Trans Québec & Maritimes Pipeline Inc.

(As mandatary of TQM Pipeline and Company, Limited Partnership)

# MANAGEMENT DISCUSSION & ANALYSIS

DECEMBER 31, 2011

*The management's discussion and analysis (MD&A), dated April 13, 2012, should be read in conjunction with the accompanying audited financial statements of Trans Québec & Maritimes Pipeline Inc. (as mandatary of TQM Pipeline and Company, Limited Partnership) ("TQM Pipeline" or "the Company"), and the notes thereto for the year ended December 31, 2011 which are prepared in accordance with Canadian generally accepted accounting principles ("CGAAP"). This MD&A covers TQM Pipeline's financial position and operations as at and for the year ended December 31, 2011. Amounts are stated in Canadian dollars unless otherwise indicated. Additional information relating to TQM Pipeline, including continuous disclosure documents, is available on SEDAR at www.sedar.com under Trans Québec & Maritimes Pipeline Inc.*

## Forward Looking Information

*This MD&A contains certain information that is forward looking and is subject to important risks and uncertainties. The words ''anticipate'', ''expect'', ''believe'', ''may'', ''should'', ''estimate'', ''project'', ''outlook'', ''forecast'', ''intend'', ''target'', ''plan'' or other similar words are used to identify such forward-looking information. Forward-looking statements in this document are intended to provide information regarding TQM Pipeline and its subsidiaries, including management's assessment of TQM Pipeline's and its subsidiaries' future plans and financial outlook. Forward-looking statements in this document may include, but are not limited to, statements regarding:*

- *anticipated business prospects;*
- *financial performance of TQM Pipeline and its subsidiaries and affiliates;*
- *expectations or projections about strategies and goals for growth and expansion;*
- *expected cash flows;*
- *expected costs;*
- *expected costs for projects under construction;*
- *expected schedules for planned projects (including anticipated construction and completion dates);*
- *expected regulatory processes and outcomes;*
- *expected outcomes with respect to legal proceedings, including arbitration;*
- *expected capital expenditures;*
- *expected operating and financial results; and*
- *expected impact of future commitments and contingent liabilities.*

*These forward-looking statements reflect TQM Pipeline's beliefs and assumptions based on information available at the time the statements were made and as such are not guarantees of future performance. By their nature, forward-looking statements are subject to various assumptions, risks and uncertainties which could cause TQM Pipeline's actual results and achievements to differ materially from the anticipated results or expectations expressed or implied in such statements.*

*Key assumptions on which TQM Pipeline's forward-looking statements are based include, but are not limited to, assumptions about:*

- *inflation rates, commodity prices and capacity prices;*
- *regulatory decisions and outcomes;*
- *foreign exchange rates;*
- *interest rates;*
- *tax rates;*
- *planned and unplanned outages and utilization of the Company's pipeline assets;*
- *asset reliability and integrity;*
- *access to capital markets; and*
- *anticipated construction costs, schedules and completion dates;*

*The risks and uncertainties that could cause actual results or events to differ materially from current expectations include, but are not limited to:*

- *the ability of TQM Pipeline to successfully implement its strategic initiatives and whether such strategic initiatives will yield the expected benefits;*
- *the operating performance of the Company's pipeline assets;*
- *regulatory decisions and outcomes;*
- *outcomes with respect to legal proceedings, including arbitration;*
- *counterparty performance;*
- *changes in environmental and other laws and regulations;*
- *competitive factors in the pipeline sector;*
- *construction and completion of capital projects;*
- *labour, equipment and material costs;*
- *access to capital markets;*
- *interest and currency exchange rates;*
- *weather;*
- *technological developments; and*
- *economic conditions in North America.*

*Additional information on these and other factors is available in the reports filed by TQM Pipeline with Canadian securities regulators. Readers are cautioned against placing undue reliance on forward-looking information, which is given as of the date it is expressed in this MD&A or otherwise, and not to use future-oriented information or financial outlooks for anything other than their intended purpose. TQM Pipeline undertakes no obligation to publicly update or revise any forward-looking information in this MD&A or otherwise, whether as a result of new information, future events or otherwise, except as required by law.*

## System

Trans Québec & Maritimes Pipeline Inc. is the mandatary of TQM Pipeline and Company, Limited Partnership (the "Partnership"). The Company was formed to administer and manage the Partnership and to develop, construct, own and operate, as mandatary of the Partnership, a natural gas pipeline system. Gaz Métro Limited Partnership ("Gaz Métro") and TransCanada PipeLines Limited ("TransCanada") are the general partners, each with 49.995 per cent participation in the Partnership, and 3118240 Canada Inc. is the limited partner with the remaining 0.01 per cent participation. Gaz Métro and TransCanada are also equal shareholders of the Company, 3118240 Canada Inc. and TQM Finance Inc., the latter of which acts as a financial intermediary between the Company and the Partnership.

TQM Pipeline built and now operates an underground natural gas transmission system. Although the system is almost invisible on the surface, it crosses more than 75 municipalities and approximately 40 watercourses, including the St. Lawrence River in two places, near Montréal and Québec City in the Province of Québec. The pipeline is 572 kilometres ("km") long, including 3.5 km in a sub-fluvial tunnel near Québec City, and has a diameter ranging from 114 millimetres ("mm") to 762 mm.

In addition to the underground system, TQM Pipeline's facilities include two compressor stations and 31 delivery points in the following areas in the Province of Québec: Montréal, the Laurentians, the Mauricie, Québec City, the Montérégie and the Eastern Townships.

The registered office of the Company is located at 1 Place Ville-Marie, 39th Floor, Montréal, Québec, H3B 4M7. TQM Pipeline's administrative functions are performed from TransCanada's office in Calgary, Alberta.

## Mission

TQM Pipeline is an energy carrier with a mandate to develop and operate its pipeline system safely, efficiently and profitably across Québec and the Maritimes.

The Company's mission statement requires it to:

- promote the efficient use of natural gas;
- aim for high quality standards while using cost effective operational and administrative technologies;
- comply with all laws, regulations and bylaws, with the utmost respect for the environment; and
- contribute to the well-being and development of the communities in which it operates, acting as a good corporate citizen.

# Directors and Officers

## Directors

James Baggs
Vice-President
Operations and Engineering,
Operations & Major Projects Division

TransCanada PipeLines Limited
450 – 1st Street S.W.
Calgary (Alberta)  T2P 5H1

Patrick Cabana [(1)]
Vice-President
Gas Supply, Procurement and
Regulatory Affairs

Gaz Métro inc.
1717, rue du Havre
Montréal (Québec)  H2K 2X3

Pierre Despars
Executive Vice-President, Corporate
Affairs and Chief Financial Officer

Gaz Métro inc.
1717, rue du Havre
Montréal (Québec)  H2K 2X3

Karl Johannson [(2)]
Senior Vice-President
Canadian and Eastern U.S.
Pipelines, Pipelines Division

TransCanada PipeLines Limited
450 – 1st Street S.W.
Calgary (Alberta)  T2P 5H1

Katia Marquier [(2)]
Corporate Controller

Gaz Métro inc.
1717, rue du Havre
Montréal (Québec)  H2K 2X3

Steve Pohlod [(1)]
Vice-President
Commercial – East, Pipelines
Division

TransCanada PipeLines Limited
450 – 1st Street S.W.
Calgary (Alberta)  T2P 5H1

Stephanie Wilson [(1)] [(2)]
General Manager

Trans Québec & Maritimes Pipeline Inc.
c/o TransCanada PipeLines Limited
450 – 1st Street S.W.
Calgary (Alberta)  T2P 5H1

(1) Executive Committee
(2) Audit Committee

## Management

Stephanie Wilson
*General Manager*
Rhonda Amundson
*Chief Financial Officer*

Patrick Cabana
*Chief Executive Officer*
Michel Brunet
*Secretary*

## Highlights

| Years ended December 31 (dollar amounts in the table are in thousands) | 2011 | 2010 | 2009 |
|---|---|---|---|
| Operating revenues (1) (2) | $82,367 | $82,225 | $102,045 |
| Partners' income and comprehensive income (1) (3) | $19,380 | $17,182 | $27,129 |
| Total assets (1) | $395,890 | $414,694 | $439,211 |
| Total long-term debt (1) (4) | $235,500 | $175,000 | $95,000 |
| Total long-term liabilities(1) | $235,605 | $175,207 | $95,750 |
| Partners' withdrawals (1) | $24,802 | $13,251 | $2,000 |
| Approved average rate base | $393,702 | $412,938 | $431,934 |
| Approved rate of return on rate base(5) | N/A | N/A | 6.40% |
| Approved monthly tolls | $6,480 | $6,901 | $7,632 |
| Total natural gas deliveries | 4.3 $10^9m^3$ | 4.3 $10^9m^3$ | 4.6 $10^9m^3$ |
| Peak day (6) | 24.3 $10^6m^3$ | 24.5 $10^6m^3$ | 23.8 $10^6m^3$ |

(1) Prepared in accordance with CGAAP.

(2) Operating revenues for 2009 include $13,348,000 of transportation revenue relating to final tolls for 2007 and 2008.

(3) Partners' income and comprehensive income for 2009 includes approximately $10,600,000 relating to the National Energy Board's ("NEB") RH-1-2008 decision with respect to 2007 and 2008 tolls.

(4) Long-term debt is presented in the financial statements net of unamortized debt issue costs and prepaid interest of $1,353,000 ($1,396,000 in 2010 and $893,000 in 2009). The $69,900,000 revolving term loan matured on September 22, 2011 and was included in long-term debt due within one year in 2010. It was presented net of prepaid interest and unamortized debt costs of $121,000. In 2009, long-term debt did not include the $100 million principal amount 7.053% Series 'I' Bond ("Series 'I' Bond") or the $75 million principal amount 3.906% Series 'J' Bond ("Series 'J' Bond") which matured on September 22, 2010, both of which were included in long-term debt due within one year.

(5) The 2009 return on rate base was based on an after-tax weighted average cost of capital ("ATWACC") methodology. This methodology focuses on the overall cost of capital without specifying a capital structure or a rate of return on equity. The 2010 - 2012 Settlement Agreement ("Settlement Agreement") fixed the return on rate base and other cost components for 2011 and 2010 at $68,960,000 and $69,560,000, respectively, and did not specify a capital structure or a return on rate base.

(6) Historical peak day achieved for 2011 on January 24, 2011 - 24.3 $10^6m^3$.

## Tolls and Tariffs

### The Settlement Agreement

In November 2010, the NEB approved, pursuant to Board Order TG-07-2010, TQM Pipeline's Settlement Agreement with its interested parties with respect to its annual revenue requirement for the years 2010 to 2012. This settlement includes an annual revenue requirement comprised of fixed and flow-through components. The fixed component includes certain operating and maintenance costs, return on rate base, depreciation and municipal taxes. Any variances between actual costs and those included in the fixed component accrue to TQM Pipeline. Any variances between actual costs and those included in the flow-through component are recorded in deferral accounts and recovered in the following year's tolls.

### 2011 Final Toll

The Company filed its 2011 interim toll application in accordance with the Settlement Agreement in December 2010, requesting a monthly interim toll of $6,579,750. The application was approved by the NEB in December 2010 in Board Order TGI-03-2010, to be effective January 1, 2011. The final toll application was filed by the Company in May 2011 and approved by the Board Order TG-04-2011 in June 2011, approving a monthly final toll of $6,480,000, which reflects the terms of the Settlement Agreement.

### 2010 Final Toll

In December 2009, the Company filed an application with the NEB for approval of interim tolls, effective January 1, 2010, setting the tolls at a level that reflected a continuation of the revenue requirement reflected in the 2009 revised interim tolls approved by the NEB in Board Order AO-01-TGI-05-2008. The interim tolls application was approved by the NEB in Board Order TGI-07-2009 on December 24, 2009 authorizing a monthly interim toll of $7,632,417. In December 2010, the NEB approved the Company's final monthly toll of $6,900,833 for 2010 which reflects the terms of the Settlement Agreement.

### Future Abandonment Costs

The NEB's Land Matters Consultation Initiative deals with pipeline abandonment, including related financial issues. The goal of this initiative is for all pipeline companies regulated under the *National Energy Board Act* (Canada) to begin collecting and setting aside funds to cover future abandonment costs. In its May 2009 decision, the NEB established several filing deadlines relating to the financial issues, including deadlines for preparing and filing an estimate of the abandonment costs to be used to begin collecting funds, developing a proposal for collecting these funds through tolls or some other satisfactory method and developing a proposed process to set aside the funds collected. TQM Pipeline filed its estimates of abandonment costs for its natural gas pipeline in November 2011, as required by the NEB decision. These costs would be recovered from shippers through tolls in accordance with the NEB's determination that abandonment costs are a legitimate cost of providing service and are recoverable upon NEB approval from users of the system. The specific toll impacts have not yet been determined as they will be the subject of a subsequent NEB filing in late 2012.

For the foreseeable future, the Company intends to operate and maintain these assets as long as supply and demand exists for natural gas. The Company continues to evaluate its obligations related to future abandonment costs.

### Regulatory Audit

In December 2010, the NEB conducted a regulatory audit of TQM Pipeline's accounts and records for the period January 1, 2009 to September 30, 2010, to determine whether they were in compliance with the *National Energy Board Act* (Canada), regulations, decisions, toll orders and other accounting and reporting directives. With the exception of the T-1 firm service toll schedule, all accounts and records were found to be in accordance with the NEB requirements. The T-1 firm service toll schedule refers only to domestic service, and as this schedule is also used for export service, it should have been updated and filed with the NEB prior to the East Hereford extension going into service. In March 2011, the Company filed a package of tariff amendments that included modifications to the T-1 toll schedule to reflect its use for export service and ensure compliance with the *National Energy Board Act* (Canada).

## Results of Operations

### Income Statement

Transportation and storage revenue in 2011 was $78,139,000, a decrease of $5,076,000 from the prior year. The decrease was mainly due to a lower monthly final toll of $6,480,000 in 2011 compared to a monthly final toll of $6,901,000 in 2010.

Deferred revenue in 2011 was $4,153,000 consisting of a $2,377,000 refund in 2011 tolls relating to prior period deferral balances and a current year revenue short-fall of $1,776,000 primarily due to costs associated with the wind-up of the Company's defined benefit registered pension plan ("Pension Plan") in 2011. The year 2010 represents a revenue surplus consisting of a $540,000 refund in 2010 tolls of prior period deferral balances and a current year revenue surplus of $1,602,000 primarily related to the deferral of the pension wind-up.

Partners' income in 2011 was $19,380,000, an increase of $2,198,000 from 2010 income of $17,182,000. The increase in 2011 is a result of increased settlement earnings compared to 2010.

Operation and maintenance expenses were $2,509,000 higher than in the prior year due to the wind-up of the Pension Plan in September 2011. Compressor electricity costs were also higher in 2011 due to higher throughput volumes. This was partially offset by lower maintenance costs as a result of the timing of pipeline integrity activities.

Financial charges were $4,469,000 lower in 2011 than in 2010 due to the refinancing of the $100 million principal amount of 7.053 per cent Series 'I' Bonds and the $75 million principal amount of 3.906 per cent Series 'J' Bonds with the $100 million principal amount of 4.25 per cent Series 'L' Bonds ("Series 'L' Bonds") in July 2010 and additional borrowings of $69,900,000 on the revolving term loan. This is partially offset by an increase in interest expense on the revolving term loan due to a higher outstanding balance and a higher interest rate compared to 2010.

