well as other factors such as hydrology and storage spreads. TransCanada's operating income from its investment in Bruce B can be significantly impacted by the effect, on uncontracted output, of changes in spot market prices for power. Excluding any changes in spot market prices for 2007 compared to 2006, Bruce Power's operating income is expected to decline in 2007 compared to 2006, reflecting lower projected generation volumes and higher operating costs resulting from an increase in planned outages in 2007. Western Power Operations' operating income in 2007 is expected to approximate 2006. Although TransCanada has sold forward significant output from its Alberta PPAs and power plants, Western Power Operations' operating income in 2007 can be significantly impacted by changes in the spot market price of power and market heat rates in Alberta. Eastern Power Operations' operating income is expected to increase in 2007 primarily due to a full year of operations for both the Bécancour natural gas-fired cogeneration facility and the first of six wind farms of the Cartier Wind project as well as the positive impact of the NEPOOL forward capacity payments received by OSP and TC Hydro commencing December 1, 2006. Gas Storage's operating income is expected to increase in 2007 over 2006 primarily due to the placing into service of the Edson facility at the end of 2006, partially offset by expected lower storage spreads.

The earnings outlook for Energy may be affected by factors such as fluctuating market prices for power and natural gas, market heat rates, sales of uncontracted power volumes, natural gas storage spreads, plant availability, regulatory changes, weather, currency movements, and overall stability of the energy industry. See "Energy Business Risks" for a complete discussion of these factors.

**54 MANAGEMENT'S DISCUSSION AND ANALYSIS**

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## CORPORATE

## CORPORATE RESULTS-AT-A-GLANCE

Year ended December 31 (millions of dollars)

	2006	2005	2004
Indirect financial charges and non-controlling interests	136	130	79
Interest income and other	(43)	(29)	(34)
Income taxes	(132)	(65)	(43)
Net (earnings)/expenses, after tax	(39)	36	2

Corporate reflects net expenses not allocated to specific business segments, including:

*Indirect Financial Charges and Non-Controlling Interests* Direct financial charges are reported in their respective business segments and are primarily associated with the debt and preferred securities related to the Company's wholly owned pipelines. Indirect financial charges, including the related foreign exchange impacts, primarily reside in Corporate. These costs are directly impacted by the amount of debt that TransCanada maintains and the degree to which TransCanada is impacted by fluctuations in interest rates and foreign exchange.

*Interest Income and Other* Interest income includes interest earned on invested cash balances and income tax refunds. Gains and losses on foreign exchange related to working capital in Corporate are also included in interest income and other.

*Income Taxes* Income tax recoveries includes income taxes calculated on Corporate's net expenses as well as income tax refunds and adjustments.

Net earnings, after tax, in Corporate were \$39 million in 2006 compared to net expenses of \$36 million in 2005 and \$2 million in 2004.

The increase of \$75 million in net earnings in 2006, compared to 2005, was primarily due to a \$50-million income tax benefit related to the resolution of certain income tax matters reported in third quarter 2006, \$12 million of income tax refunds and related interest income in fourth quarter 2006, and a \$10-million favourable impact on future income taxes arising from reductions in Canadian federal and provincial corporate income tax rates in second quarter 2006. In addition, net earnings in 2006 were positively impacted by the effect of a weaker U.S. dollar.

The increase of \$34 million in net expenses in 2005 compared to 2004 was primarily due to increased interest expense on higher average long-term debt and commercial paper balances in 2005 as well as the release in 2004 of previously established restructuring provisions. Income tax refunds and positive tax adjustments were comparable in 2004 and 2005.

Corporate's net expenses are expected to be higher in 2007 compared to 2006 primarily due to income tax refunds and positive income tax adjustments realized in 2006 that are not expected to recur in 2007. Financing costs associated with the acquisition of ANR are expected to increase net expenses in Corporate in 2007. In addition, Corporate's results could be impacted by debt levels, interest rates, foreign exchange movements and income tax refunds and adjustments. The performance of the Canadian dollar relative to the U.S. dollar will either positively or negatively impact Corporate's results, although this impact is mitigated by offsetting exposures in certain of TransCanada's other businesses as well as through the Company's hedging activities.

**DISCONTINUED OPERATIONS**

In 2006, the Company recognized income from discontinued operations of \$28 million, reflecting bankruptcy settlements with Mirant related to TransCanada's Gas Marketing business divested in 2001. In 2005, the Company reviewed the provision for loss on discontinued operations and concluded that the provision was adequate. In 2004, \$52 million was recognized in income which related to the original \$102 million after-tax deferred gain included in the sale of the Gas Marketing business.

**LIQUIDITY AND CAPITAL RESOURCES****Summarized Cash Flow**

*Year ended December 31 (millions of dollars)*

	<b>2006</b>	2005	2004
Funds generated from operations	<b>2,378</b>	1,951	1,703
(Increase)/decrease in working capital	<b>(303)</b>	(49)	29
Net cash provided by operations	<b>2,075</b>	1,902	1,732
Net cash used in investing activities	<b>(2,116)</b>	(1,336)	(1,648)
Net cash provided by/(used in) financing activities	<b>219</b>	(556)	(150)
Effect of foreign exchange rate changes on cash and short-term investments	<b>9</b>	11	(87)
Increase/(decrease) in cash and short-term investments	<b>187</b>	21	(153)
Cash and short-term investments beginning of year	<b>212</b>	191	344
Cash and short-term investments end of year	<b>399</b>	212	191

**HIGHLIGHTS***Investing Activities*

At December 31, 2006, total capital expenditures and acquisitions, including assumed debt, were approximately \$7.0 billion over the past three years.