### Balance Sheet

Total assets of $395,890,000 as at December 31, 2011 decreased by $18,804,000 from December 31, 2010. The decrease was mainly due to a net decrease in property, plant and equipment of $19,665,000 as a result of depreciation of $21,900,000 offset by capital expenditures of $2,235,000, and a decrease of $523,000 in trade accounts receivable due from partners. Current deferred charges increased by $3,346,000 mainly due to a current revenue shortfall of $1,776,000, a $1,229,000 deferral due to the wind-up of the Pension Plan in 2011, and a $454,000 deferral due to a class location review.

In September 2011, the pension asset was wound up at a cost of $3,688,000. In accordance with the 2010-2012 Settlement Agreement, the cost of the Pension Program wind-up was to be realized over the life of the agreement. Due to the timing of the asset wind-up, two-thirds of the expense was recognized in the current year, and one-third or $1,229,000, was deferred until 2012.

Current liabilities decreased by $73,780,000 as at December 31, 2011 compared to December 31, 2010, mainly due to the reclassification of the revolving term loan from short term liabilities to long term liabilities as a result of refinancing the five-year amended and restated revolving term loan on August 19, 2011. Current liabilities were further reduced by the decrease in current deferred charges of $2,308,000 due to a prior year revenue surplus of $2,355,000 that flowed through to the current year revenue requirement. Partners' accounts payable decreased by $1,219,000 due to a lower payable balance to TransCanada for operating and capital services rendered. Interest payable decreased by $546,000 as a result of refinancing of long term debt at lower interest rates.

Long-term debt increased by $60,543,000 compared to December 31, 2010 mainly due to the reclassification of the revolving term loan from short term liabilities to long term liabilities as a result of refinancing the five-year amended and restated revolving term loan on August 19, 2011. The increase was partially offset by the repayment of $9,400,000 of the revolving term loan.

## Liquidity

### Operating Activities

Cash provided from operating activities generated $38,429,000 during 2011, a decrease of $3,123,000 compared to the previous year. This decrease primarily relates to the increase of $7,573,000 in deferred charges, net of credits due to a refund of the prior year revenue surplus of $2,377,000 in 2011 tolls, the build up of the 2011 revenue short-fall of $1,776,000, and the pension wind-up. Cash provided by operating activities was further reduced by an increase of $2,039,000 in working capital items due to a decrease in partners' accounts payable for services rendered. This is partially offset by an increase in pension funding lower than amounts expensed of $3,484,000 due to the wind-up of the Pension Plan, and a $2,198,000 increase in partners' income generated under the Settlement Agreement.

### Investing Activities

In 2011, cash used in investing activities was $2,235,000, an increase of $416,000 compared to the previous year. The investing activities reflect the Company's capital expenditure program. In 2010, the capital expenditure program included a one time receipt for a legal settlement relating to a capital project.

### Financing Activities

In 2011, cash used in financing activities was $35,564,000, a decrease of $4,144,000 compared to 2010. During 2011, the revolving term loan decreased by $9,400,000 compared to an increase of $49,900,000 in 2010. In July 2010, TQM Pipeline issued the $100 million Series 'L' Bonds maturing in September 2017. The revolving term loan facility and Series 'L' Bonds were used to repay the Series 'I' Bonds and Series 'J' Bonds, totalling $175 million in September 2010. In addition, a distribution of $24,802,000 was paid to the partners in 2011 compared to $13,251,000 in 2010 as a result of the change in capital structure. Based on the NEB's RH-1 2008 Decision in March 2009 which granted an aggregate return on capital leaving the Company to determine its optimal capital structure, the Company reduced partner withdrawals until mid-2010 to move towards a 60 per cent debt to 40 per cent equity capital structure.

## Capital Structure

| Description | Amount As at 2011-12-31 ($000,000) | Amount As at 2010-12-31 ($000,000) | Interest Rate % | Date Issue | Date Maturity |
|---|---|---|---|---|---|
| Series 'K' Bonds | 75.0 | 75.0 | 4.050 | 2009-08-24 | 2014-09-15 |
| Series 'L' Bonds | 100.0 | 100.0 | 4.250 | 2010-07-28 | 2017-09-15 |
| Revolving term loan(1) | 60.5 | 69.9 | (1) | 2011-08-19 | 2016-08-19 |
| Principal amount of total debt (2) | 235.5 | 244.9 | | | |
| Partners' equity | 157.0 | 162.4 | | | |
| Total debt and equity | 392.5 | 407.3 | | | |

| Distribution | As at 2011-12-31 | As at 2010-12-31 |
|---|---|---|
| Bonds | 44.6% | 43.0% |
| Revolving term loan | 15.4% | 17.0% |
| Partners' equity | 40.0% | 40.0% |
| | 100.0% | 100.0% |

(1) The Company has four borrowing options for the revolving term loan:
- Canadian prime rate based loans and advances - Canadian prime rate.
- Bankers acceptance ("BA") borrowings and loans - BA rate plus 1.00%.
- U.S. bank rate advances – U.S. bank rate.
- London Interbank Offered Rate ("LIBOR") advances - LIBOR rate plus 1.00%.
- Rates are determined based on the Company's current DBRS Limited rating of "A (low)".

(2) At December 31, 2011, long-term debt was presented in the financial statements net of unamortized debt issue costs of $1,353,000 ($1,396,000 in 2010).

## Liquidity and Capital Resources

The Company's financial position remains sound and consistent with recent years as does its ability to generate cash in the short and long term to provide liquidity, maintain financial capacity and flexibility, and provide for planned growth. The Company's liquidity is underpinned by predictable cash flow from operations as well as a committed revolving term loan of $85,000,000 which matures on August 19, 2016. TQM Pipeline's liquidity and other risks are discussed in the Risk Management section of this MD&A.

In 2010, the Company had a defined benefit pension plan for its former employees and a supplemental pension plan for its former executive officers. Benefits under these plans were primarily based on years of service and highest average eligible earnings during three years not necessarily consecutive. The Company also had a life insurance plan for retired employees. In May 2011, TQM Pipeline received approval from the Office of the Superintendent of Financial Institutions ("OSFI"), the regulator of the Company's Pension Plan, to terminate the Pension Plan effective November 15, 2010. Upon settlement of the Pension Plan, a pension expense was recognized in September 2011 to write-off the assets on the Balance Sheet. All pension program costs which include other retirement benefits are treated on a flow-through basis, in accordance with the terms of the Settlement Agreement. The Company still maintains the supplemental pension plan.

## Future Accounting Changes

### United States Generally Accepted Accounting Principles ("U.S. GAAP")

The CICA's Accounting Standards Board ("AcSB") previously announced that Canadian publicly accountable enterprises were required to adopt International Financial Reporting Standards ("IFRS") effective January 1, 2011, with the exception of certain qualifying entities historically using rate-regulated accounting ("RRA") that were given a one year deferral from adopting IFRS. The Company is a qualifying entity for these purposes and has deferred the adoption of IFRS. The Company has prepared its consolidated financial statements for 2011 in accordance with CGAAP in order to continue using RRA.

In accordance with CGAAP, TQM Pipeline currently follows specific accounting policies unique to a rate-regulated business. These RRA standards allow the timing of recognition of certain expenses and revenues to differ from that which may otherwise be expected in a non-rate-regulated business under CGAAP in order to appropriately reflect the economic impact of regulators' decisions regarding the Company's revenues and tolls. These timing differences are recorded as Regulatory Assets and Regulatory Liabilities and included in Deferred Accounts on TQM Pipeline's Balance Sheet. They represent current rights and obligations regarding cash flows expected to be recovered from or refunded to customers based on decisions and approvals by the applicable regulatory authorities.

In October 2010, the AcSB and the Canadian Securities Administrators amended their policies applicable to Canadian publicly accountable enterprises that use RRA in order to permit these entities to defer the adoption of IFRS for one year. Due to the continued uncertainty around the timing, scope and eventual adoption of an RRA standard under IFRS, TQM Pipeline has deferred its adoption of IFRS accordingly and has continued preparing its financial statements in 2011 in accordance with CGAAP, as defined by Part V of the CICA Handbook, in order to continue using RRA. The International Accounting Standards Board has concluded that the development of RRA under IFRS requires further analysis and the Company does not expect a final RRA standard under IFRS to be effective in the foreseeable future.

In August 2011, TQM Pipeline filed a dual application with Québec's Autorité des marchés financiers ( "AMF"), as its principal financial regulator, and the Ontario Securities Commission for an exemption from the requirements under subsection 3.2(1) of National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards* to permit TQM Pipeline to use U.S. GAAP as the accounting framework for the preparation of its financial statements for financial years commencing on or after January 1, 2012 but before January 1, 2015.

In March 2012, the AcSB issued a decision to extend the deferral of the mandatory IFRS changeover date for entities with qualifying rate-regulated activities by one year to January 1, 2013.

The Company continues to work with the AMF and expects to receive approval to use U.S. GAAP. If approval is not received prior to reporting the 2012 results TQM Pipeline will take the AcSB one year extension of the deferral period for changeover to IFRS and continue reporting under CGAAP.

### Transition to U.S. GAAP

The adoption of U.S. GAAP in first quarter 2012 will result in fewer significant changes in the Company's accounting policies than would have been experienced with the adoption of IFRS. Management believes this will result in financial information that better reflects the economic impact of regulator's decisions regarding the Company's revenue and tolls. In addition, it is more comparable to the Company's prior years' financial statements prepared under CGAAP, making them easier for readers to understand.

Areas where there is a financial impact of transitioning to U.S. GAAP are outlined below. The net impact of all adjustments required to restate retained earnings on January 1, 2011 to U.S. GAAP is not expected to be material. The items of any adjustments to the financial statements are identified below under the financial statement item to which the adjustments relate.

### Pension and Other Post-employment Benefits

Under U.S. GAAP, an employer is required to recognize the overfunded or underfunded status of a defined benefit post-retirement plan as an asset or liability in its Balance Sheet and to recognize changes in that funded status, through Accumulative Other Comprehensive Income, in the year in which the changes occur. However, since pension costs are generally recoverable in TQM Pipeline's Tolls, Other Comprehensive Income is offset by a regulatory asset or liability.

Currently, under CGAAP, the unamortized amounts together with their impact on the funded status of the pension liability or asset, are disclosed but not recognized.

Restating the Company's U.S. GAAP Balance Sheet for its defined benefit plan and other post-retirement benefits will not result in a material impact.

### Debt Issue Costs

CGAAP requires debt issue costs to be included in long-term debt. Under U.S. GAAP these costs are classified as deferred assets.

By restating the amounts under U.S. GAAP, this results in an increase to long term debt and an increase to deferred assets on January 1, 2011. The net effect to the Balance Sheet is immaterial.

## Significant Accounting Policies and Critical Accounting Estimates

To prepare financial statements that conform with CGAAP, TQM Pipeline is required to make estimates and assumptions that affect both the amount and timing of recording assets, liabilities, revenues and expenses, since the determination of these items may be dependent on future events. The Company uses the most current information available and exercises careful judgement in making these estimates and assumptions. The Company regularly assesses the assets and liabilities associated with these estimates and assumptions, and believes that no material adjustments are required. The Company believes the following accounting policies and estimates require it to make assumptions about highly uncertain matters and changes in these estimates could have a material impact on the Company's financial information.

### Regulated Accounting

The Company accounts for the impacts of rate regulation in accordance with CGAAP. Three criteria must be met to use these accounting principles:

- the rates for regulated services or activities must be established by or subject to approval by a regulator;
- the regulated rates must be designed to recover the costs of providing the services or products; and
- it must be reasonable to assume that rates set at levels to recover the costs can be charged to and collected from customers in view of the demand for services or products and the level of direct and indirect competition.

The Company's management believes all three of these criteria have been met. The most significant impact from the use of these accounting principles is that the timing of recognition of certain expenses and revenues in the regulated business may differ from that otherwise expected under policies adopted by a non-regulated enterprise using CGAAP in order to appropriately reflect the economic impact of the regulators' decisions regarding the Company's revenues and tolls. At December 31, 2011, the Company reported regulatory assets of $3,285,000 and $58,000 in Current and Long-term Deferred Accounts, respectively, (2010 - $393,000 and $286,000, respectively), and regulatory liabilities of $47,000 in Current Deferred Accounts (2010 - $2,355,000).

### Financial Instruments

The Company initially records all financial instruments on the balance sheet at their fair value. Subsequent measurement of the financial instruments is based on their classification as held for trading, available for sale, held-to-maturity investments, loans and receivables, and other financial liabilities. Changes in the fair value of financial instruments are recorded in partners' income except those for available-for-sale assets, whose fair value adjustments are recorded in other comprehensive loss. In 2011 and 2010, the Company did not record any fair value adjustments.

Held-for-trading derivative financial assets and liabilities consist of swaps, options, forwards and futures. The available-for-sale classification includes non-derivative financial assets that are designated as available for sale or are not included in the other three classifications. Trade receivables and loans and other receivables with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables and are measured at amortized cost using the effective interest method, net of any impairment. The Company does not have any held-to-maturity investments or available-for-sale financial assets. Other financial liabilities consist of liabilities not classified as held for trading and are recognized at amortized cost using the effective interest method.

### Depreciation and Amortization Expense

The Company's property, plant and equipment are depreciated on a straight-line basis over their estimated useful lives once they are ready for their intended use. The estimation of useful lives requires management's judgement regarding the period of time the assets will be in use based on third-party engineering studies, experience and industry practice. However, depreciation rates for TQM Pipeline are approved by the NEB and depreciation expense is generally recoverable as part of the cost of providing the services. Depreciation and amortization expense for the year ended December 31, 2011 was $21,900,000 (2010 - $21,809,000). Depreciation for 2011 and 2010 was calculated based on rates approved in the Settlement Agreement, resulting in a composite annual rate of depreciation of approximately 2.49 per cent.

The fixed component of the Settlement Agreement includes depreciation and certain other costs. Accordingly, any variance between the actual depreciation expense and the amount of depreciation expense included in the fixed component accrue to TQM Pipeline. A change in the estimation of the useful lives of the Company's property, plant and equipment would therefore have no material impact on the Company's net income but would directly impact the cash flows from operating activities.

### Impairment of Long-Lived Assets

The Company reviews its long-lived assets such as property, plant and equipment for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. If the total of the estimated undiscounted future cash flows is less than the carrying value of the assets, an impairment loss would be recognized for the excess of the carrying value over the fair value of the assets. The valuation is based on management's projections of future cash flows and, therefore, requires estimates and assumptions with respect to certain factors such as discount rates, market supply and demand assumptions, growth opportunities, competition from other companies, regulatory changes, etc. Significant changes in these assumptions could affect the Company's need to record an impairment charge.

## Contractual Obligations

Other than obligations for future debt and interest payments relating to debt issuances, and repayments discussed in the "Liquidity" and "Capital Structure" sections of this MD&A, there have been no other material changes to TQM Pipeline's contractual obligations from December 31, 2010 to December 31, 2011, including payments due for each of the next five years and thereafter.

At December 31, 2011, the Company's contractual obligations were as follows:

| **Contractual Obligations** (thousands of dollars) | **2012** | **2013** | **2014** | **2015** | **2016+** | **Total** |
|---|---|---|---|---|---|---|
| Principal payments on long-term debt | - | - | 75,000 | - | 160,500 | 235,500 |
| Interest payments on long-term debt | 7,288 | 7,288 | 7,287 | 4,250 | 8,500 | 34,613 |
| Operating leases (1) | 25 | 6 | - | - | - | 31 |
| Purchase obligations(2) | 10,634 | 10,624(3) | - | - | - | 21,258 |
| Total | 17,947 | 17,918 | 82,287 | 4,250 | 169,000 | 291,402 |

(1) Annual payment, net of sub-lease receipts.

(2) The services agreement ("TQM Services Agreement") between the Company and TQM Services Inc. ("TQM Services") became effective January 1, 2003, and remains in effect until one of the parties provides a termination notice to the other. The majority of the Company's operating functions are performed by TQM Services. The amount for 2012 will be $10,624,000, which is based on the 2011 amount ($10,331,000) adjusted for inflation. The remaining purchase obligations in 2012 ($9,700) and 2013 ($nil) are amounts owing to third-party suppliers for the purchase of services and equipment.

(3) TQM Services' fee will be adjusted for inflation from the previous year.

## Guarantees

The Company had no outstanding guarantees related to third parties at December 31, 2011.

## Contingencies

In October 2008, the Company was notified by The Sintra Group ("Sintra") of a potential claim against the Company with regards to land that was expropriated from Sintra in 1998. Sintra is operating a gravel/stone quarry on the land. TQM Pipeline and Sintra are currently in discussions regarding the operations of the quarry. At this time, there has been no official claim made by Sintra, hence an estimate of the amount of the contingency cannot yet be determined.

## Related Party Transactions

During the year, the Company entered into the following transactions with related parties in the normal course of business.

Transportation revenues totalling $77,760,000 in 2011 ($82,810,000 in 2010) have been recorded for natural gas transportation services rendered to TransCanada.

Revenues relating to storage and transportation totalling $341,600 in 2011 ($367,600 in 2010) have been recorded for services rendered to Gaz Métro.

Municipal and other taxes included amounts of $5,000 in 2011 ($330,000 in 2010) incurred by the partners in respect of capital taxes.

Other interest expense included $7,900 of interest paid to the partners in 2011 ($278,700 in 2010).

Operation and maintenance expenses included $100,000 paid to Gaz Métro for contracted services in 2011 ($100,000 in

2010).

As at December 31, 2011, the Company had a receivable due from TransCanada for $6,488,600 ($6,900,100 as at December 31, 2010) and from Gaz Métro for $62,700 ($174,200 as at December 31, 2010) related to natural gas transportation services and financial charges.

As at December 31, 2011, TQM Pipeline had a payable due to TransCanada for $347,200 and due to Gaz Métro for $485,800 ($1,360,600 and $692,100 respectively, as at December 31, 2010), mainly for income taxes and flow-through costs.

Effective January 1, 2003, pursuant to the TQM Service Agreement, the majority of the Company's operating functions are provided by TQM Services, which is owned equally by TransCanada and Gaz Métro.

TQM Services charged the Company the following amounts for services that it provided to TQM Pipeline:

| | **As at December 31** | |
|---|---|---|
| (thousands of dollars) | **2011** | 2010 |
| Fee for operating services | **10,331** | 10,052 |
| Services related to capital expenditures | **2,933** | 2,330 |
| Additional operating services | **2,837** | 3,564 |
| Total | **16,101** | 15,946 |

## Effect of Toll Regulation

The Company is subject to the authority of the NEB and its operations are regulated with respect to the determination of revenues, tolls, construction, and operations. In order to appropriately reflect the economic impact of the regulators' decisions regarding the Company's revenues and tolls, and thereby achieve a proper matching of revenues and expenses, the timing of recognition of certain revenues and expenses may differ from that otherwise expected under accounting policies adopted by non-regulated enterprises using CGAAP. As at December 31, 2011, net revenue and cost variances totalling $2,067,000 (2010 - $1,676,000) were recorded as regulatory assets. In the absence of rate-regulated accounting, the operating results for 2011 would have been $3,785,900 lower (2010 – $1,180,000 higher).

In November 2010, the NEB approved TQM Pipeline's multi-year Settlement Agreement with its interested parties with respect to its annual revenue requirement for 2010 to 2012 which included an annual revenue requirement comprised of fixed and flow-through components. The NEB approved the Company's final tolls for 2010 and 2011 in December 2010 and June 2011, respectively.

## Risk Management

### Foreign Exchange and Interest Rate Risk

Foreign exchange and interest rate risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's net income or the value of its holdings of financial instruments. Foreign exchange risk and interest rate risk is created by fluctuations in the fair values or cash flows of financial instruments due to changes in foreign exchange rates and/or market interest rates.

The Company has long-term debt that has a fixed interest rate, and therefore its valuation is subject to fluctuations in fair value due to changes in market interest rates. During the period, the Company had no positions in derivatives for interest rate or foreign exchange management.

### Competitive Risk

The Company faces competition from other sources of gas supply to the Québec and New England markets and also faces pressure owing to decreased demand for natural gas in favour of electricity or oil. There is an unusually high level of competition between the gas and electricity market in Québec as compared to the competition observed in markets outside Québec. The price of electricity in Québec is relatively stable and predictable, and it is increasing at approximately the rate of inflation. Recent environmental programs and politics implemented by the Québec government favour cleaner sources of energy, such as natural gas. These programs may promote consumers to switch their fuel consumption from oil to natural gas in the short term. However, over the medium to long term, these programs and new hydro-electric projects in Québec could encourage an overall switch from carbon-based fuels to electricity. In the New England market, which is served via the Portland Natural Gas Transmission System ("PNGTS"), the Company faces significant competitive risk where new natural gas infrastructure and new natural gas supplies could reduce the market share currently served by the Western Canada Sedimentary Basin ("WCSB") and the Southwestern Ontario Dawn Hub gas delivered via the Company's pipeline system.

The Company could also face competition from TransCanada's Restructuring Proposal filed with the NEB in September 2011. The application proposes to change the allocation of TQM Pipeline costs by allocating them directly to transportation services that physically use the TQM Pipeline system. If the application proves to be successful before the NEB, it would result in changes in the TransCanada Mainline transportation tolls for transportation services with receipt or delivery located on the TQM Pipeline system and some users might decide to choose an alternative fuel supply. The NEB decision for this filing is expected in late 2012 or early 2013.

### Cost Risk

The Company is at risk for costs in excess of levels fixed for the period from January 1, 2010 to December 31, 2012 under the terms of the Settlement Agreement. The Company is not exposed to commodity price movements as part of its normal business operations.

### Supply Risk

TQM Pipeline faces the risk that insufficient natural gas supply in the longer term may increase tolls to levels that significantly reduce the demand for natural gas in the markets served by the Company. TQM Pipeline's T-1 transportation service is contracted by TransCanada for deliveries from its Canadian Mainline through to the end of 2018 under a Transportation Service Agreement. TransCanada's Canadian Mainline natural gas is supplied primarily from the WCSB. Other potential sources of natural gas supply include natural gas from Dawn, Ontario, from imported Liquefied Natural Gas ("LNG") and from shale gas production in Québec. The expected levels of LNG imports into Canada remain unclear at this time. The Government of Quebec announced in March 2011 that it will not disclose the new rules for shale gas exploration and development until the completion of a full environmental impact study, which is expected to take up to 30 months. However, shale gas developers can continue to apply for exploration permits through the *Mining Act*.

### By-pass Risk

Interest in shale gas in Québec has increased significantly since the announcement in April 2007 of a discovery of reserves that are believed to contain commercially viable quantities of natural gas in the Utica Shale of Québec's St. Lawrence lowlands. This source of supply in Québec, should it materialize, could present an opportunity for the Company to receive and transport such natural gas production. Exploration is also being considered in areas which are in close proximity to the Gaz Métro network. The natural gas production from these areas could potentially flow directly into the Gaz Métro network thereby reducing the need for certain quantities of natural gas currently transported by the Company. Due to regulatory uncertainty in shale-gas supply, the by-pass risk in the near term is expected to be minimal.

## Regulatory Risk

The Company's cost of capital, capital structure and tolls are subject to approval by the NEB. Since 1982, the Company's pipeline system has effectively been part of the integrated TransCanada Canadian Mainline system as a result of TransCanada having contracted for virtually all of the firm transportation capacity, pursuant to a Transportation Service Agreement, on the Company's pipeline system from Saint Lazare, Québec. TransCanada includes the cost of transportation it pays to the Company in its revenue for services to its shippers. Furthermore, TransCanada offers service from receipt points on its Canadian Mainline to all the delivery points located along the Company's pipeline system. As a result of the integration of the Company's pipeline system with TransCanada's Canadian Mainline, and for so long as the Transportation Services Agreement remains in place, the Company's risk of not recovering its revenue requirement is, and will remain low. However, there are factors that, if they materialize, may cause the integration of the Company's pipeline system with the Canadian Mainline to be challenged by certain parties. If such challenge proves to be successful before the NEB, it would result in changes in the current regulatory framework, and other shippers would be required to contract for transportation services with TQM Pipeline in order to serve customers currently served by TransCanada. Consequently, the Company may have to assume additional risk associated with the recovery of its revenue requirement from multiple shippers.

Throughput on the Company's pipeline system has been decreasing as a result of several factors, including the increased competition faced by PNGTS, in the New England market, the continued and increasing competition faced by the Gaz Métro market from alternative fuels; and the specific Québec government policies that encourage a move away from carbon-based fuels. These factors could have an influence on the ongoing integration of the Company's pipeline system with the Canadian Mainline or prompt a challenge to the current tolling method of the Company's pipeline system. Similarly, there is currently reduced throughput on the Canadian Mainline and as a result, Canadian Mainline tolls have been increasing. Further, shippers are able to opt for short-haul transportation service in lieu of long-term contractual arrangements and have access to supplies from other North American supply basins. Ultimately, lower throughput on the Canadian Mainline and on the Company's pipeline system may cause TransCanada to reconsider extending 80 per cent of the contract demand under the Transportation Service Agreement that expires on October 31, 2013. Taken together, these factors could give rise to a challenge to TQM Pipeline's current tolling method.

## Pipeline Abandonment Cost risk

Through the Land Matters Consultation Initiative (LMCI), the NEB is addressing several significant issues relating to future pipeline abandonment costs for Canadian regulated pipelines. During the LMCI process, the NEB provided several key guiding principles including the position that abandonment costs are a legitimate cost of providing pipeline service and are recoverable, upon NEB approval, from users of the system. Based on the NEB's direction, the earliest that collection of funds for future pipeline abandonment costs through cost-of-service tolls on Canadian regulated pipelines could begin would be 2015.

## Liquidity & Re-financing Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure that it will have sufficient cash and credit facilities to meet its obligations, under both normal and stressed conditions, without incurring unacceptable losses or damage to the Company's reputation. In general, the Company's financial needs may be met through a combination of operating cash flow, its revolving term loan facility, issuance of long-term debt, and partner contributions.

The Company's business operations result in reasonably predictable cash flows. Management typically forecasts these cash flows for a period of 12 months to identify operational and investing requirements over and above its operating cash flow. These short-term requirements are addressed using a revolving term loan credit facility. At December 31, 2011, $24,500,000 was available for borrowing from the Company's unused portion of its $85,000,000 revolving term loan.

### Environmental Risk

The Company's facilities are subject to various environmental laws and regulations. Environmental risks from the Company's operating facilities typically include: the use, storage or release of chemicals or hydrocarbons; the generation, handling and disposal of wastes and hazardous wastes; potential impacts on land, including land reclamation or restoration following construction; and water impacts such as uncontrolled water discharge. Environmental controls including physical design programs, procedures and processes are in place to effectively manage these risks. The Company has ongoing audit and inspection programs designed to keep all of its facilities in compliance with environmental requirements and the Company is confident that its systems are in material compliance with the applicable requirements.

TQM Pipeline is not aware of any material outstanding orders, claims or lawsuits against the Company in relation to the release or discharge of any material into the environment or in connection with environmental protection.

Ensuring the pipeline system's integrity and avoiding interruptions to the Company's operations depends on TQM Pipeline's ability to closely monitor and protect the pipeline system, including equipment and information stored in data centres. Ensuring safety and continuity of service from damage due to unauthorized encroachments, fire, natural disasters, power outages, break-ins, computer viruses, acts of war or terrorism and other similar situations is also of utmost importance to the Company as any one of these events could interrupt service at any time, with repercussions to customers, landowners, the public and the Company's operating results. Accordingly, TQM Pipeline places a high priority on operating, maintaining and protecting the integrity of the pipeline system in order to avoid or minimize service interruptions and inadvertent gas leakages.

The personnel working on the pipeline system are trained in current environmental protection techniques and are well aware of the importance of environmental issues. Independent experts periodically conduct environmental audits to identify any noncompliance with governmental or corporate standards. Any corrective measures required are taken without delay.

The impact of new or proposed provincial or federal safety and environmental laws, regulations, guidelines and enforcement in Canada on the Company's business is not yet certain. TQM Pipeline makes assumptions about possible expenditures related to safety and environmental matters based on current laws and regulations and interpretations thereof. If the laws or regulations or the interpretation thereof changes, the Company's assumptions may change. Incremental costs may or may not be recoverable under existing rate structures or commercial agreements. Proposed changes in environmental policy, legislation or regulation are routinely monitored by the Company and where the risks are potentially large or uncertain, the Company works independently or through industry associations to comment on proposals.

## Safety

### Integrated Public Awareness

In 2011 the Integrated Public Awareness Program ("IPA") continued to focus on safety and pipeline awareness messages to stakeholders. Historically, the Company has experienced a number of unauthorized encroachments. The IPA program's goal is to visit with every landowner along the TQM Pipeline at appropriate intervals to ensure they are aware of safe practices along the Right of Way. The program also facilitates an annual calendar mail-out program to provide landowners and contractors with emergency and informational phone numbers for their reference. The Company also meets regularly with emergency services in communities near the TQM Pipeline system to discuss emergency planning.

In recent years, the Company has measured a significant reduction in unauthorized activities. The Company is committed to ensuring that the public is aware of appropriate practices for working and living near a high-pressure natural gas pipeline. To accomplish this, the Company's IPA program will continue to be evaluated and changes will be made as required.

### Management of System Integrity

The Company did not experience any pipeline ruptures or leaks in 2011. The TQM Pipeline system is regulated by the NEB with respect to system design, operations and pipeline integrity management requirements. The Company's overall approach meets or exceeds regulatory requirements to ensure safety and service reliability of the pipeline system. The Company's approach to pipeline integrity management utilizes a risk-based methodology combined with state-of-the-art inspection and mitigation technologies. Risk assessment is used to identify potential integrity threats for initiation of inspection/mitigation activities, while results from these activities are used to further refine future risk assessments and program decisions. The approach also incorporates compliance with all applicable codes and regulations.

### Right of Way Monitoring

The Company monitors the Right of Way for both leaks and unauthorized encroachments using aerial patrols. Patrols are completed twice a year in remote areas and more frequently in areas with a history of unauthorized activity. In fourth quarter of 2011, an additional two patrols per week were implemented to address an interim NEB condition at four locations related to the class program described in the following section.

### Class Location Review

During the initial construction of a pipeline, the Canadian Standards Association Pipeline Standard ("CSA Z662 Standard") requires that the pipeline be designed to a specific class location designation, which is determined by existing and planned dwelling density and surrounding structures. When development around the pipe occurs that could change the initial class location designation, the CSA Z662 Standard allows three acceptable measures to address the pipe class location designations, such as: (i) reducing the maximum operating pressure in that location, (ii) replacing the pipe to a higher specification or (iii) conducting an Engineering Assessment.