*Dividend*

TransCanada's Board of Directors declared a \$0.34 per common share dividend for the quarter ending March 31, 2007.

In January 2007, TransCanada's Board of Directors authorized the issue of common shares from treasury at a two per cent discount under the Company's DRP, beginning with the dividend payable April 30, 2007 to shareholders of record at March 30, 2007.

**56 MANAGEMENT'S DISCUSSION AND ANALYSIS**



*Funds Generated from Operations*

Funds generated from operations were \$2.4 billion in 2006 compared to \$2.0 billion and \$1.7 billion, in 2005 and 2004, respectively. The increase in 2006 compared to 2005 was mainly a result of higher net income, excluding gains, and lower current income tax expense. The Pipelines business was the primary source of funds generated from operations for each of the three years. As a result of rapid growth in the Energy business in the last few years, the Energy segment's funds generated from operations increased in 2006 compared to the two prior years.

At December 31, 2006, TransCanada's ability to generate adequate amounts of cash in the short term and the long term when needed, and to maintain financial capacity and flexibility to provide for planned growth, was consistent with recent years.

*Investing Activities*

Capital expenditures, totalled \$1,572 million in 2006 compared to \$754 million in 2005 and \$530 million in 2004, respectively. Expenditures in all three years related primarily to construction of new power plants and natural gas storage facilities in Canada as well as maintenance and capacity capital in the Pipelines business.

During 2006, PipeLines LP acquired an additional 49 per cent interest in Tuscarora, subject to closing adjustments, for US\$100 million, in addition to indirectly assuming US\$37 million of debt. In addition, PipeLines LP acquired an additional 20 per cent general partnership interest in Northern Border for US\$307 million, in addition to indirectly assuming US\$122 million of debt. At December 31, 2006, TransCanada held a 13.4 per cent interest in PipeLines LP. In 2006, TransCanada sold its 17.5 per cent general partner interest in Northern Border Partners, L.P. for proceeds of \$23 million.

During 2005, TransCanada acquired the remaining rights and obligations of the Sheerness PPA for \$585 million, invested a net cash outlay of \$100 million in Bruce A as part of the Bruce Power reorganization, purchased the TC Hydro assets from USGen New England, Inc. (USGen) for US\$503 million and acquired an additional 3.52 per cent ownership interest in Iroquois

for US\$14 million. TransCanada sold its ownership interest in Power LP for proceeds of \$444 million, net of current tax, its approximate 11 per cent ownership interest in Paiton Energy for proceeds of \$125 million, net of current tax, and PipeLines LP units for proceeds of \$102 million, net of current tax.

During 2004, TransCanada acquired GTN for US\$1.2 billion, excluding assumed debt of approximately US\$500 million, and sold the ManChief and Curtis Palmer power facilities to Power LP for US\$403 million, excluding closing adjustments.

*Financing Activities*

On February 22, 2007, the Company completed its acquisition of ANR and an additional interest in Great Lakes which was financed through issuance of a combination of debt and equity. At the same time, PipeLines LP completed the acquisition of its interest in Great Lakes which was financed through the issuance of a combination of debt and equity. These financings are summarized in the section "Subsequent Events" in this MD&A.

On February 15, 2007, the Company retired \$275 million of 6.05 per cent medium term notes. In 2006, TransCanada retired long-term debt of \$729 million and reduced its notes payable by \$495 million. In January 2006, the Company issued \$300 million of 4.3 per cent five-year medium-term notes due 2011. In March 2006, the Company issued US\$500 million of 5.85 per cent 30-year senior unsecured notes due 2036. In October 2006, TransCanada issued \$400 million of 4.65 per cent ten-year medium-term notes due 2016.

In April 2006, PipeLines LP borrowed US\$307 million under its unsecured credit facility to finance the cash portion of the purchase price of its acquisition of an additional 20 per cent interest in Northern Border. In December 2006, the credit facility was repaid in full and replaced with a US\$410 million syndicated revolving credit and term loan

agreement, of which US\$397 million was drawn as at December 31, 2006. Borrowings under the credit and term loan agreement will bear interest at the London interbank offered rate plus an applicable margin.

In 2005, TransCanada retired long-term debt of \$1,113 million and increased its notes payable by \$416 million. In June 2005, Gas Transmission Northwest Corporation (GTNC) redeemed all of its outstanding US\$150 million 7.8 per cent Senior Unsecured Debentures (Debentures) and US\$250 million 7.1 per cent Senior Unsecured Notes. As a consequence, upon application by GTNC, the Debentures were de-listed from the New York Stock Exchange and GTNC no longer has any securities registered under U.S. securities laws. In June 2005, GTNC also completed a US\$400-million multi-tranche private placement of senior debt with a weighted average interest rate of 5.28 per cent and weighted average life of approximately 18 years. In 2005, TransCanada also issued \$300 million of 5.1 per cent medium-term notes due 2017 under the Company's Canadian shelf prospectus.