In accordance with the CSA Z662 Standard, the Company continually monitors the development of structures near and adjacent to the TQM Pipeline right-of-way that could cause the pipe to change class location designation. In 2009, the Company advised the NEB that several sections of its pipeline had changed class location designations. An Engineering Assessment was submitted to the NEB in April 2011, detailing a mitigation plan to meet the new class location designation requirements. The plan included additional mitigation measures such as: increased signage, installation of buried markers, investigative digs, increased public awareness in the area, and increased protection against third party damage.

In September 2011, investigative digs, along with a precautionary reduction in operating pressure, was requested by the NEB. The results from the investigative digs were submitted to the NEB and the precautionary pressure reduction was lifted. As this work was carried out prior to high flow demand period, there was no impact to shippers. On March 12, 2012, the NEB approved the Engineering Assessment plan for the new class location designations. TQM Pipeline has already implemented several of the mitigations measures from its plan and continues to work with the NEB in completing the implementation of the remaining measures.

## Capital Management

The primary objective of capital management is to ensure the Company has strong credit ratings to support its business and maximize value for its partners.

Based on the NEB's RH-1-2008 Decision in March 2009 which granted an aggregate return on capital leaving the Company to determine its optimal capital structure, the Company has maintained a 60 per cent debt, 40 per cent equity capital structure.

The Company's debt is composed of two long-term bond issues and a revolving term loan facility. The Company manages its optimal capital ratio through the use of its revolving term loan as well as withdrawals and cash calls to its partners. Through the use of models, the Company can reasonably predict future cash requirements and financing to attain its optimal debt-to-equity ratio.

## Financial Instruments

The CICA Handbook requires that all financial instruments must initially be included on the balance sheet at their fair market value. Subsequent measurement of the financial instrument is based on their classification. Financial assets are classified into the following categories: held-for-trading, available-for-sale, held-to-maturity investments, and loans and receivables. Financial liabilities are classified as held-for-trading or other financial liabilities.

Trade accounts receivable and other receivables with fixed or determinable payments that are not quoted in an active market, are classified as loans and receivables. They are measured at amortized cost, which is generally the initial recognized amount, less any allowance for doubtful accounts.

Accounts payable and accrued liabilities, and interest payable are classified as other financial liabilities. They are measured at cost using the effective interest method.

Long-term debt is classified as other financial liabilities and is measured at amortized cost using the effective interest method. The Company offsets debt transaction costs against the associated debt. In 2011, the offset against debt was $1,353,000 ($1,396,000 in 2010).

The fair value of the Company's long-term debt is as follows:

| | **December 31, 2011** | | December 31, 2010 | |
|---|---|---|---|---|
| (thousands of dollars) | **Carrying value** (1) | **Fair value** (2) | Carrying value (1) | Fair value (2) |
| Revolving term loan | **60,221** | **60,500** | 69,779 | 69,900 |
| Series 'K' Bonds | **74,575** | **79,122** | 74,375 | 78,236 |
| Series 'L' Bonds | **99,351** | **108,860** | 99,229 | 103,648 |

(1) Carrying value in financial statements is net of prepaid interest and unamortized debt costs.
(2) The fair value of the revolving term loan is equivalent to its carrying value, as it bears interest at a rate that varies with market rates. The fair value of the bonds is determined based on current market prices, normally the current bid price for the outstanding bonds. When such information was not available, the fair value of the bonds was estimated by discounting future payments of interest and principal at estimated interest rates.

## Outlook

Looking forward to 2012, TQM Pipeline will:

- focus on continued safe and reliable delivery of natural gas to existing markets;
- work with upstream and downstream pipelines to maintain volumes delivered through its pipeline system;
- remain apprised of potential opportunities that may arise from new demand centers and new sources of supply such as Utica Shale and LNG while maintaining a consistent approach of considering only those projects that create value, that have a risk profile similar to TQM Pipeline's current profile and in the case of development projects, that include long-term agreements with solid counterparties; and

- pursue a new multi-year agreement with its interested parties for its revenue requirements after 2012.

## Recent Developments

### TQM Pipeline Developments

On April 4, 2011, TransCanada, on behalf of TQM Pipeline, notified the NEB that it would be carrying out mitigative work on the TQM Pipeline system due to class location designation changes. In its letter, TransCanada indicated it expected to begin the installation of concrete slabs and a series of planned investigative digs. On September 8, 2011, the Board indicated that it was of the view that the results of the investigative digs comprised an essential component in determining if the pipeline sections at the class change locations are satisfactory for the higher class location designation and thus issued Order SG-T201-002-2011 ("Order") directing TransCanada to conduct the planned investigative digs on TQM Pipeline system. The Order also imposed a precautionary reduction in operating pressure for three class location change sites and indicated that once the results of the investigative digs were submitted, TransCanada could apply to have the pressure reductions altered or lifted. On September 28, 2011, TransCanada applied to have the pressure reduction lifted. On October 28, 2011, the Board noted that it had sufficient information from the investigative digs to lift the precautionary pressure reduction imposed on the TQM Pipeline system and directed TransCanada to provide additional measures related to the class change locations. On March 12, 2012, the NEB approved TransCanada's plan for addressing the new class location designation changes. TQM Pipeline continues to work with the NEB in implementing additional measures for the class change locations.
On August 19, 2011, the Partnership and the Company entered into a five year amended and restated revolving term loan credit agreement to mature August 19, 2016. A maximum $85,000,000 revolving term loan is authorized under this agreement.

In May 2011, TQM Pipeline received approval from the OSFI, the regulator of the Company's Pension Plan, to terminate the Pension Plan effective November 15, 2010. Upon settlement of the Pension Plan and confirmation from OSFI that the Pension Plan was closed, a pension expense was recognized in September 2011 to write-off the assets on the Balance Sheet. All pension program costs which include other retirement benefits are treated on a flow-through basis, subject to the NEB's approval, in accordance with the terms of the Settlement Agreement.

## Selected Quarterly Financial Data (1)

| Three months ended | **2011** | | | | |
|---|---|---|---|---|---|
| (thousands of dollars) | **Mar. 31** | **Jun. 30** | **Sep. 30** | **Dec. 31** | **Total** |
| Operating revenue | 19,951 | 19,956 | 21,925 | 20,535 | 82,367 |
| Partners' income | 4,329 | 5,156 | 5,121 | 4,774 | 19,380 |
| Partners' withdrawals | 4,800 | 7,651 | 5,551 | 6,800 | 24,802 |

| Three months ended | 2010 | | | | |
|---|---|---|---|---|---|
| (thousands of dollars) | Mar. 31 | Jun. 30 | Sep. 30 | Dec. 31 | Total |
| Operating revenue | 21,275 | 21,147 | 20,950 | 18,853 | 82,225 |
| Partners' income | 4,192 | 3,799 | 3,668 | 5,523 | 17,182 |
| Partners' withdrawals | - | 500 | 6,651 | 6,100 | 13,251 |

(1) The selected quarterly financial data has been prepared in accordance with CGAAP.

The Company's annual revenues and partners' income fluctuate over the long term based on decisions by the NEB and negotiated settlements with interested parties, which in turn are influenced by changes in the Company's annual costs. These costs include operating, maintenance and administration costs, depreciation and amortization, income taxes, capital taxes and municipal taxes and operating return, the latter of which comprises an allowance for debt costs and a return on equity.

Generally, quarter-over-quarter revenues and partners' income during any particular fiscal year remain fairly stable with fluctuations resulting from adjustments being recorded due to regulatory decisions and developments outside of the normal course of operations. Subsequent to the NEB's RH-1-2008 decision in 2009, partners' withdrawals each quarter were reduced until mid-2010 in order to achieve a debt-to-equity ratio that the Company considered optimal. The Company has maintained a 60 per cent debt to 40 per cent equity ratio since this time, and partners' withdrawals have been made regularly to maintain the ratio.

Significant developments that impacted previous quarterly revenues, partners' income and comprehensive income were as follows:

- Fourth quarter 2010 included a retroactive adjustment of $8,047,400, a decrease in transportation revenues, offset by $5,607,200 of deferred revenues with respect to 2010 Settlement Agreement in November 2010 and related adjustments to recognize settlement earnings for the first ten months of 2010.

## Fourth Quarter 2011 Highlights

Partners' income and comprehensive income for the three months ended December 31, 2011 of $4,774,000 was $749,000 lower than the same period in 2010. The decrease was primarily due to the approval of the 2010 Settlement Agreement in November 2010 and related adjustments to recognize settlement earnings for the first ten months of 2010.

Cash flows from operating activities generated $11,835,000 for the three months ended December 31, 2011, an increase of $4,416,000 compared to the same period in 2010. The increase was primarily due to approval of the 2010 Settlement Agreement in November 2010 which resulted in adjustments for the first ten months of 2010 to refund the difference between the interim and final tolls and reflect a lower depreciation expense. This increase in 2011 cash flow was partially offset by a change in working capital items.

Cash flows used in investing activities was $1,127,000 for the three months ended December 31, 2011, which reflected the Company's capital expenditures for the period.

Cash flows used in financing activities was $10,139,000 for the three months ended December 31, 2011. This was primarily the result of withdrawals by the partners of $6,800,000 and a repayment of $3,000,000 on the revolving term loan.

## Credit Ratings

TQM Pipeline's credit ratings as assigned by credit rating firms are "BBB+" by Standard & Poor's and "A (low)" by DBRS Limited.

## Audit Committee

### Charter

The Company's audit committee charter is attached to this MD&A as Schedule "A".

### Composition

The audit committee of the Company (the "Audit Committee") is composed of three members, two of which are independent. The members of the Audit Committee of the Company are Karl Johannson, Katia Marquier and Stephanie Wilson. All of the members of the Audit Committee are financially literate. Mr. Johannson and Ms. Marquier are also independent. As General

Manager of the Company, Ms. Wilson is not considered to be independent.

### Relevant Education and Experience

Karl Johannson became Senior Vice-President, Canadian and Eastern U.S. Pipelines of TransCanada in January of 2011. Prior to this position, Mr. Johannson worked for over 16 years in the power business at TransCanada; most recently holding the position of Senior Vice-President, Canadian Power, where he was responsible for all activities relating to the management of TransCanada's Canadian and western U.S. unregulated electricity business. Mr. Johannson holds a Master's of Business Administration from Haskayne School of Business and an Arts degree from the University of Calgary, and is a graduate of Harvard Business School's General Management program.

Katia Marquier started her career and acquired her accounting and auditing knowledge with the accounting firm KPMG LLP where she worked for approximately ten years. She joined Gaz Métro as Corporate Controller in June of 2008. She is a member of audit committees and finance committees of several Gaz Métro subsidiaries, joint ventures and a company subject to significant influence. She is also a member of the board of directors of the Cancer Research Society. Ms. Marquier is a member of the Ordre des comptables agréés du Québec.

Stephanie Wilson was appointed by the partnership to serve as General Manager of TQM Pipeline in October of 2009. Ms. Wilson also holds the position of Director, Commercial Affiliated Pipelines with TransCanada which includes responsibilities for TransCanada's Mexico assets and from October 2010 to July 2011, she held the position Vice-President, Commercial for TC PipeLines GP, Inc. Prior to joining TransCanada in 2001, Ms. Wilson held various positions in operations and engineering with New Brunswick Power and with the Company. Prior to being in her current role, Ms. Wilson held a variety of engineering and general management positions within TransCanada's Operations and Engineering group. Ms. Wilson holds a Bachelor of Science in Engineering (Mechanical) degree from the University of New Brunswick.

### Exemption

Given that the Company's securities are not listed or quoted on the Toronto Stock Exchange or on an international marketplace, it is considered a "venture issuer" and as such, it benefits from and is relying upon the exemption in Section 6.1 of Multilateral Instrument 52-110, *Audit Committees* regarding the composition of the audit committee and certain other disclosure requirements.

### External Auditors' Fees

The following table shows, by category, the fees paid to KPMG LLP, Chartered Accountants, the external auditors of the Company for their services for the 2011 and 2010 financial years, respectively:

| **Fees** (by category) | 2011 | 2010 |
|---|---|---|
| Audit Fees(1) | $73,500 | $72,000 |
| Audit Related Fees(2) | - | $38,500 |
| Tax Fees | - | - |
| All Other Fees | $18,500 | $11,500 |
| Total | $92,000 | $122,000 |

(1) Audit fees include the total fees paid for the audits of the 2011 and 2010 annual financial statements, and reviews of the quarterly reports and other documents to be filed with the securities commissions.
(2) The nature of these services was related to a financing.

## Corporate Governance Information

### Board of Directors

All of the directors of the Company are independent, with the exception of Stephanie Wilson, who is not independent since she is the General Manager of the Company. The directors have delegated their powers to the Executive Committee. See "Corporate Governance Information – Executive Committee", below.

### Directorships

The following directors of the Company are presently directors of other reporting issuers in a jurisdiction of Canada or the equivalent in a foreign jurisdiction. James Baggs is a director of TC PipeLines GP, Inc., the general partner of TC PipeLines, LP a United States limited partnership quoted on the New York Stock Exchange.

### Compensation

The Directors, Chief Executive Officer, Chief Financial Officer and Secretary do not receive compensation from the Company. The General Manager of TQM Pipeline is compensated by TransCanada. The Executive Committee does have responsibility for evaluating and determining the reasonableness of the total amount the Company is charged for managerial, administrative and operational support that perform services on behalf of the Company. The base salaries that are allocable to the Company vary for each employee of a general partner performing services on the Company's behalf and are based on the amount of time an employee devotes to matters related to the business of the Company. Other benefit and incentive compensation expenses related to our officers are reimbursed based upon an agreed upon calculation.

### Executive Committee

The Executive Committee was formed pursuant to a partnership agreement and has equal representation from each of TransCanada and Gaz Métro, and a joint nominee of both. The members of the Executive Committee of the Company are Patrick Cabana, Steve Pohlod, and Stephanie Wilson.

All of the powers of the Company's board of directors have, to the extent permitted by law and by a partnership agreement, been delegated to the Executive Committee.

## Other Information

Additional information relating to the Company and other continuous disclosure documents is available on SEDAR at www.sedar.com under Trans Québec & Maritimes Pipeline Inc.

**SCHEDULE A**

**TRANS QUÉBEC & MARITIMES PIPELINE INC.**

**AUDIT COMMITTEE CHARTER**

## 1. ESTABLISHMENT OF THE COMMITTEE

1.1. Establishment of Audit Committee Confirmed - The establishment of the audit committee of the Board is hereby confirmed with the purpose, constitution and responsibilities set forth herein.

1.2. Certain Definitions - In this Charter:

(a) "Board" means the board of directors of the Corporation;

(b) "Chair" means the chairperson of the Committee;

(c) "Charter" means this written charter of the Committee and any such charter for the Committee which the Board resolves from time to time shall be the charter of the Committee, as amended from time to time;

(d) "Committee" means the audit committee of the Board;

(e) "Corporation" means Trans Québec & Maritimes Pipeline Inc.;

(f) "Director" means a member of the Board;

(g) "MD&A" means Management's Discussion & Analysis as contemplated in National Instrument 51-102 – Continuous Disclosure Obligations; and

(h) "External Auditor" means the Corporation's independent auditor.

1.3. Interpretation - The provisions of this Charter are subject to the provisions of the by-laws of the Corporation and to the applicable provisions of applicable legislation.

## 2. PURPOSE

2.1. Purpose - The primary purpose of the Committee is to assist Board oversight of:

(a) the integrity of the Corporation's financial statements;

(b) the Corporation's compliance with legal and regulatory reporting requirements;

(c) the External Auditor's qualifications and independence;

(d) the performance of the External Auditor; and

(e) risk management.

## 3. CONSTITUTION AND FUNCTIONING OF THE COMMITTEE

3.1. Number of Members - The Committee shall consist of not fewer than three members, each of whom shall be a Director.

3.2. Appointment and Removal of Members of the Committee

(a) *Board Appoints Members.* The members of the Committee shall be appointed by the Board.

(b) *Annual Appointments.* The appointment of members of the Committee shall take place annually at the first meeting of the Board after a meeting of the shareholders at which Directors are elected, provided that if the appointment of members of the Committee is not so made, the Directors who are then serving as members of the Committee shall continue as members of the Committee until their successors are appointed.

(c) *Vacancies.* The Board may appoint a member to fill a vacancy which occurs in the Committee between annual elections of Directors.

(d) *Removal of Member*. Any member of the Committee may be removed from the Committee by a resolution of the Board.

(e) *Exceptional Appointments*. To the extent permitted by applicable regulatory and stock exchange requirements, the Board may exceptionally appoint one or more members of the Committee who do not fulfill the criteria for membership set out in section 3.3 or 3.4 hereof in cases where the Board determines that such appointment(s) would be in the best interest of the Corporation.

3.3. Independence - Each member of the Committee shall be independent to the extent required by any applicable regulatory requirements.

3.4. Financial Literacy

(a) *Financial Literacy Requirement.* Each member of the Committee shall be financially literate or must become financially literate within a reasonable period of time after his or her appointment to the Committee, to the extent required by any applicable regulatory requirements.

(b) *Definition of Financial Literacy.* “Financially literate” means the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Corporation’s financial statements.

## 4. COMMITTEE CHAIR

4.1. Board to Appoint Chair - The members of the Committee shall appoint the Chair of the Committee from among its members.

4.2. Chair to be Appointed Annually - The designation of the Chair shall take place annually at the first meeting of the Board after a meeting of the members at which Directors are elected, provided that if the designation of Chair is not so made, the Director who is then serving as Chair shall continue as Chair until his or her successor is appointed.

## 5. COMMITTEE MEETINGS

5.1. Quorum - A quorum of the Committee shall be a majority of its members.

5.2. Secretary - Subject to the by-laws of the Corporation, the Chair shall designate from time to time a person who may, but need not, be a member of the Committee, to be Secretary of the Committee.

5.3. Time and Place of Meetings - The time and place of the meetings of the Committee and the calling of meetings and the procedure in all things at such meetings shall be determined by the Committee.

5.4. Notice of Meetings - Notice of the time and place of each meeting of the Committee shall be given to each member not less than 48 hours before the time when the meeting is to be held (or such shorter period of time as may be agreed to by all members of the Committee).

Notice of a meeting of the Committee shall:

(a) be in writing (which may be communicated by facsimile or e-mail);

(b) state the nature of the business to be transacted at the meeting in reasonable detail; and

(c) to the extent practicable, be accompanied by copies of documentation to be considered at the meeting.

5.5. Right to Vote - Each member of the Committee shall have the right to vote on matters that come before the Committee.

5.6. Invitees - The Committee may invite Directors, officers and employees of the Corporation or any other person, including the External Auditor, to attend meetings of the Committee to assist in the discussion and examination of the matters under consideration by the Committee.

5.7. Minutes - Minutes shall be prepared following each meeting of the Committee.

## 6. AUTHORITY OF COMMITTEE

6.1. Retaining and Compensating Advisors - The Committee shall have the authority to engage independent counsel and other advisors as the Committee may deem appropriate in its sole discretion and to set and pay the compensation for any such advisors.

6.2. Recommendations to the Board – The Committee shall have the authority to make recommendations to the Board, but shall have no decision-making authority other than as specifically contemplated in this Charter.

6.3. Communication with Auditors – The Committee shall have the authority to communicate directly with the internal and external auditors of the Corporation regarding matters as the Committee determines necessary to carry out its duties.

6.4. Communication with Management – The Committee shall communicate with officers of the Corporation as needed and as often as circumstances may, in the Committee's opinion, require.

## 7. REMUNERATION OF COMMITTEE MEMBERS

7.1. Remuneration of Committee Members - Members of the Committee and the Chair shall receive such remuneration for their service on the Committee as the Board may determine from time to time.

## 8. DUTIES AND RESPONSIBILITIES OF THE COMMITTEE

8.1. Review and Approval of Financial Information

(a) *Annual Financial Statements.* The Committee shall review and discuss with management and the External Auditor, the Corporation's audited annual financial statements and related MD&A together with the report of the External Auditor thereon and, if appropriate, recommend to the Board that it approve the audited annual financial statements, and shall approve any press release regarding same prior to its dissemination.

(b) *Interim Financial Statements.* The Committee shall review and discuss with management and, if appropriate, approve, the Corporation's interim unaudited financial statements and related MD&A, and shall approve any press release regarding same prior to its dissemination.

(c) *Annual Information Form and Other Documents.* The Committee shall review and discuss with management and the External Auditor and, if appropriate, recommend to the Board that it approve the annual information form as well as any offering memorandum of the Corporation, any prospectus, any document incorporated by reference in a prospectus (excluding any pricing supplement under a medium term note program) and any information circular of the

Corporation.

(d) *Procedures for Review.* The Committee shall satisfy itself that adequate procedures are in place for the review of the Corporation's disclosure of financial information extracted or derived from the Corporation's financial statements (other than financial statements, MD&A and earnings press releases, which are dealt with elsewhere in this Charter) and shall periodically assess the adequacy of those procedures.

(e) *Accounting Treatment.* The Committee shall review and discuss with management and the External Auditor:

(i) major issues regarding accounting principles and financial statement presentations, including any significant changes in the Corporation's selection or application of accounting principles and major issues as to the adequacy of the Corporation's internal controls and any special audit steps adopted in light of material control deficiencies;

(ii) analyses prepared by management and/or the External Auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements;

(iii) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures on the Corporation's financial statements;

(iv) the certifications of the financial statements as required under applicable securities laws in Canada or otherwise; and

(v) pension plan financial statements, if any.

8.2. External Auditor

(a) The External Auditor shall report directly to the Committee.

(b) *Authority with Respect to External Auditor.* The Committee shall be directly responsible for the oversight of the work of the External Auditor engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Corporation. In the discharge of this responsibility, the Committee shall:

(i) have responsibility for recommending to the Board the person or firm to be proposed to the Corporation's shareholders for appointment as External Auditor for the above-described purposes as well as the responsibility for recommending such External Auditor's compensation and determining at any time whether the Board should recommend to the Corporation's shareholders whether the incumbent External Auditor should be removed from office; and

(ii) review the terms of the External Auditor's engagement, discuss the audit fees with the External Auditor and be responsible for approving such audit fees.

(c) *Independence.* The Committee shall satisfy itself as to the independence of the External Auditor. As part of this process the Committee shall:

(i) unless and until the Committee adopts pre-approval policies and procedures and subject to subsection 8.2(d)(ii), approve any non-audit services to be provided by the External Auditor; and

(ii) review and approve the policy setting out the restrictions on the Corporation hiring partners, employees and former partners and employees of the Corporation's current or former external auditor.

(d) *Issues Between External Auditor and Management*. The Committee shall:

(i) review any problems or concerns experienced by the External Auditor in conducting the audit, including any restrictions on the scope of the External Auditor's activities or an access to requested information;

(ii) review any significant disagreements with management and, to the extent possible, resolve any disagreements between management and the External Auditor.

(e) *Oversight in Respect of Audit and Non-Audit Services.*

(i) The Committee shall pre-approve all audit services and all permitted non-audit services provided by the External Auditor or the external auditor of any subsidiary of the Corporation to the Corporation (including its subsidiaries), other than non-audit services where:

(A) The aggregate amount of all such non-audit services provided to the Corporation constitutes not more than 5% of the total fees paid by the Corporation and its subsidiaries to the external auditor during the fiscal year in which the non-audit services are provided;

(B) such services were not recognized by the Corporation at the time of the engagement to be non-audit services; and

(C) such services are promptly brought to the attention of the Committee and approved prior to the completion of the audit by the Committee or by one or more members of the Committee to whom authority to grant such approvals has been delegated by the Committee.

(ii) The Committee may delegate to one or more members of the Committee the authority to pre-approve non-audit services in satisfaction of the requirement in this section, provided that such member or members must present any non-audit services so approved to the full Committee at its first scheduled meeting following such pre-approval.

(iii) If the 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 the purposes of this section.

(f) *Evaluation of External Auditor.* The Committee shall evaluate the External Auditor each year, and present its conclusions to the Board. In connection with this evaluation, the Committee shall:

(i) review and evaluate the performance of the lead partner of the External Auditor; and

(ii) obtain the opinions of management with respect to the performance of the External Auditor.

(g) *Review of Management's Evaluation and Response*. The Committee shall:

(i) review management's evaluation of the External Auditor's audit performance;

(ii) review the External Auditor's recommendations, and review management's response to and subsequent follow-up on any identified weaknesses;

(iii) review management's response to significant internal control recommendations of the External Auditor; and

(iv) recommend to the Board whether any new material strategies presented by management should be considered appropriate and approved.

8.3. <u>Whistle-Blowing</u> - The Committee shall put in place procedures for:

(a) the receipt, retention and treatment of complaints received by the Corporation regarding accounting, internal accounting controls or auditing matters; and

(b) the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters.

8.4. Disclosure of Risks - The Committee shall ask management, after consultation with the internal and external auditors, to indicate to the Committee the principal risks to which the Company is exposed and the measures taken to minimize such risks, and report to the Committee with respect to these matters at least once a year or each time there is a change in the situation as reported.

8.5. Litigation - The Committee shall review, on a quarterly basis, the status of pending or actual litigation as well as any potential litigation.

8.6. Insurance - The Committee shall ensure that the Company's general insurance portfolio is adequate and formulate appropriate recommendations to the Board.

## 9. SUBCOMMITTEES

9.1. Delegation to Subcommittees – When the Board confers to the Committee the authority to delegate to subcommittee, the Committee may form and delegate authority to subcommittees if it considers that it would be appropriate to do so.

## 10. REPORTING TO THE BOARD

10.1. Regular Reporting - The Committee shall report to the Board following each meeting of the Committee and at such other times as the Chair may determine to be appropriate.

## 11. CHARTER REVIEW

11.1. Charter Review - The Committee shall review and assess the adequacy of this Charter on an annual basis and recommend to the Board any changes it deems appropriate.

Trans Québec & Maritimes Pipeline Inc.
(As mandatary of TQM Pipeline and
Company, Limited Partnership)

Financial Statements
December 31, 2011 and 2010

**Chartered Accountants**
2700 205 – 5th Avenue SW
Calgary AB  T2P 4B9

Telephone (403) 691-8000
Telefax (403) 691-8008
Internet www.kpmg.ca

# Independent Auditors' Report

To the Partners of TQM Pipeline and Company, Limited Partnership

We have audited the accompanying financial statements of Trans Québec & Maritimes Pipeline Inc. (as mandatory of TQM Pipeline and Company, Limited Partnership), which comprise the balance sheet as at December 31, 2011 and 2010 the statements of income and comprehensive income partners equity and cash flow for the years then ended and notes, compromising a summary of significant accounting policies and other explanatory information.

**Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of Trans Québec & Maritimes Pipeline Inc. (as mandatory of TQM Pipeline and Company, Limited Partnership) as at December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Calgary, Canada

April 13, 2012

**TRANS QUÉBEC & MARITIMES PIPELINE INC.**
**(As mandatary of TQM Pipeline and Company, Limited Partnership)**
**BALANCE SHEET**

| *As at December 31* *(thousands of dollars)* | **2011** | 2010 |
|---|---|---|
| **ASSETS** | | |
| Current assets | | |
| Cash and cash equivalents | **1,318** | 688 |
| Trade accounts receivable | | |
| Partners *(Note 11)* | **6,551** | 7,074 |
| Others | **20** | 310 |
| Other receivables | **911** | 589 |
| Inventories | **1,843** | 1,851 |
| Deposits and prepayments | **285** | 320 |
| Deferred accounts *(Note 7)* | **3,739** | 393 |
| | **14,667** | 11,225 |
| Property, plant and equipment, less accumulated depreciation and amortization *(Note 6)* | **381,157** | 400,822 |
| Deferred accounts *(Note 7)* | **66** | 2,647 |
| | **395,890** | 414,694 |
| **LIABILITIES** | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | | |
| Partners *(Note 11)* | **833** | 2,052 |
| Others | **267** | 195 |
| Interest payable | **2,170** | 2,716 |
| Long-term debt due within one year *(Note 8)* | **-** | 69,779 |
| Deferred accounts *(Note 7)* | **47** | 2,355 |
| | **3,317** | 77,097 |
| Long-term debt *(Note 8)* | **234,147** | 173,604 |
| Deferred accounts *(Note 7)* | **1,458** | 1,603 |
| | **238,922** | 252,304 |
| **PARTNERS' EQUITY** | | |
| Gaz Métro Limited Partnership | **78,476** | 81,187 |
| TransCanada PipeLines Limited | **78,476** | 81,187 |
| 3118240 Canada Inc. | **16** | 16 |
| | **156,968** | 162,390 |
| | **395,890** | 414,694 |

**Commitments – Note 10;**
**Contingencies – Note 14;**

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

On behalf of the Board,

/s/ Patrick Cabana
Patrick Cabana
Director

/s/ Steve Pohlod
Steve Pohlod
Director

**TRANS QUÉBEC & MARITIMES PIPELINE INC.**
**(As mandatary of TQM Pipeline and Company, Limited Partnership)**
**INCOME AND COMPREHENSIVE INCOME**

| *Years ended December 31* *(thousands of dollars)* | **2011** | 2010 |
|---|---|---|
| **OPERATING REVENUE** | | |
| Transportation and storage *(Note 11)* | **78,139** | 83,215 |
| Deferred revenues *(Note 12)* | **4,153** | (1,062) |
| Miscellaneous operating revenues | **75** | 72 |
| | **82,367** | 82,225 |
| **OPERATING REVENUE DEDUCTION** | | |
| Operation and maintenance expenses *(Note 11)* | **19,102** | 16,593 |
| Depreciation and amortization | **21,900** | 21,809 |
| Charges by the partners for income taxes | **10,006** | 9,639 |
| Municipal and other taxes *(Note 11)* | **2,802** | 3,125 |
| National Energy Board costs recovery | **385** | 636 |
| | **54,195** | 51,802 |
| Net operating income | **28,172** | 30,423 |
| Allowance for funds used during construction | **46** | 51 |
| Other income | **5** | 20 |
| Income before financial charges | **28,223** | 30,494 |
| Interest and amortization of discount and expenses related to the issuance of long-term debt | **8,815** | 12,913 |
| Other interest expense *(Note 11)* | **28** | 399 |
| | **8,843** | 13,312 |
| **PARTNERS' INCOME AND COMPREHENSIVE INCOME** | **19,380** | 17,182 |