In 2004, TransCanada retired long-term debt of \$1,005 million. The Company issued \$200 million of 4.1 per cent medium-term notes due 2009, US\$350 million of 5.6 per cent senior unsecured notes due 2034 and US\$300 million of 4.875 per cent senior unsecured notes due 2015. The Company increased its notes payable by \$179 million during 2004.

Financing activities included a net reduction in TransCanada's proportionate share of non-recourse debt of joint ventures of \$14 million in 2006 compared to \$42 million in 2005 and a net increase of \$105 million in 2004.

Dividends on common shares amounting to \$617 million were paid in 2006 compared to \$586 million in 2005 and \$552 million in 2004.

In January 2007, TransCanada's Board of Directors approved an increase in the quarterly common share dividend payment to \$0.34 per share from \$0.32 per share for the quarter ending March 31, 2007. This was the seventh consecutive year of dividend increase since the \$0.20 per share declared in fourth quarter 2000, which represents a 70 per cent increase in the dividend rate since 2000.

In January 2007, TransCanada's Board of Directors authorized the issue of common shares from treasury at a discount to participants in the Company's DRP. Under this plan, eligible shareholders may reinvest their dividends to obtain additional TransCanada common shares. Previously, shares purchased through the DRP were purchased by TransCanada on the open market and provided to DRP participants at cost. Commencing with the dividend payable in April 2007, the shares will be provided to the participants at a two per cent discount. The Company reserves the right to alter the discount or return to purchasing shares on the open market at any time.

At December 31, 2006, total credit facilities of \$2.1 billion were available to support the Company's commercial paper program and for general corporate purposes. Of this total, \$1.5 billion is a committed five-year term syndicated credit facility. The facility is extendible on an annual basis and is revolving. In December 2006, the maturity date of this facility was extended to December 2011. The remaining amounts are either demand or non-extendible facilities.

At December 31, 2006, TransCanada had used approximately \$190 million of its total lines of credit for letters of credit to support ongoing commercial arrangements. If drawn, interest on the lines of credit would be charged at prime rates of Canadian chartered and U.S. banks or at other negotiated financial bases.

TransCanada's issuer rating assigned by Moody's Investors Service (Moody's) is A3 with a stable outlook. TransCanada PipeLines Limited's (TCPL) senior unsecured debt is rated A, with a stable outlook, by Dominion Bond Rating Service Limited (DBRS); A2, with a stable outlook, by Moody's; and A-, with a negative outlook, by Standard and Poor's (S&P). DBRS had placed TCPL's rating under review with developing implications on December 22, 2006 as a result of the announcement of the acquisition of ANR and Great Lakes. Moody's and S&P reaffirmed their ratings after the announcement. On February 22, 2007, DBRS confirmed their rating and outlook for TCPL and removed the rating from being under review.

**CONTRACTUAL OBLIGATIONS***Obligations and Commitments*

Total long-term debt at December 31, 2006 was approximately \$11.5 billion compared to approximately \$10.0 billion at December 31, 2005. TransCanada's share of total debt of joint ventures at December 31, 2006 was \$1.3 billion compared to \$1.0 billion at December 31, 2005. Total notes payable at December 31, 2006, including TransCanada's proportionate share of the notes payable of joint ventures, were \$467 million compared to \$962 million at December 31, 2005. The security provided by each joint venture, except for the capital lease obligation at Bruce Power, is limited to the rights and assets of that joint venture and does not extend to the rights and assets of TransCanada, except to the extent of TransCanada's investment. TransCanada has provided certain pro-rata guarantees related to the capital lease obligations of Bruce Power.

**CONTRACTUAL OBLIGATIONS**

*Year ended December 31 (millions of dollars)*

	<b>Payments Due by Period</b>				
	Total	Less than one year	1 - 3 years	3 - 5 years	More than 5 years
Long-term debt	12,531	750	1,605	1,803	8,373
Capital lease obligations	250	8	20	28	194
Operating leases <sup>(1)</sup>	919	39	83	84	713
Purchase obligations	11,871	2,707	3,274	1,403	4,487
Other long-term liabilities reflected on the balance sheet	304	10	23	27	244
<b>Total contractual obligations</b>	<b>25,875</b>	<b>3,514</b>	<b>5,005</b>	<b>3,345</b>	<b>14,011</b>

(1) Represents future annual payments, net of sub-lease receipts, for various premises, services, equipment and a natural gas storage facility. The operating lease agreements for premises expire at various dates through 2016, with an option to renew certain lease agreements for three to five years. The operating lease agreement for the natural gas storage facility expires in 2030 with lessee termination rights every fifth anniversary commencing in 2010 and with the lessor having the right to terminate the agreement every five years commencing in 2015.

At December 31, 2006, scheduled principal repayments and interest payments related to long-term debt and the Company's pro