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

**TRANS QUÉBEC & MARITIMES PIPELINE INC.**
**(As mandatary of TQM Pipeline and Company, Limited Partnership)**
**PARTNERS' EQUITY**

| *Year ended December 31* *(thousands of dollars)* | **2011** | | | |
|---|---|---|---|---|
| | **Gaz Métro Limited Partnership** | **TransCanada PipeLines Limited** | **3118240 Canada Inc.** | **Total** |
| **Balance, beginning of year** | **81,187** | **81,187** | **16** | **162,390** |
| Add | | | | |
| Partners' income and comprehensive income for the year | **9,689** | **9,689** | **2** | **19,380** |
| | **90,876** | **90,876** | **18** | **181,770** |
| Deduct | | | | |
| Withdrawals during the year | **12,400** | **12,400** | **2** | **24,802** |
| **Balance, end of year** | **78,476** | **78,476** | **16** | **156,968** |

| *Year ended December 31* *(thousands of dollars)* | 2010 | | | |
|---|---|---|---|---|
| | Gaz Métro Limited Partnership | TransCanada PipeLines Limited | 3118240 Canada Inc. | Total |
| **Balance, beginning of year** | 79,222 | 79,222 | 15 | 158,459 |
| Add | | | | |
| Partners' income and comprehensive income for the year | 8,590 | 8,590 | 2 | 17,182 |
| | 87,812 | 87,812 | 17 | 175,641 |
| Deduct | | | | |
| Withdrawals during the year | 6,625 | 6,625 | 1 | 13,251 |
| **Balance, end of year** | 81,187 | 81,187 | 16 | 162,390 |

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

**TRANS QUÉBEC & MARITIMES PIPELINE INC.**
**(As mandatary of TQM Pipeline and Company, Limited Partnership)**
**CASH FLOWS**

| *Years ended December 31* *(thousands of dollars)* | **2011** | 2010 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Partners' income | **19,380** | 17,182 |
| Non-cash items | | |
| Depreciation and amortization | **21,900** | 21,809 |
| Amortization of discount and expenses related to the issuance of long-term debt | **1,526** | 810 |
| Pension funding lower than amounts expensed | **3,505** | 21 |
| | **46,311** | 39,822 |
| Deferred charges, net of deferred credits relating to operating activities | **(6,723)** | 850 |
| Changes in working capital items *(Note 5)* | **(1,159)** | 880 |
| Cash flows from operating activities | **38,429** | 41,552 |
| **INVESTING ACTIVITIES** | | |
| Additions to property, plant and equipment | **(2,235)** | (1,893) |
| Retirements of property, plant and equipment | **-** | 74 |
| Cash flows used in investing activities | **(2,235)** | (1,819) |
| **FINANCING ACTIVITIES** | | |
| (Repayment) /issuance of revolving term loan | **(9,400)** | 49,900 |
| Issuance of Bonds | **-** | 100,000 |
| Repayment of Bonds | **-** | (175,000) |
| Withdrawals by the partners | **(24,802)** | (13,251) |
| Deferred charges relating to financing activities | **(1,362)** | (1,357) |
| Cash flows used in financing activities | **(35,564)** | (39,708) |
| **Net increase in cash** | **630** | 25 |
| **Cash and cash equivalents, beginning of year** | **688** | 663 |
| **Cash and cash equivalents, end of year** | **1,318** | 688 |

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

**Trans Québec & Maritimes Pipeline Inc.**
**(As mandatary of TQM Pipeline and Company, Limited Partnership)**
**NOTES TO THE FINANCIAL STATEMENTS**

## NOTE 1 MANDATARY (AGENT) RELATIONSHIP

Trans Québec & Maritimes Pipeline Inc. ("TQM Pipeline" or the "Company") was incorporated under the *Canada Business Corporations Act* on April 24, 1980. On January 5, 1982, the Company was appointed mandatary (agent) of a partnership (the "Partnership") then known as TQM Pipeline Partnership to construct and operate a natural gas pipeline system in the provinces of Québec, New Brunswick and Nova Scotia, including the transportation and sale of natural gas to distributors. The pipeline connects with the system operated by TransCanada PipeLines Limited ("TransCanada") at Saint-Lazare, Québec, near the Ontario border. A portion of the pipeline extends from Saint-Lazare to Saint-Nicolas on the South Shore of Québec City, while the other portion extends from Lachenaie to East Hereford, where it connects to the Portland Natural Gas Transmission System network ("PNGTS") in the northeast United States ("U.S.").

Until August 24, 1995, Gaz Métro Limited Partnership ("Gaz Métro") and TransCanada were equal partners in the Partnership, which was, up to that date, a general partnership formed under the laws of the Province of Québec. On August 24, 1995, the Partnership continued its existence as a limited partnership governed by the laws of the Province of Québec of which Gaz Métro and TransCanada became the general partners and of which 3118240 Canada Inc. became the limited partner, and the Partnership changed its name to TQM Pipeline and Company, Limited Partnership. A capital contribution of $8,250 was made on that date by 3118240 Canada Inc. to the Partnership. Consequently, Gaz Métro and TransCanada each hold a 49.995% general partner interest in the Partnership, while 3118240 Canada Inc. holds a 0.01% limited partner interest in the Partnership. Gaz Métro and TransCanada are equal shareholders in the Company, 3118240 Canada Inc. and TQM Finance Inc. ("TQMF"). TQMF acts as a financial intermediary between the Company and the Partnership and holds no ownership interest in any of the aforementioned entities.

These financial statements include the assets, liabilities, and operations of the Company, as mandatary of the Partnership, and those of the Partnership.

## NOTE 2 BASIS OF OPERATIONS

**Operations**
The Company transports natural gas from Saint-Lazare, Québec, to the various points of interconnection with the distributor's systems in Québec and to PNGTS at the New Hampshire border.

The natural gas is transported by the Company, on behalf of TransCanada, to the various points of interconnection under a long-term Transportation Service Agreement between the two parties.

## NOTE 3 SIGNIFICANT ACCOUNTING POLICIES

**Accounting estimates**
The financial statements of the Company, as mandatary of the Partnership, have been prepared by management in accordance with Canadian generally accepted accounting principles ("CGAAP") as defined in Part V of the Canadian Institute of Chartered Accountants ("CICA") Handbook. Amounts are stated in Canadian dollars unless otherwise indicated. In preparing these financial statements, the Company's management is required to make estimates and assumptions that affect both the amount and timing of recording assets, liabilities, revenues and expenses as the determination of these items may be dependent on future events. The most significant accounting estimates relate to financial instruments, depreciation and amortization expense and impairment of long-lived assets.

**Cash and cash equivalents**
The Company's policy is to present cash and temporary investments having a term of three months or less from the acquisition date as cash and cash equivalents.

**Inventories**
Inventories represent plant materials, operating supplies and transmission line pack gas. Inventories are valued at the lower of cost on an average cost basis and net realizable value.

**Property, plant and equipment**
Property, plant and equipment are carried at cost less accumulated depreciation and amortization.

Additions to gas plant under construction are capitalized at cost and include materials, construction and engineering costs and overhead applicable to the capital construction program. In addition, as approved by the National Energy Board ("NEB"), an allowance for funds used during construction at the rate approved by the NEB is capitalized to the project.

The depreciation and amortization expense is calculated on a straight-line basis using rates approved by the NEB. Depreciation for 2011 and 2010 were calculated based on rates approved in the 2010-2012 Tolls Settlement Agreement ("Settlement Agreement"), resulting in a composite annual rate of depreciation of approximately 2.49%.

**Regulation**
The Company is subject to the authority of the NEB and its operations are regulated with respect to the determination of revenues, tolls, construction and operations. In order to appropriately reflect the economic impact of the regulator's decisions regarding the Company's revenues and tolls, and thereby achieve a proper matching of revenues and expenses, the timing of recognition of certain revenues and expenses may differ from that otherwise expected under policies adopted by a non-regulated enterprise using CGAAP. The impact of rate regulation on the Company's financial statements is provided in Note 13 of these financial statements.

In November 2010, the NEB approved TQM Pipeline's Settlement Agreement with its interested parties with respect to its annual revenue requirement for 2010, 2011 and 2012. As part of this agreement, the annual revenue requirement is composed of fixed and flow-through components. The fixed component includes certain operating and maintenance costs, return on rate base, depreciation and municipal taxes. Any variances between actual costs and those included in the fixed component accrue to TQM Pipeline. The NEB approved the Company's final tolls for 2011 and 2010 which reflect the terms of the Settlement Agreement.

**Revenue recognition**
The Company's revenues, which are subject to rate regulation, are recognized in accordance with decisions made by the NEB. The Company's 2011 and 2010 revenues are based on a cost-of-service model, whereby a fixed-cost component and a forecasted flow-through cost component equal the revenues for the year.

**Deferred accounts**
Included in current deferred assets for 2011 and 2010 are costs incurred in excess of forecasted flow-through amounts in the Settlement Agreement.

Current deferred liabilities for 2011 and 2010 represent costs incurred which were less than forecasted flow-through amounts in the Settlement Agreement. Pension costs payable based on an actuarial valuation are included in the 2011 and 2010 non-current deferred liabilities.

**Pension and life insurance plans**
The Company maintains a supplemental pension plan and other post retirement benefits for its former employees. Until July 2011, the Company also maintained a non-contributory defined benefit pension plan and life insurance plan.

Under CICA Handbook Section 3461, the following accounting policies are applied for these plans:

– the cost of the pension and other retirement benefit plans earned by former employees is actuarially determined using the projected benefit method prorated on service and is charged to earnings as services are provided by employees. The calculations take into account Management's best estimate of expected plan investment performance, salary escalation, retirement ages of former employees and mortality rates;

– for the purpose of calculating the expected return on plan assets, those assets are valued at fair value; and

– actuarial gains or losses arise from the difference between the actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net actuarial gain or loss over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining life expectancy of the employee group covered by the plan. The average residual life expectancy of the former employees covered by the pension plan is 17 years (18 years in 2010). The average residual life expectancy of the former employees covered by the life insurance plan is nil years (13 years in 2010).

**Income taxes**
Other than charges by the partners for income taxes, no other provision for income taxes has been reflected in the financial statements, since income taxes on income earned by the Partnership, for which the Company is acting as mandatary, are payable by each of the partners.

**Impairment of long-lived assets**
The Company reviews long-lived assets such as property, plant and equipment, and intangible assets for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. If the total of the estimated undiscounted future cash flows is less than the carrying value of the asset, an impairment loss is recognized for the excess of the carrying value over the fair value of the assets.

**Financial instruments**
The CICA Handbook requires that all financial instruments must initially be included on the balance sheet at their fair market value. Subsequent measurement of the financial instrument is based on their classification. Financial assets are classified into the following categories: held-for-trading, available-for-sale, held-to-maturity investments, and loans and receivables. Financial liabilities are classified as held-for-trading or other financial liabilities.

– Trade accounts receivable and other receivables with fixed or determinable payments that are not quoted in an active market, are classified as loans and receivables. They are measured at amortized cost, which is generally the initial recognized amount, less any allowance for doubtful accounts.

– Accounts payable and accrued liabilities and interest payable are classified as other financial liabilities. They are measured at cost using the effective interest method.

– Long-term debt is classified as other financial liabilities. It is measured at amortized cost using the effective interest method. The Company offsets debt transaction costs against the associated debt. In 2011 the offset against debt was $1,353,000 ($1,395,500 in 2010).

## NOTE 4 CHANGES IN ACCOUNTING POLICIES

**Future Accounting Changes**

*United States Generally Accepted Accounting Principles ("U.S. GAAP")*
The CICA's Accounting Standards Board ("AcSB") previously announced that Canadian publicly accountable enterprises were required to adopt International Financial Reporting Standards ("IFRS") effective January 1, 2011, with the exception of certain qualifying entities historically using rate-regulated accounting ("RRA") that were given a one year deferral from adopting IFRS. The Company is a qualifying entity for these purposes and has deferred the adoption of IFRS. The Company has prepared its consolidated financial statements for 2011 in accordance with CGAAP in order to continue using RRA.

In accordance with CGAAP, TQM Pipeline currently follows specific accounting policies unique to a rate-regulated business. These RRA standards allow the timing of recognition of certain expenses and revenues to differ from that which may otherwise be expected in a non-rate-regulated business under CGAAP in order to appropriately reflect the economic impact of regulators' decisions regarding the Company's revenues and tolls. These timing differences are recorded as Regulatory Assets and Regulatory Liabilities and included in Deferred Accounts on TQM Pipeline's Balance Sheet. They represent current rights and obligations regarding cash flows expected to be recovered from or refunded to customers based on decisions and approvals by the applicable regulatory authorities.

In October 2010, the AcSB and the Canadian Securities Administrators amended their policies applicable to Canadian publicly accountable enterprises that use RRA in order to permit these entities to defer the adoption of IFRS for one year. Due to the continued uncertainty around the timing, scope and eventual adoption of an RRA standard under IFRS, TQM Pipeline has deferred its adoption of IFRS accordingly and has continued preparing its financial statements in 2011 in accordance with CGAAP, as defined by Part V of the CICA Handbook, in order to continue using RRA. The International Accounting Standards Board has concluded that the development of RRA under IFRS requires further analysis and the Company does not expect a final RRA standard under IFRS to be effective in the foreseeable future.

In August 2011, TQM Pipeline filed a dual application with Québec's Autorité des marchés financiers ("AMF"), as its principal financial regulator, and the Ontario Securities Commission for an exemption from the requirements under subsection 3.2(1) of National Instrument 52-107, *Acceptable Accounting Principles and Auditing Standards* to permit TQM Pipeline to use U.S. GAAP as the accounting framework for the preparation of its financial statements for financial years commencing on or after January 1, 2012 but before January 1, 2015.

In March 2012, the AcSB issued a decision to extend the deferral of the mandatory IFRS changeover date for entities with qualifying rate-regulated activities by one year to January 1, 2013.

The Company continues to work with the AMF and expects to receive approval to use U.S. GAAP. If approval is not received prior to reporting the 2012 results TQM Pipeline will take the AcSB one year extension of the deferral period for changeover to IFRS and continue reporting under CGAAP.

## NOTE 5 INFORMATION INCLUDED IN THE STATEMENT OF CASH FLOWS

The changes in working capital items are detailed as follows:

| *Years ended December 31*<br>*(thousands of dollars)* | **2011** | 2010 |
|---|---|---|
| Trade accounts receivable | | |
| Partners | **523** | 3,204 |
| Others | **290** | (305) |
| Other receivables | **(322)** | 326 |
| Inventories | **8** | 694 |
| Deposits and prepayments | **35** | 30 |
| Accounts payable and accrued liabilities | | |
| Partners | **(1,219)** | (1,742) |
| Others | **72** | (228) |
| Interest payable | **(546)** | (1,099) |
| | **(1,159)** | 880 |

Interest paid in 2011 on operating activities was $8,995,000 ($13,700,000 in 2010).

## NOTE 6 PROPERTY, PLANT AND EQUIPMENT

| *As at December 31* *(thousands of dollars)* | **2011** Depreciation and amortization rates | Cost | Accumulated depreciation and amortization | Net |
|---|---|---|---|---|
| **Gas plant in service** | | | | |
| Franchises and consents | **0.77 %** | **21,295** | **16,286** | **5,009** |
| Other plant | **-** | **12,784** | **12,784** | **-** |
| Land | **-** | **1,875** | **-** | **1,875** |
| Land rights | **1.10 to 4.51 %** | **46,645** | **31,462** | **15,183** |
| Mains | **1.14 to 4.43 %** | **688,720** | **396,146** | **292,574** |
| Measuring and regulating structures and equipment and other structures | **0.28 to 4.40 %** | **24,284** | **18,984** | **5,300** |
| Compressor structures and equipment | **3.05 to 6.04 %** | **81,462** | **22,070** | **59,392** |
| Leasehold improvements, office furniture and other equipment | **0.24 to 12.75 %** | **611** | **61** | **550** |
| | | **877,676** | **497,793** | **379,883** |
| Gas plant held for future use | | **14** | **-** | **14** |
| Retirement work in progress | | **(5)** | **-** | **(5)** |
| Gas plant under construction | | **1,265** | **-** | **1,265** |
| | | **878,950** | **497,793** | **381,157** |

| *As at December 31* *(thousands of dollars)* | 2010 Depreciation and amortization rates | Cost | Accumulated depreciation and amortization | Net |
|---|---|---|---|---|
| **Gas plant in service** | | | | |
| Franchises and consents | 0.77 % | 21,295 | 16,122 | 5,173 |
| Other plant | - | 12,784 | 12,784 | - |
| Land | - | 1,875 | - | 1,875 |
| Land rights | 1.10 to 4.51 % | 46,645 | 24,403 | 22,242 |
| Mains | 1.14 to 4.43 % | 688,175 | 385,902 | 302,273 |
| Measuring and regulating structures and equipment and other structures | 0.28 to 4.40 % | 24,185 | 18,682 | 5,503 |
| Compressor structures and equipment | 3.05 to 6.04 % | 79,717 | 18,146 | 61,571 |
| Leasehold improvements, office furniture and other equipment | 0.24 to 12.75 % | 3,714 | 3,578 | 136 |
| | | 878,390 | 479,617 | 398,773 |
| Gas plant held for future use | | 14 | - | 14 |
| Retirement work in progress | | 7 | - | 7 |
| Gas plant under construction | | 2,028 | - | 2,028 |
| | | 880,439 | 479,617 | 400,822 |

## NOTE 7 DEFERRED ACCOUNTS

| *As at December 31* *(thousands of dollars)* | **2011** | 2010 |
|---|---|---|
| **Deferred assets** | | |
| **Current** | | |
| Costs incurred for 2011 and 2010 that are in excess of amounts approved in the Settlement Agreement: | | |
| Income taxes | **49** | 157 |
| Capital variance | **95** | 5 |
| Pension program | **1,459** | - |
| Storage revenues | **197** | - |
| Financial charges on deferred expenses | **45** | 3 |
| | **1,845** | 165 |
| Inventory management | **211** | 228 |
| Capital project | **454** | - |
| Pension program | **1,229** | - |
| | **3,739** | 393 |
| **Non-current** | | |
| Inventory management | **-** | 228 |
| Accrued pension benefit asset | **-** | 2,310 |
| Other | **66** | 109 |
| | **66** | 2,647 |
| **Deferred liabilities** | | |
| **Current** | | |
| Costs incurred for 2011 and 2010 that are less than amounts approved in the Settlement Agreement: | | |
| Carry forward of prior year deferrals | **-** | 533 |
| NEB cost recovery | **-** | 4 |
| Stress corrosion cracking expenses | **24** | 776 |
| Storage revenues | **-** | 5 |
| Pension program | **-** | 979 |
| Financial charges on deferred credits | **23** | 58 |
| | **47** | 2,355 |
| **Non-current** | | |
| Accrued pension and other post-employment benefit liability | **1,458** | 1,603 |

## NOTE 8 LONG-TERM DEBT

| *As at December 31*<br>*(thousands of dollars)* | Interest rate | Maturity date | **2011** | 2010 |
|---|---|---|---|---|
| Revolving term loan | (1) | **2016-08-19** | **60,500** | 69,900 |
| Series 'K' Bonds | **4.050 %** | **2014-09-15** | **75,000** | 75,000 |
| Series 'L' Bonds | **4.250 %** | **2017-09-15** | **100,000** | 100,000 |
| Principal amount of total long-term debt | | | **235,500** | 244,900 |
| Less current portion of long-term debt | | | **-** | (69,900 ) |
| Less prepaid interest and unamortized debt costs | | | **(1,353 )** | (1,396 ) |
| Net long-term debt | | | **234,147** | 173,604 |
| | | | | |
| Current portion of long-term debt | | | **-** | 69,900 |
| Less prepaid interest and unamortized debt costs | | | **-** | (121 ) |
| Net current portion of long-term debt | | | **-** | 69,779 |

(1) The Company has four borrowing options for the revolving term loan:

- Canadian prime rate based loans and advances - Canadian prime.
- Bankers acceptance borrowings and loans - BA rate plus 1.00%.
- U.S. bank rate advances – U.S. bank rate.
- LIBOR advances - LIBOR rate plus 1.00%.
- Rates are determined based on the Company's current DBRS Limited rating of "A (low)".

On August 19, 2011, the Partnership and the Company entered into an amended and restated five year revolving term loan credit agreement. A maximum $85,000,000 revolving term loan is authorized under this agreement. In 2010, the revolving term loan balance was included in current liabilities.

The interest rate on the Company's revolving term loan as at December 31, 2011 was 1.77% (1.63% in 2010).

In July 2010, TQM Pipeline issued $100,000,000 principal amount 4.25% Series 'L' Bonds ("Series 'L' Bonds") maturing in September 2017. The proceeds from the issuance of the Series 'L' Bonds together with an amount available under the revolving term loan facility were used to repay the principal amount of the outstanding Series 'I' and Series 'J' Bonds which matured on September 22, 2010.

**Contractual repayments**

The contractual repayment requirements for the long-term debt are as follows:

| *(thousands of dollars)* | Payments due by period |
|---|---|
| 2012 | - |
| 2013 | - |
| 2014 | 75,000 |
| 2015 | - |
| 2016 and thereafter | 160,500 |
| | 235,500 |

The contractual interest payments required for the outstanding bonds and revolving term loan are as follows:

| *(thousands of dollars)* | Payments due by period |
|---|---|
| 2012 | 7,288 |
| 2013 | 7,288 |
| 2014 | 7,287 |
| 2015 | 4,250 |
| 2016 and thereafter | 8,500 |
| | 34,613 |

**Sensitivity**
A one percent change in interest rates would have the following effect on net income assuming all other variables were to remain constant:

| *(thousands of dollars)* | Increase | Decrease |
|---|---|---|
| Effect on interest expense of variable interest rate debt | 467 | (467 ) |

**Other**
Through a series of related transactions, the Company (being the holder of title to the pipeline system) had as of December 31, 2009, $250,000,000 aggregate principal amount of its bonds issued to TQMF, in consideration for a like principal amount of demand bonds of TQMF. TQMF in turn sold the Series 'I' Bonds, Series 'J' Bonds and Series 'K' Bonds to the Partnership in consideration for demand promissory notes in like aggregate principal amount. The Series 'I' Bonds and Series 'J' Bonds were repaid in September 2010 at maturity. The demand bonds of TQMF and demand promissory notes of the Partnership were correspondingly reduced by this amount, leaving the demand bonds of TQMF and a promissory note (the "Series 'K' Partnership Note"), each in the amount of $75,000,000, with respect to the Series 'K' Bonds still outstanding at December 31, 2011.

The Series 'L' Bonds, issued in connection with the September 2010 repayment of the Series 'I' Bonds and Series 'J' Bonds, were issued directly to the Partnership in consideration for a demand promissory note in like principal amount (the "Series 'L' Partnership Note" and together with the Series 'K' Partnership Note, collectively referred to as the "Partnership Notes").

The Partnership is liable for the indebtedness evidenced by the Series 'K' Bonds and the Series 'L' Bonds and consequently such bonds are not treated as an asset in the accounts of the Partnership. The indebtedness evidenced by the Partnership Notes, being discharged without payment upon surrender for redemption or repayment of the Series 'K' Bonds, is not treated as a liability in the accounts of the Partnership.

## NOTE 9 PENSION PLANS AND OTHER RETIREMENT BENEFITS

In 2010, the Company had a defined benefit pension plan for its former employees and a supplemental pension plan for its former executive officers. Benefits under these plans were primarily based on years of service and highest average eligible earnings during three years not necessarily consecutive. The Company also had a life insurance plan for retired employees. At December 31, 2011, only the supplemental pension plan remains.

On the recommendation of TQM Pipeline's Pension Committee and Executive Committee, the Board of Directors resolved to terminate the existing defined benefit pension plan, effective November 15, 2010 and the life insurance plan, effective April 1, 2011. The pension plan's regulator, the Office of the Superintendent of Financial Institutions ("OSFI"), upon being notified of TQM Pipeline's intent to terminate this pension plan, acknowledged receipt of the notification of pending termination and wind-up. Members of the pension plan were notified mid-December 2010 of TQM Pipeline's intent.

In May 2011, TQM Pipeline received approval from the OSFI to terminate the defined benefit registered pension plan ("Pension Plan"), effective November 15, 2010. Upon settlement of the Pension Plan, a pension expense was recognized in September 2011 to write-off the assets on the Balance Sheet. All pension program costs, which include other retirement benefits, are treated on a flow-through basis, subject to the NEB's approval, in accordance with the terms of the Settlement Agreement.

Total cash payments for pension plans and other retirement benefits, consisting of cash contributed by the Company to its funded pension plan and cash payments directly to beneficiaries for its unfunded other plans were $1,487,000 in 2011 ($320,000 in 2010).

The Company measures its accrued benefit obligation and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation for funding purposes of the supplemental pension plan was prepared as at December 31, 2011.

The supplemental pension plan does not hold any of the Company's securities in their investments.

Information relating to the various plans is as follows:

| *As at December 31* | Pension plans | | Life insurance plan | |
|---|---|---|---|---|
| *(thousands of dollars)* | **2011** | 2010 | **2011** | 2010 |
| **Reconciliation of accrued benefit obligation** | | | | |
| Opening balance | **10,801** | 10,192 | **191** | 123 |
| Current service cost | **-** | - | **-** | - |
| Interest cost on accrued benefit obligation | **343** | 593 | **2** | 7 |
| Benefit payments | **(458 )** | (608 ) | **(232 )** | (15 ) |
| Special event - pension wind-up | **(9,661 )** | - | **-** | - |
| Actuarial loss | **1,028** | 624 | **39** | 76 |
| Closing balance | **2,053** | 10,801 | **-** | 191 |
| **Reconciliation of fair value of assets** | | | | |
| Opening balance | **8,850** | 8,661 | | |
| Employer contributions | **1,255** | 305 | | |
| Actual return on assets | **14** | 492 | | |
| Benefits paid | **(458 )** | (608 ) | | |
| Special event - pension wind-up | **(9,661 )** | - | | |
| Closing balance | **-** | 8,850 | | |
| **Reconciliation of accrued benefit obligation to accrued benefit liability at end of year** | | | | |
| Plan assets at fair value | **-** | 8,850 | **-** | - |
| Accrued benefit obligation | **2,053** | 10,801 | **-** | 191 |
| Plan deficit[(1)] | **(2,053 )** | (1,951 ) | **-** | (191 ) |
| Unamortized transitional (asset) obligation | **-** | (86 ) | **-** | - |
| Unamortized past service costs | **-** | 30 | **-** | - |
| Unamortized net actuarial loss | **595** | 2,817 | **-** | 88 |
| Accrued benefit (liability) assets[(2)] | **(1,458 )** | 810 | **-** | (103 ) |

(1) As at December 31, 2011, the unfunded supplemental pension plan had a deficit consisting of an accrued benefit obligation of $1,400,000 ($1,500,000 as at December 31, 2010).

(2) The accrued benefit (liability) asset is included in the deferred accounts.

| *Years ended December 31* *(thousands of dollars)* | Pension plans 2011 | 2010 | Life insurance plan 2011 | 2010 |
|---|---|---|---|---|
| **Determination of benefit cost** | | | | |
| Current service cost | **-** | - | **-** | - |
| Interest cost on accrued benefit obligation | **343** | 593 | **2** | 7 |
| Actual return on plan assets | **(14 )** | (492 ) | **-** | - |
| Actuarial loss on obligation | **1,028** | 624 | **39** | 76 |
| Special event - pension wind-up | **-** | - | **127** | - |
| Benefit cost before adjustments | **1,357** | 725 | **168** | 83 |
| Adjustments | | | | |
| Difference between expected return and actual return on plan assets | **14** | (107 ) | **-** | - |
| Difference between current year loss on obligation and the amortization of loss in the year | **(906 )** | (563 ) | **(39 )** | (76 ) |
| Difference between current year past service cost and the amortization of past service cost in the year | **18** | 31 | **-** | - |
| Amortization of the transitional (asset) obligation | **(34 )** | (58 ) | **-** | 6 |
| Total adjustments | **(908 )** | (697 ) | **(39 )** | (70 ) |
| Benefit cost for defined benefit | **449** | 28 | **129** | 13 |

For 2011 and 2010, the significant assumptions which management considers to be the most likely and which were used to measure the Company's accrued benefit obligations are as follows:

| | Pension plans 2011 | 2010 | Life insurance plan 2011 | 2010 |
|---|---|---|---|---|
| **Assumptions** | | | | |
| Benefit cost (current year) | | | | |
| Discount rate | **5.00 %** | 6.00 % | **5.00 %** | 6.00 % |
| Expected long-term rate of return on plan assets | **n/a** | 7.00 % | **n/a** | n/a |
| Rate of salary escalation | **n/a** | n/a | **n/a** | n/a |
| Accrued benefit obligation (end of year) | | | | |
| Discount rate | **4.25 %** | 5.00 % | **n/a** | 5.00 % |
| Rate of salary escalation | **n/a** | n/a | **n/a** | n/a |
| **End of year allocation of fair value of assets** | | | | |
| Money market | **n/a** | 100.00 % | **n/a** | n/a |

## NOTE 10 COMMITMENTS

**Operating leases**

Future annual payments, net of sub-lease receipts, under the Company's operating lease for premises at December 31, 2011 are as follows:

| *Years ended December 31* *(thousands of dollars)* | Net payments |
|---|---|
| 2012 | 25 |
| 2013 | 6 |
| 2014 and thereafter | - |
| | 31 |

The lease for the premises expires March 31, 2013. Net rental expense in 2011 was $25,000 ($20,000 in 2010).

**Other commitments**
Under an agreement ("TQM Services Agreement") between the Company and TQM Services Limited Partnership ("TQM Services"), beginning on January 1, 2003, the majority of the Company's operating functions are being performed by TQM Services. The Company has committed to pay the following minimum amounts to TQM Services for these operating services:

| *Years ended December 31* *(thousands of dollars)* | Minimum payments |
|---|---|
| 2012 | 10,624 |
| 2013 | 10,624 [1] |

(1) Will be adjusted for inflation from the previous year.

The Company has signed commitments of approximately $9,700 in 2012 and nil in 2013 to third-party suppliers for the purchase of services and equipment.

## NOTE 11 RELATED PARTY TRANSACTIONS

During the year, the Company entered into the following transactions with related parties in the normal course of business.

Transportation revenues totalling $77,760,000 in 2011 ($82,810,000 in 2010) have been recorded for natural gas transportation services rendered to TransCanada.

Revenues relating to storage and transportation totalling $341,600 in 2011 ($367,600 in 2010) have been recorded for services rendered to Gaz Métro.

Municipal and other taxes included amounts of $5,000 in 2011 ($330,000 in 2010) incurred by the partners in respect of capital taxes.

Other interest expense included $7,900 of interest paid to the partners in 2011 ($278,700 in 2010).

Operation and maintenance expenses included $100,000 paid to Gaz Métro for contracted services in 2011 ($100,000 in 2010).

As at December 31, 2011, the Company had a receivable due from TransCanada for $6,488,600 ($6,900,100 as at December 31, 2010) and from Gaz Métro for $62,700 ($174,200 as at December 31, 2010) related to natural gas transportation services and financial charges.

As at December 31, 2011, TQM Pipeline had a payable due to TransCanada for $347,200 and due to Gaz Métro for $485,800 ($1,360,600 and $692,100 respectively, as at December 31, 2010), mainly for income taxes and flow-through costs.

Effective January 1, 2003, pursuant to the TQM Service Agreement, the majority of the Company's operating functions are provided by TQM Services, which is owned equally by TransCanada and Gaz Métro.

TQM Services charged the Company the following amounts for services that it provided to TQM Pipeline:

| *Years ended December 31* *(thousands of dollars)* | **2011** | 2010 |
|---|---|---|
| Fee for operating services | **10,331** | 10,052 |
| Services related to capital expenditures | **2,933** | 2,330 |
| Additional operating services | **2,837** | 3,564 |
| | **16,101** | 15,946 |

All transactions have been measured at the exchange amount.

## NOTE 12 DEFERRED REVENUES

| *Years ended December 31* *(thousands of dollars)* | **2011** | 2010 |
|---|---|---|
| Variances of costs for 2011 and 2010 related to the Settlement Agreement: | | |
| Storage revenues | **197** | (5) |
| Stress corrosion cracking expenses | **(24)** | (776) |
| Income taxes | **49** | 157 |
| Capital variance | **95** | 5 |
| Pension program | **1,459** | (979) |
| NEB cost recovery | **-** | (4) |
| Amortization of prior year's regulatory deferrals | **2,377** | 540 |
| | **4,153** | (1,062) |

## NOTE 13 REGULATED BUSINESS

TQM Pipeline's regulatory assets and liabilities represent future revenues that are expected to be recovered from or refunded to customers based on decisions and approvals by the NEB. In addition to CGAAP financial reporting, TQM Pipeline files financial reports using accounting regulations required by the NEB.

The Company provides gas transmission services under natural gas transportation tariffs that provide for cost recovery including return of and return on capital as approved by the NEB. Tolls charged by the Company are set through a process that involves the filing of an application for a change in tolls with the regulator, the NEB. Under the regulation, tolls are underpinned by the total annual revenue requirement which includes an annual return on capital, including debt and equity, and all necessary operating expenses, taxes and depreciation.

The Company is regulated using a cost-of-service model, where the forecast costs which may include a fixed and flow-through component plus a return of capital equals the revenues for the upcoming year. To the extent that actual costs are more or less than forecast flow-through costs, the regulator generally allows the difference to be deferred to a future period and recovered or refunded in revenues at that time. Those costs for which the regulator does not allow the difference between actual and forecasted costs to be deferred, are included in the determination of net income in the year in which they are incurred.

The NEB approves pipeline tolls on an annual cost of service basis and allows the Company to charge a schedule of tolls based on the estimated cost of service. This schedule of tolls is used for the current year until a new toll filing is made for the following year. TQM Pipeline operated under final tolls in 2011 and 2010 as approved by the NEB in June 2011 and December 2010, respectively.

| *As at December 31* *(thousands of dollars)* | **2011** | 2010 | Remaining Recovery/ Settlement Period (years) |
|---|---|---|---|
| **Regulatory assets** | | | |
| Operating and debt service regulatory assets(1) | **1,845** | 165 | 1 |
| Pension program(2) | **1,229** | - | 1 |
| Inventory management(3) | **211** | 456 | 1 |
| Other | **58** | 58 | |
| **Total regulatory assets (Deferred accounts)** | **3,343** | 679 | |
| **Regulatory liabilities (Deferred accounts)** | | | |
| Operating and debt service regulatory liabilities(1) | **47** | 2,355 | 1 |

(1) Operating and debt-service regulatory assets and liabilities represent the accumulation of cost and revenue variances approved by the NEB for inclusion in determining tolls for the following calendar year. Pre-tax operating results would have been $3,987,900 lower in 2011 (2010 - $1,636,000 higher) if these amounts had not been recorded as regulatory assets and liabilities.

(2) In September 2011, the pension asset was wound up at a cost of $3,688,000. In accordance with the 2010-2012 Settlement Agreement, the cost of the Pension Program wind-up was to be realized over the life of the agreement. Due to the timing of the asset wind-up, two-thirds of the expense was recognized in the current year, and one-third was deferred until 2012. Pre-tax operating results would have been $1,229,000 lower in 2011 (2010-nil) if this amount had not been recorded as a regulatory asset.

(3) In 2010, based on an inventory rationalization program, the Company wrote-down its materials and supplies inventory. Under the terms of the Settlement Agreement, $1,000,000 related to the inventory rationalization will be collected in tolls over the three years of the multi-year settlement. In the absence of rate-regulated accounting, CGAAP would have required the inventory write-down to be included in the operating results of the company in the year the inventory was written down. If this amount had not been recorded as a regulatory asset, pre-tax operating results would have been $228,000 higher in 2011(2010 - $456,000 lower).

## NOTE 14 CONTINGENCIES

In October 2008, the Company was notified by The Sintra Group ("Sintra") of a potential claim against the Company with regards to land that was expropriated from Sintra in 1998. Sintra is operating a gravel/stone quarry on the land. TQM Pipeline and Sintra are currently in discussions regarding the operations of the quarry. At this time, there has been no official claim made by Sintra, hence an estimate of the amount of the contingency cannot yet be determined.

## NOTE 15 ASSET RETIREMENT OBLIGATIONS

At December 31, 2011, no amount has been recorded for asset retirement obligations as it is not possible to make a reasonable estimate of the fair value of the liability due to the inability to determine the timing of the asset retirements. Management believes it is reasonable to assume that all retirement costs will be recovered through the tolls in future periods.

## NOTE 16 RISK AND CAPITAL MANAGEMENT AND FINANCIAL INSTRUMENTS

**Foreign exchange and interest rate risk**

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's net income or the value of its holdings of financial instruments. Foreign exchange risk and interest rate risk is created by fluctuations in the fair values or cash flows of financial instruments due to changes in foreign exchange rates and/or market interest rates.

The Company has long-term debt that has a fixed interest rate, and therefore its valuation is subject to fluctuations in fair value due to changes in market interest rates. During the period, the Company had no positions in derivatives for interest rate or foreign exchange management.

**Liquidity & Re-financing Risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure that it will have sufficient cash and credit facilities to meet its obligations, under both normal and stressed conditions, without incurring unacceptable losses or damage to the

Company's reputation. In general, the Company's financial needs may be met through a combination of operating cash flow, its revolving term loan facility, issuance of long-term debt, and partner contributions.

The Company's business operations result in reasonably predictable cash flows. Management typically forecasts these cash flows for a period of 12 months to identify operational and investing requirements over and above its operating cash flow. These short-term requirements are addressed using a revolving term loan credit facility. At December 31, 2011, $24,500,000 was available for borrowing from the Company's unused portion of its $85,000,000 revolving term loan.

**Capital management**

The primary objective of capital management is to ensure the Company has strong credit ratings to support its business and maximize value for its partners.

Based on the NEB's RH-1-2008 Decision in March 2009 which granted an aggregate return on capital leaving the Company to determine its optimal capital structure, the Company has maintained a 60 per cent debt, 40 per cent equity capital structure.

The Company's debt is composed of two long-term bond issues and a revolving term loan facility. The Company manages its optimal capital ratio through the use of its revolving term loan as well as withdrawals and cash calls to its partners. Through the use of models, the Company can reasonably predict future cash requirements and financing to attain its optimal debt-to-equity ratio.

At December 31, 2011 the capital structure was 60% debt and 40% equity and the total capital managed by the Company was as follows:

| *As at December 31*<br>*(thousands of dollars)* | **2011** | 2010 |
|---|---|---|
| Revolving term loan | **60,500** | 69,900 |
| Series 'K' Bonds | **75,000** | 75,000 |
| Series 'L' Bonds | **100,000** | 100,000 |
| Principal amount of total debt | **235,500** | 244,900 |
| | | |
| Total equity | **156,968** | 162,390 |
| Total capital | **392,468** | 407,290 |

| *As at December 31* | **2011** | 2010 |
|---|---|---|
| Revolving term loan | **15.4**% | 17.0% |
| Bonds | **44.6**% | 43.0% |
| Equity | **40.0**% | 40.0% |
| Total capital | **100.0**% | 100.0% |

**Financial instrument summary**

At December 31, the carrying and fair value of the Company's long-term debt is detailed as follows:

| | **2011** | | 2010 | |
|---|---|---|---|---|
| *(thousands of dollars)* | **Carrying value** (1) | **Fair value** | Carrying value(1) | Fair value |
| **Current** | | | | |
| Revolving term loan | - | - | 69,779 | 69,900 |
| **Long-term** | | | | |
| Revolving term loan | **60,221** | **60,500** | - | - |
| Series 'K' Bonds | **74,575** | **79,122** | 74,375 | 78,236 |
| Series 'L' Bonds | **99,351** | **108,860** | 99,229 | 103,648 |

(1) Carrying value is net of prepaid interest and unamortized debt costs.

The fair value of the revolving term loan is equivalent to its carrying value, as it bears interest at a rate that varies with market rates.

The fair value of the bonds is determined based on current market prices, normally the current bid price for the outstanding bonds. When such information was not available, the fair value of the bonds was estimated by discounting future payments of interest and principal at estimated interest rates.

All other financial instruments are short-term financial instruments whose fair value approximates the carrying amount given that they have a short time to maturity.

Net income in 2011 and 2010 included unrealized gains and losses of nil related to fair value adjustments of all financial instruments of the Company.

Trans Québec & Maritimes Pipeline Inc.
Financial Statements
December 31, 2011 and 2010

**Chartered Accountants**
2700 205 – 5th Avenue SW
Calgary AB  T2P 4B9

Telephone (403) 691-8000
Telefax (403) 691-8008
Internet www.kpmg.ca

# Independent Auditors' Report

To the Shareholders of Trans Québec & Maritimes Pipeline Inc.

We have audited the accompanying financial statement of Trans Québec & Maritimes Pipeline Inc., which comprises the balance sheet as at December 31, 2011 and 2010 and notes, including a summary of significant accounting policies and other explanatory information.

**Management's Responsibility for the Financial Statement**

Management is responsible for the preparation and fair presentation of this financial statement in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on this financial statement based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statement.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the financial statement presents fairly, in all material respects, the financial position of Trans Québec & Maritimes Pipeline Inc. as at December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants
Calgary, Canada

April 13, 2012

**TQM FINANCE INC.**
**BALANCE SHEET**

| *As at December 31* | **2011** | 2010 |
|---|---|---|
| | **$** | $ |
| **ASSETS** | | |
| Cash | **200** | 200 |
| **SHAREHOLDERS' EQUITY** | | |
| Capital stock | | |
| Authorized | | |
| Unlimited number of common shares, without par value | | |
| Issued | | |
| 200 shares | **200** | 200 |

The accompanying notes are an integral part of the balance sheet.

On behalf of the Board,

/s/ Patrick Cabana
Patrick Cabana
Director

/s/ Steve Pohlod
Steve Pohlod
Director

## NOTE 1 RELATIONSHIP WITH TQM PIPELINE AND COMPANY, LIMITED PARTNERSHIP

Trans Québec & Maritimes Pipeline Inc. (the "Company") was incorporated under the *Canada Business Corporations Act* on April 24, 1980. On January 5, 1982, the Company was appointed mandatary (agent) of a partnership (the "Partnership") then known as TQM Pipeline Partnership to construct and operate a natural gas pipeline system in the provinces of Québec, New Brunswick and Nova Scotia, including the transportation and sale of natural gas to distributors. The Company realizes that another pipeline has been built in the Maritimes but has not however modified its original mandate. The pipeline (the "Pipeline System") connects with the system operated by TransCanada PipeLines Limited ("TransCanada") at Saint-Lazare, Québec, near the Ontario border. A portion of the pipeline extends from Saint-Lazare to Saint-Nicolas on the South Shore of Québec City, while the other portion extends from Lachenaie to East Hereford, where it connects to the Portland Natural Gas Transmission System network ("PNGTS") in the northeast United States ("U.S").

Until August 24, 1995, Gaz Métro Limited Partnership ("Gaz Métro") and TransCanada were equal partners in the Partnership, which was up to that date a general partnership formed under the laws of the Province of Québec. On August 24, 1995, the Partnership continued its existence as a limited partnership governed by the laws of Québec. Gaz Métro and TransCanada became its general partners and 3118240 Canada Inc. became its limited partner, and the Partnership changed its name to TQM Pipeline and Company, Limited Partnership. A capital contribution of $8,250 was made on that date by 3118240 Canada Inc. to the Partnership. Consequently, the percentage participation of the general partners in the Partnership is 49.995% each and the percentage participation of the limited partner in the Partnership is 0.01%. Gaz Métro and TransCanada are equal shareholders in the Company, 3118240 Canada Inc. and TQM Finance Inc. ("TQMF"), which acts as a financial intermediary between the Company and the Partnership.

Reference is made to the financial statements of the Company, as mandatary of the Partnership.

## NOTE 2 CONTINGENCY

In September 2010, an aggregate principal amount of $175,000,000 of the Company's bonds were repaid at maturity. The pledged demand bonds of TQMF and pledged promissory notes of the Partnership were correspondingly reduced by this amount, with demand bonds of TQMF and a promissory note (the "2014 Promissory Note") of the Partnership, each in the amount of $75,000,000, with respect to the Company's bonds maturing in 2014 (the "2014 Bonds") still outstanding at December 31, 2011.

In connection with the September 2010 repayment, the Company issued a new series of bonds directly to the Partnership in consideration for a promissory note (the "2017 Promissory Note" and together with the 2014 Promissory Note, collectively referred to as the "Promissory Notes") in like principal amount. The 2017 promissory note is pledged to the trustee as security until such time as the 2014 Bonds are redeemed or otherwise repaid.

The bonds of the Company are unconditionally guaranteed by the Partnership, and all amounts payable by the Company by way of principal or interest on the bonds of the Company are to be paid out of the funds of the Partnership held by the Company as its mandatary.

The indebtedness evidenced by the bonds of the Company is an obligation of the Partnership and, consequently, the bonds of the Company are not treated as a liability of the Company. The indebtedness evidenced by the demand bonds of TQMF and the 2014 Promissory Note are to be discharged without payment upon the redemption or repayment of the 2014 Bonds of the Company and consequently the demand bonds of TQMF and Promissory Notes of the Partnership are not treated as assets of the Company.

## NOTE 3 CASH FLOW STATEMENT

No cash flow statement has been presented since principal operating, investing and financing activities may be readily apparent from the other financial statements and presenting such a statement would provide no additional information.

## NOTE 4 CHANGES IN ACCOUNTING POLICIES

### International Financial Reporting Standards ("IFRS")

The Canadian Institute of Chartered Accountant's Accounting Standards Board announced that Canadian publicly accountable enterprises are required to adopt IFRS, as issued by the International Accounting Standards Board, effective January 1, 2011. Accordingly, the Company has adopted IFRS commencing January 1, 2011. The adoption of IFRS does not have a material impact on the balance sheet and accompanying notes of the Company.

### Future Accounting Changes

In August 2011, TQM Pipeline filed a dual application with Québec's Autorité des marchés financiers ("AMF"), as its principal financial regulator, and the Ontario Securities Commission for an exemption from the requirements under subsection 3.2(1) of National Instrument 52-107, Acceptable Accounting Principles and Auditing Standards to permit TQM Pipeline to use U.S. GAAP as the accounting framework for the preparation of its financial statements for financial years commencing on or after January 1, 2012 but before January 1, 2015.

Assuming approval of the application, the AMF will require the Company to adopt U.S. GAAP and present combined financial statements of TQM Inc. and the Partnership, effective January 1, 2012.